

# STREAMLINING STATE GOVERNMENT

REFORMING THE REGULATORY STRUCTURE OF PENNSYLVANIA



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Foundation



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# Streamlining State Government: Reforming the Regulatory Structure of Pennsylvania

*Commonwealth Foundation*

## Executive Summary

Across the nation, states are facing formidable fiscal challenges. In an effort to provide core government functions with fewer resources, a number of states are looking to streamline state government by consolidating departments, outsourcing services, and eliminating outdated, less useful, or under-performing agencies.

Three states, Michigan, Louisiana, and Virginia, have made significant efforts to streamline government. Michigan has identified seven core functions of government and started consolidating unnecessary state departments. Louisiana has begun implementing more than 120 recommendations submitted by its Government Streamlining Panel. Virginia's commission made 133 recommendations and will continue to identify streamlining opportunities throughout the McDonnell administration.

The Keystone State should likewise look at streamlining efforts to trim the size of government and reduce the bureaucracy that inhibits economic growth.

Pennsylvania businesses must navigate a complex web of regulations from more than 340 independent state agencies, offices, state departments, boards, commissions, and committees stemming from the executive branch. Several other boards, committees, and commissions in state government primarily provide an advisory or public relations role, often with little to show for their work.

The expansion of regulatory bodies requires additional administrators and enforcement staff—paid for with higher taxes and fees. The number and complexity of state agencies, boards, and commissions impose indirect costs to residents and job creators, with untold costs to comply with the regulatory burden. Pennsylvania must actively pursue every opportunity to trim state spending and the regulatory burden place on job creators by streamlining government, thus encouraging economic growth and prosperity.

This report looks at reforming Pennsylvania's state government agencies and regulatory process. The following pages outline the regulatory structure in state government and present three case studies comparing Pennsylvania regulations with other states in telecommunications, prevailing wage laws, and natural gas drilling.

Telecommunication regulatory reforms include giving all telecommunication providers the same flexibility in pricing, eliminating rules regulating how companies interact with consumers, increasing the transparency of telecommunications access fees for consumers, and consolidating the Office of the Consumer Advocate and parts of the Public Utilities Commission (PUC) into the Attorney General's office to create one agency with jurisdiction over consumer protection. Similar reforms in Indiana helped create 2,000 new private sector jobs and generate \$1.5 billion in industry investment through greater competition. Georgia taxpayers saved \$15 million per year through adopting reforms in telecommunications regulations.

The prevailing wage mandate costs taxpayers an estimated \$1 billion each year through increased labor costs on government projects. On top of this are the taxpayer costs of monitoring and enforcement, and the employers' costs of staff time to complete paperwork and fulfill reporting requirements. Lawmakers should reexamine the necessity of prevailing wage laws, increase the project threshold amounts, exempt school districts and hospitals from mandates, or eliminate the prevailing wage law entirely.

The Marcellus Shale industry is one of the few industries growing in the state, despite one of the worst recessions in years. In 2009, the industry paid out \$2 billion in signing bonuses to landowners and will generate \$8 to \$15 billion in economic activity each year in the state, according to FBR Capital Markets. To ensure the Keystone State remains a competitive location for natural gas development, lawmakers should consider how drilling oversight could be improved, including preventing agency overlap and encouraging predictability among local government ordinances and zoning.

These three areas represent but the tip of the iceberg of opportunities for Pennsylvania to begin streamlining its regulations. This report looks at comprehensive streamlining efforts in other states, and calls on Gov. Tom Corbett to convene a temporary commission of business leaders, regulators, and experts to create a plan for reducing the maze of regulatory agencies. Streamlining state government will better serve residents, bring state expenses into line with revenue, and encourage economic growth.

## **Pennsylvania's Regulatory Maze**

Government regulation adds to the costs of businesses through increased direct costs, indirect costs, and induced costs.

- *Direct costs.* The cost of hiring regulators and operating costs of boards, commissions, and agencies require taxes on residents and businesses or fees imposed on businesses or individuals.
- *Indirect costs.* Compliance with mandates and regulation can result in fewer jobs, lower employee benefits, decreased output, lost revenues, or an increase in current employees' responsibilities.
- *Induced costs.* Induced costs represent the higher prices for goods and services passed on to customers as a result of regulation.

