Walking the thin line of new taxes on shale

MICHAEL WISE | ENERGY INSIGHTS | DEC 16, 2014

Bloomberg provided an upbeat report on shale this past week:

> **"The shale boom has driven U.S. output to the highest on a weekly basis since 1983, with oil production up 65 percent in just five years and the country supplying 89 percent of its own energy in 2014. Higher production has allowed the United States to import the least oil in almost two decades, build more chemical plants and increase fuel shipments abroad to 3.6 million barrels a day, the most in the world."**

At its conclusion, the report contains the increasingly common disclaimer about the effect of low oil prices.

Analysts are in continuous discussion mode regarding shale and low oil prices. Common themes are the motivation of OPEC to continue high production and the effects on U.S. drilling rates. On the latter issue, ABC reported that an Australian drilling company had been placed in bankruptcy by its lender. Red Fork Energy was completely exposed to the U.S. shale industry and became a casualty of lower drilling activity. In Ohio, SE Ohio has been the hot spot of activity for the Utica shale play. However, *The Intelligencer Wheeling News Register* reports that "PDC Energy, a firm with wells across Ohio, does not plan any drilling in the Buckeye State next year because of the lower oil prices, as the company will instead focus its efforts on the Wattenberg gas field in Colorado."

Every boom period for the U.S. Oil & Gas industry has contained corrections. Major price fluctuations are the rule not the exception. This article includes an interview with 76-year old Texas Wildcatter Autry Stephens, the CEO of Endeavor Energy Resources. Mr. Stephens has seen four boom/bust periods in his career. "Though the collapse in prices since June doesn't yet have him in a panic, Stephens recognizes the signs of another downturn on the horizon." Current indications are that the U.S. and world are entering a period of 1-2 years of depressed oil pricing due to OPEC production and depressed world demand.

This is the backdrop for a fierce debate next year in Ohio and Pennsylvania over whether to increase taxes on the Oil & Gas industry. Both states have newly elected (PA) and reelected (OH) Governors who ran on increasing the state severance tax. Both Governors will be introducing their proposals early in 2015. American Statesman Daniel Webster argued in the Supreme Court case *McCulloch v. Maryland* that "[t]he power to tax is the power to destroy." The argument made and accepted by the Court was that at a certain level, taxes will drive out or eliminate the subject of the taxes. This is the worst case scenario for the Governors. The best case scenario is that the taxes can be raised a reasonable amount (generating revenue for the effected areas along with cuts in other taxes), while not causing any decrease in drilling activity.

The shale industry is the most significant economic activity taking place in many U.S. regions. Both Governors will be attempting to fulfill their campaign pledges, while at the same time not intensifying the effects of low oil prices. This will be a debate worth watching and engaging in next year.

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