In Pennsylvania, 19 state departments and 19 independent agencies oversee a host of regulatory bodies that promulgate numerous regulations. In addition, many state government boards, commissions, and committees create regulatory restrictions or serve advisory roles.

The complexity of more than 340 state agencies, offices, boards, and commissions creates untold costs for businesses and individuals. The direct cost to taxpayers to fund the regulatory apparatus runs in the hundreds of millions of dollars annually. Simply understanding the regulatory bodies to which a business must answer and report requires education and training; the staff time and mandated expenses to actually comply with the host of regulations promulgated by these agencies imposes immeasurable costs on employers and citizens.

The following case studies examine the agencies providing oversight and implementation, practices of other states, and costs created in three state regulatory areas: the telecommunications industry, prevailing wage mandates, and natural gas drilling.

## **Telecommunications Case Study**

The Pennsylvania Public Utility Commission (PUC) has jurisdiction over local and long distance telephone service providers. The Commission cannot regulate cellular and wireless phone companies or cable TV companies (though there is some regulatory oversight of these companies by the Federal Communications Commission).

### *A Brief History of the PUC*

The Public Utility Commission was created by the Pennsylvania Legislative Act of 1937, which abolished the Public Service Commission.<sup>1</sup> The Commission was created to regulate utilities with monopoly control over vital public resources. Put another way, the PUC's role is to act as a surrogate for competition in a monopoly system. The PUC has transformed from a utility regulator into an organization that fields consumer complaints, runs educational campaigns like *PA Power Switch* and *Prepare Now*, monitors emerging markets, and promotes new technology.

The PUC has failed to revamp or eliminate outdated regulations to better address the rapid rise of new technology in telecommunications. Throughout the past 40 years, the telecommunications industry has transformed, with an elimination of the old monopoly structure and greater access to electronic communications. The companies, products, and services that exist today were incomprehensible as recently as the 1990s—let alone when the PUC was formed in 1937.

Despite some deregulation of electric, gas, and telephone utilities in the past 15 years, the PUC remains one of the largest such state commissions in the nation, with a budget of \$56 million last year.<sup>2</sup>

The Commission places assessments upon regulated utilities to fund its operations. The PUC can assess Pennsylvania utilities up to three-tenths of one percent of revenue to cover the cost of regulation and general operations.<sup>3</sup> Utility assessments are paid into the General Fund for use solely by the PUC.

### *Responsibilities of the PUC*

The PUC oversees entities from taxicabs to telephones. This creates a major balancing act, as the PUC provides regulation of about 6,000 separate utilities in Pennsylvania, including electricity, natural gas, water, telecommunications, and transportation.

Like utility commissions in other states, the PUC has a charge to:

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<sup>1</sup> Pennsylvania Public Utility Commission, "A History of the Pennsylvania Public Utility Commission," [www.puc.state.pa.us](http://www.puc.state.pa.us).

<sup>2</sup> Pennsylvania Public Utility Commission, [www.puc.state.pa.us](http://www.puc.state.pa.us).

<sup>3</sup> Pennsylvania Public Utility Commission, About PUC, [www.puc.state.pa.us](http://www.puc.state.pa.us).

- Foster a competitive utility market;
- Investigate and resolve complaints and inquiries from consumers about utilities and service;
- Review rates and costs, and enforce general regulations and service standards; and
- Encourage conservation and public safety.

The following table highlights PUC services and those utilities in Pennsylvania exempt from PUC regulation.

<b>PUC Regulatory Authority</b>	
<b>Regulated by PUC</b>	<b>Exempt from PUC Regulation</b>
Electric Utilities	Rural Electric Cooperatives
Natural Gas Utilities	Municipal Utility Service
Wired Local and Long Distance Telephone Service	Wireless Telecommunication Services
Water and Wastewater (Collection and Disposal)	Bottled Water
Steam Heat	Heating Oil
Transportation of Passengers or Property by Motor Coach, Truck, and Taxicab	School Buses
Alternative Energy Portfolio Standards (AEPS)	Some Classes of Internet Service Providers
Pipeline Transmission of Natural Gas	Cable Television

#### *Organization of the Pennsylvania Public Utilities Commission*

Five full-time PUC commissioners, nominated by the governor and confirmed by the Senate, serve staggered five-year terms. These commissioners oversee the daily operations of the PUC and officially determine policy for setting utility rates and services in the commonwealth. This process includes regularly scheduled public hearings and official meetings where voting takes place. The PUC is headquartered in Harrisburg, but also has regional offices in Altoona, Philadelphia, Pittsburgh, and Scranton. More than 500 employees make up the 11 offices or bureaus of the PUC; 59 of these employees earned in excess of \$100,000 in 2010.<sup>4</sup>

The complexity of utility issues is reflected in a PUC staff that includes attorneys, rate and financial analysts, auditors, economists, engineers, motor vehicle and railroad specialists, safety inspectors, and enforcement officers.

Primary players in the regulatory process are the administrative law judges and hearing officers in the PUC's Office of Administrative Law Judge (currently employing 21 administrative judges and hearing officers in the four regional offices). They conduct formal hearings in cases involving regulated utilities. The PUC also has mediators who resolve disputes in the hope of avoiding a hearing or future legal actions.

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<sup>4</sup> Pennsylvania Public Utility Commission, "A History of the Pennsylvania Public Utility Commission," [www.puc.state.pa.us](http://www.puc.state.pa.us;); Data provided via Right-to-Know Request, Pennsylvania Office of Administration.

The PUC's oversight of local telecommunication providers is very detailed and includes mandatory reporting of customer service metrics, regulations on how bills must be organized, scripts directing how companies speak with customers, and the setting of tariffs.

## **Telecommunications Regulations in Other States**

The introduction of market competition to the telecommunication industry has made many of the monopoly-era regulations useless, and in some cases, obstacles to improving quality and customer services. A review of telecommunications regulations and reforms in other states provide examples of successful streamlining.

### *Indiana*

Arguably the most complete and successful streamlining of telecommunications occurred in Indiana under Gov. Mitch Daniels. In 2006, the legislature removed all rate regulations on the industry with a few caveats, including a mechanism to keep all carriers from abandoning a geographic area and a requirement to invest in broadband expansion.<sup>5</sup>

Critical to the success of Indiana's reforms was the elimination of hidden subsidies in intrastate access charges. Since serving a dense urban area is much cheaper than serving rural regions, intrastate charges are often manipulated to artificially suppress rural rates and maintain inflated prices for urban areas.

Today, the entire industry has complete freedom to invest, price, and market their services. As a result, AT&T and Verizon expanded their high-speed Internet access service to 102 new rural communities across Indiana. Most importantly, the economy benefited from more than \$1.5 billion in investments and more than 2,000 new jobs.<sup>6</sup>

### *Georgia*

In 1995, then-State Sen. Sonny Perdue successfully led a movement to end Southern Bell's monopoly on telecommunications. By 2006, the state boasted nearly 500 local exchange carriers and more than 140 long distance companies.<sup>7</sup> That same year, Gov. Perdue signed a bill ending the ability of the Georgia Public Service Commission to regulate new advanced services such as wireless providers.

In 2010, the Telecom Jobs and Investment Act was passed to further streamline state regulations through lowered access charges and the elimination of outdated subsidy mechanisms. Under pressure by traditional carriers, legislators set up a special Universal Access Fund (UAF) to temporarily compensate rural carriers who benefited from subsidies. Additionally, reforms were implemented to regulate the existing UAF, which was being

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<sup>5</sup> *Inside Indiana Business*, "Governor Mitch Daniels Is Hailing the Telecommunications Reform Bill," [www.freedomworks.org/news/governor-mitch-daniels-is-hailing-the-telecommunic](http://www.freedomworks.org/news/governor-mitch-daniels-is-hailing-the-telecommunic).

<sup>6</sup> *Inside Indiana Business*, "AT&T Indiana Makes Major Telecom Investment," May 31, 2006; Information obtained from company press releases; *Inside Indiana Business*, "Verizon to Hire 100, Make Investments in Indiana", Nov. 28, 2006; "Verizon Seeks to Fill 50 Positions," Verizon Press Release, Aug. 7, 2006; additional information obtained from the Indiana Telecommunications Association and company press release; *The Muncie Free Press*, "Comcast to Expand Operations in Indiana, Create 225 New Jobs," Dec. 11, 2006.

<sup>7</sup> Glassman, James K., "How Communications Technology Can Build a Grand Conversation for Georgia," remarks to the Georgia Public Policy Foundation, June 18, 2009, [www.gppf.org](http://www.gppf.org).

used as a slush fund for telecom companies. The reforms will save Georgia consumers more than \$15 million per year.<sup>8</sup>

### *Virginia*

Virginia has adopted legislation to both streamline and lower communication taxes and fees. The state did away with four existing taxes, including local government franchise fees that charged for use of public right-of-ways or local infrastructure, and imposed a five percent sales tax rate—the same rate imposed on other goods and services. The new rate closely represents the actual cost, ending the practice of local governments overcharging for access.<sup>9</sup>

High, discriminatory taxes and fees, along with outdated reporting requirements, are leftovers from an era of monopoly control. Current regulations must be streamlined to allow telephone carriers to operate as real businesses in a competitive market. Legislators could attract new jobs and investment, improve consumer services, and cut government costs simply by updating archaic regulations. The PUC's regulation of telecommunications is ripe for the streamlining measures developed in other states to improve service and generate government savings.

Telecommunication regulations from benchmark states that could be beneficial to Pennsylvania include:

- Allow all telecommunication providers the same flexibility in pricing and replace pricing notices with online pricing guides.
- Eliminate regulations on the appearance of bills and phone scripts. The availability of alternatives gives providers an incentive to practice high-quality customer service.
- Continue to foster a competitive telecommunications environment by prohibiting the expansion of jurisdiction over new technologies, including voice over Internet protocol (VOIP) service.
- Consolidate consumer protection agencies such as the Office of the Consumer Advocate and parts of the PUC into the Attorney General's office create one agency with jurisdiction over consumer protection.
- Revamp telecommunications access fees to make them more transparent and guard against local governments that charge excessive fees.
- Discontinue the cross-subsidization of rural markets by customers in urban markets, including ending Pennsylvania's \$32 million universal service fund. These funds are used to subsidize some providers, and evidence indicates they do little to reduce local service rates.<sup>10</sup>

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<sup>8</sup> Americans for Tax Reform, "Georgia Committee Votes to Expand Telecommunications Slush Fund," [www.atr.org](http://www.atr.org).

<sup>9</sup> *Telecom Policy Report*, "Gov. Kaine Signs Virginia Flat Tax," April 17, 2006, [findarticles.com/p/articles/mi\\_m0PJR/is\\_16\\_4/ai\\_n16126043/](http://findarticles.com/p/articles/mi_m0PJR/is_16_4/ai_n16126043/).

<sup>10</sup> Wallsten, Scott, *The Universal Service Fund: What Do High-Cost Subsidies Subsidize?*, February 2011, [www.techpolicyinstitute.org/files/wallsten%20universal\\_service\\_money\\_trail\\_final.pdf](http://www.techpolicyinstitute.org/files/wallsten%20universal_service_money_trail_final.pdf)



## Prevailing Wage Case Study

Pennsylvania's Prevailing Wage Act mandates that all contractors on public construction projects over \$25,000 pay their employees wages and benefits determined by the Department of Labor and Industry for each occupation. These wages are higher than what constructors—even the same companies—pay for identical work on private sector projects, increasing labor costs upward of 30 percent.

The \$25,000 threshold cost for public projects has not been updated since the original passage of the act in 1961. Simply adjusting this threshold for inflation would increase the minimum for which projects are subject to the prevailing wages to about \$180,000.

### *Department Responsibilities*

The Department of Labor and Industry, through the Bureau of Labor Law Compliance (part of the L&I's \$25 million annual appropriation for "occupational safety and stability"), determines prevailing wage rates for the construction industry and enforces the mandate. The prevailing minimum wage rates can include not only pay, but benefits set by local collective bargaining units.

### *Reporting Requirements*

Every contractor and subcontractor must keep accurate records including the name, craft, and the hourly wage rate paid to each worker, and maintain those records for two years. The records must be available for inspection to the governmental body paying for the project and the Department of Labor and Industry. In addition, contractors must report wage information to the government agency funding the project.

Contractors and subcontractors must post the prevailing minimum wage rates for each craft and classification involved in the project in easily accessible places for employees to view.

### *Organization of Prevailing Wage Agencies*

The law creates two additional organizations to support the administration of the Act:

- *Prevailing Wage Advisory Board.* The law created this board, appointed by the Governor, to advise the Secretary of Labor and Industry. The seven board members must representatives of: an association of general contractors, an association of the heavy and highway construction industry, a union representing labor in the building construction industry, a union representing labor in the heavy and highway construction industry, and an association representing a local government, a lawyer employed by the secretary, and the general public.
- *Prevailing Wage Appeals Board.* The board consists of seven members. The criteria for selecting members of the Appeals Board are the same as those for the Advisory Board. The board hears grievances or appeals of decisions made by the Secretary of Labor & Industry, and makes final determinations. The Board also promulgates rules and regulations necessary to carry out its duties.

The dispersed management of prevailing wage regulations created by having two separate boards within the Department in addition to the bureau in charge of enforcing the mandate along with the numerous reporting requirements on contractors highlights the complexity of complying with prevailing wage laws. These compliance costs are on top of the additional expenses required by the prevailing wage rates themselves.

## **Prevailing Wage State Comparisons**

Eighteen states have no prevailing wage regulations. The remaining 32 states significantly differ in terms of application, threshold requirements, and projects subject to regulation. For instance, some states, like Arkansas and Ohio, exempt school districts from prevailing wage mandates.

The table Prevailing Wage Law by State summarizes these differences.

In most states, prevailing wage laws have remained relatively unchanged since they were enacted, except for states that have rescinded their prevailing wage laws. Pennsylvania's original prevailing wage legislation has not been amended for decades; since 1961, litigation has been the main source for changes.

Prevailing wage laws were enacted by states long before Congress passed the federal prevailing wage law, the Davis-Bacon Act, in 1931. Prevailing laws have existed for over 75 years in Kansas (1891), New York (1897), Idaho (1911), Arizona (1912), New Jersey (1913), Massachusetts (1914), and Nebraska (1923). Many of these prevailing wage laws, including the Davis-Bacon Act, were driven by fears of competition from African-American workers migrating from the Deep South. Prevailing wage laws were imposed to prevent black workers from taking jobs at lower wages.<sup>11</sup>

In the past 30 years, 10 states have repealed their prevailing wage laws. Studies found that in these states, repeal has reduced the wage gap between black and non-black construction workers by 60 percent. On average, wages for black construction workers increased 5.5 percent after repeal.<sup>12</sup>

A large number of states, including Pennsylvania, enacted prevailing wage laws and regulations around 1960, partly in concert with a surge in public sector unionism. These states included Alabama, Arkansas, Delaware, Hawaii, Louisiana, Michigan, Missouri, Oklahoma, Oregon, and Wyoming.

The source of project funding dictates which prevailing wage regulations apply and how projects are managed. Projects with federal funding are subject to federal Davis-Bacon regulations first, then to state regulations. Under Pennsylvania prevailing wage regulations, road and bridge maintenance projects are not subject to prevailing wages, while new road construction and all other construction projects funded by state or local government over \$25,000 are subject to these regulations.

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<sup>11</sup> Dodds, Christopher, "Prevailing Wage Law Harms Philadelphia's Black Workers," Commonwealth Foundation, [www.commonwealthfoundation.org](http://www.commonwealthfoundation.org).

<sup>12</sup> *ibid.*

<b>Prevailing Wage Law by State</b>			
<b>State</b>	<b>Cost Threshold for Mandating Prevailing Wage</b>	<b>State</b>	<b>Cost Threshold for Mandating Prevailing Wage</b>
Alabama	No Prevailing Wage Law	Maine	\$50,000
Alaska	\$2,000	Nebraska	No Minimum; \$40,000 for School Projects
Arizona	No Prevailing Wage Law	Nevada	\$100,000
Arkansas	School District Exempt; \$75,000	New Hampshire	No Prevailing Wage Law
California	\$1,000	New Jersey	\$2,000; \$9,850 for Cities
Colorado	No Prevailing Wage Law	New Mexico	\$20,000
Connecticut	\$400,000 New; \$100,000 Remodel	New York	No Minimum
Delaware	\$100,000 New; \$15,000 Remodel	North Carolina	No Prevailing Wage Law
District of Columbia	\$2,000	North Dakota	No Prevailing Wage Law
Florida	No Prevailing Wage Law	Ohio	School District Exempt; \$78,258 New and \$23,447 Remodel
Georgia	No Prevailing Wage Law	Oklahoma	Terminated by State Court Ruling
Hawaii	\$2,000	Oregon	No Prevailing Wage Law
Idaho	No Prevailing Wage Law	Pennsylvania	\$25,000
Illinois	No Minimum	Rhode Island	\$1,000
Indiana	\$150,000	South Carolina	No Prevailing Wage Law
Iowa	No Prevailing Wage Law	South Dakota	No Prevailing Wage Law
Kansas	No Prevailing Wage Law	Tennessee	\$50,000
Kentucky	\$250,000	Texas	No Minimum
Louisiana	No Prevailing Wage Law	Utah	No Prevailing Wage Law
Maryland	\$500,000	Vermont	\$100,000
Massachusetts	No Minimum	Virginia	No Prevailing Wage Law
Michigan	No Minimum	Washington	No Minimum
Minnesota	\$2,500 for One Trade; \$25,000 More than One.	West Virginia	No Minimum
Mississippi	No Prevailing Wage Law	Wisconsin	Set by Trade, Ranging From \$30,000 to \$150,000
Missouri	No Minimum	Wyoming	\$25,000
Montana	\$25,000		

Prevailing wage regulations primarily affect municipalities and school districts in Pennsylvania. As is the case with increased costs for construction materials, any increases in wages—whether caused by inflation, increased demand for skilled personnel, or prevailing wages—negatively affect municipalities. For example, the labor costs for public sector construction jobs in Pennsylvania average 37 percent higher than what the private

sector pays for the same work, and 44 percent higher in Philadelphia. This adds more than 20 percent to the cost of every taxpayer-funded construction project.<sup>13</sup>

Prevailing wage reform from benchmark states that could be beneficial to Pennsylvania include:

- Consolidate the Advisory Board and Appeals Board with the Department of Labor & Industry.
- Reduce the multiple reporting requirements and compliance rules for contractors.
- Increase project threshold amounts.
- Exempt specific public works such as school districts, hospitals, and water authorities from prevailing wage mandates.
- Commit to research that clearly examines the real cost of prevailing wage regulations.
- Eliminate prevailing wage requirements entirely, which could save the state an estimated \$1 billion yearly.<sup>14</sup>

### **Natural Gas Drilling Case Study**

The final case study looks at the development of natural gas drilling in the Marcellus Shale, a geological formation that underlies roughly two thirds of Pennsylvania, which is stimulating the rapid growth of the state's natural gas industry. In 2009, the industry paid out \$2 billion in signing bonuses to landowners,<sup>15</sup> and will generate \$8 to \$15 billion in economic activity each year in the state, according to FBR Capital Markets.<sup>16</sup>

The primary responsibility for regulating the natural gas industry is in the hands of the Bureau of Oil and Gas Management, a division of the Department of Environmental Protection (DEP). Other important regulators of natural gas extraction include the Pennsylvania Utility Commission, the Susquehanna River Basin Commission (SRBC) and the Delaware River Basin Commission (DRBC), which have authority to regulate water withdrawals and other water-related aspects of gas drilling within their jurisdictions. In addition, gas drilling occurring within Pennsylvania's state forest system is administered by the Department of Conservation and Natural Resources (DCNR), which can impose additional restrictions. Finally, local governments have some authority to use zoning ordinances to impose restrictions on gas extraction operations.

#### *The Oil and Gas Act*

The basis for DEP's regulation of gas exploration and extraction in Pennsylvania is the Oil and Gas Act, enacted in 1984. Major regulatory requirement for gas wells include the following:

- Permitting: Prior to drilling a gas company must obtain a permit from DEP.

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<sup>13</sup> Dodds, Christopher, "The Cost of Pennsylvania's Prevailing Wage Law," Commonwealth Foundation, [www.commonwealthfoundation.org](http://www.commonwealthfoundation.org).

<sup>14</sup> *ibid.*

<sup>15</sup> Weaver, Rachel, "Marcellus gas wells generate an amazing bounty for landowners," *Pittsburgh Tribune-Review*, February 27, 2011, [www.pittsburghlive.com](http://www.pittsburghlive.com).

<sup>16</sup> *International Business Times*, "Marcellus Shale to bring \$250 bln to Pennsylvania," March 2, 2011, [www.ibtimes.com](http://www.ibtimes.com).

- Bonding: Prior to drilling the gas company must post a bond to cover the cost of plugging the well and restoring the area, which is forfeited if requirements of the Act are violated.
- Location restrictions: A gas well may not be dug within 200 feet of a building or water well, or within 100 feet of a water body or wetland.
- Well site restoration: The gas company must restore the well pad from disturbance caused by drilling activities, including removing equipment, filling pits, and restoring the land service.
- Water supply protection: Cement casings are required to protect groundwater aquifers.
- Plugging: The gas well must be plugged before it is abandoned.<sup>17</sup>
- Reporting: Drillers must file reports to DEP, including semi-annual production reports, which are available to the public on the DEP's Web site.<sup>18</sup>

The Oil and Gas Act also states that erosion and sediment control measures must be implemented in accordance with Pennsylvania's Clean Streams Law, which requires permitting of projects that result in significant earth disturbance, including gas drilling operations.<sup>19</sup> For well pads disturbing more than five acres, companies must obtain an Erosion and Sediment Control General permit; smaller well pads require companies to develop and implement best management practices.<sup>20</sup>

Another relevant statute is the Coal and Gas Resources Act, which requires coordination between coal mine and gas well operators. Applicable only to gas wells that penetrate a workable coal seam, this law prohibits issuing permits for such wells if they are within 1,000 feet of any other oil or gas well or storage well.

DEP also regulates fresh water and produced water (water that comes to the surface after the fracturing process) impoundment pits and dams at gas well drilling sites under authority of the Dam Safety and Encroachments Act. Operators must obtain permits to ensure that such structures comply with DEP standards.<sup>21</sup>

### *Regulation of Water Usage*

Pennsylvania's two river basin commissions, SRBC and DRBC, have more authority to regulate water usage than does DEP. In the Susquehanna drainage, SRBC regulates consumptive water uses, including Marcellus Shale operations. With respect to other industries, the quantity of water used for drilling is minimal. The gas industry uses fewer than 2 million gallons of water per day from the Susquehanna watershed. In comparison, livestock ranchers use 61 million gallons per day, public water supplies about 1.4 billion

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<sup>17</sup> Pennsylvania's Oil and Gas Act (Act 223), Title 58., Chapter 11.

<sup>18</sup> Pennsylvania General Assembly, Act 15 of 2010.

<sup>19</sup> Department of Environmental Protection, *Erosion and Sediment Control Requirements for Oil and Gas Activities*, [www.eLibrary.dep.state.pa.us](http://www.eLibrary.dep.state.pa.us).

<sup>20</sup> US Environmental Protection Agency, "Regulation of Oil and Gas Construction Activities," [cfpub.epa.gov/npdes/stormwater/oilgas.cfm](http://cfpub.epa.gov/npdes/stormwater/oilgas.cfm).

<sup>21</sup> Department of Environmental Protection, *Dam Permit for a Centralized Impoundment Dam for Marcellus Shale Gas Wells*, [www.eLibrary.dep.state.pa.us](http://www.eLibrary.dep.state.pa.us).

gallons per day, and thermoelectric power uses a whopping 6.4 million gallon per day in Pennsylvania.<sup>22</sup>

As of this writing, DRBC has issued a temporary moratorium on new reviews and approvals for water usage associated with gas drilling in the Delaware basin until the commission finalizes its own regulations. Draft regulations have already been released. The public commenting period ends in March, 2011.

DEP is responsible for regulating water usage in the Ohio River Basin, but lacks legal authority to approve or deny water withdrawals. However, the Water Resources Planning Act (Act 220 of 2002) does give DEP authority to require water users who withdraw more than 10,000 gallons a day for a period of 30 days to submit water use reports.<sup>23</sup>

DEP requires all gas companies to complete water management plans, regardless of the basin in which their water sources are located. Drilling companies must also identify where the produced water from drilling and fracking operations will be stored, treated and disposed. Produced water must be recycled and reused, or else collected and treated at authorized treatment facilities. Only treatment facilities licensed by the DEP can accept produced water from gas operations.

### *Drilling in State Forests and Parks*

The Bureau of Forestry, a division of DCNR, has been issuing oil and gas leases since 1947; as of 2008, more than 1,300 wells had been drilled. License fees and royalty payments for gas extracted go toward the Oil and Gas Lease Fund, which funds DCNR operations, though this fund has been raided in the past to balance the state budget.<sup>24</sup>

DCNR sells gas drilling leases only where it owns the mineral rights. On about 15 percent of state forest land, the state owns the surface rights, but not the oil and gas rights. While DCNR has limited ability to control exploration and drilling activities on such land, it requests that gas companies enter into a surface-use agreement designed to limit impacts on the forest.<sup>25</sup>

While DCNR does not sell oil and gas leases within state parks, the commonwealth has failed to purchase mineral rights for roughly 80 percent of the land within the state park system. Most of the system is thus open to drilling, at least in principle. The department has been fairly successful in persuading gas companies to sign its standard surface-use agreement when operating within state parks. According to a recent Pennsylvania Supreme Court ruling, however, DCNR may not compel gas companies to consent to that agreement.<sup>26</sup>

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<sup>22</sup> Danahy, Anne, "Water-use fee urged for business," *The Centre Daily Times*, March 3, 2011, [www.centredaily.com](http://www.centredaily.com).

<sup>23</sup> Pennsylvania Environment Council, *Developing the Marcellus Shale: Environmental Planning and Policy Recommendations for the Development of the Marcellus Shale Play in Pennsylvania*, July 2010.

<sup>24</sup> Department of Conservation and Natural Resources, "Oil and Gas Position Statement," [www.dcnr.state.pa.us](http://www.dcnr.state.pa.us).

<sup>25</sup> *ibid.*

<sup>26</sup> *Associated Press*, "Worries over gas drilling in PA state parks," August 16, 2010.

## *Local Government Regulations*

Pennsylvania's Oil and Gas Act largely preempts regulation of oil and gas well operations by local governments. The law does grant that local ordinances pursuant to the Municipalities Planning Code and the Flood Plain Management Act may regulate aspects of oil and gas well operations that are not covered by the Oil and Gas Act.

The question of how much authority local governments actually have is currently being debated in the courts. Matters such as drilling techniques, protection of water supplies, well site safety and well site bonding are clearly beyond the scope of local regulations.<sup>27</sup> Previous legal cases<sup>28</sup> suggest that municipalities may use zoning ordinances to limit where companies may drill. The case of *Penneco Oil Co. Inc. v. the County of Fayette* granted power beyond zoning ordinances.

Municipalities can now impose greater restrictions on drilling companies, such as requiring well sites be surrounded by fencing and scrubs or requiring drilling to occur a minimal distance away from property lines.<sup>29</sup>

Given the courts' rulings, Pennsylvania's 2,562 township and municipal governments could create 2,562 separate regulatory codes over drilling operations. This creates an incredibly complex regulatory maze for gas drillers.

## **Natural Gas Regulation by State**

Most states enact statewide regulations for natural gas drilling, but a great deal of variation exists between these states. Some of these differences come from different geology and water availability within states. Due to low wholesale gas prices, natural gas companies in Pennsylvania have begun limiting their capital investment in the state.<sup>30</sup> Unlike Pennsylvania, Texas and Oklahoma saw drilling expansions despite low gas prices in January 2011.<sup>31</sup> These states have been actively regulating unconventional shale gas, similar to Pennsylvania's Marcellus Shale, for years and serve as good benchmark states.

### *Texas*

The Barnett Shale in Texas spans more than 5,000 square miles, and is about 350 feet deep. Gas reserves in this region are estimated to be as high as 50 Tcf (trillion cubic feet). For comparison, the Marcellus Shale is an area of about 50,000 square miles in Pennsylvania, New York, Ohio, Maryland and West Virginia, and has an estimated reserve of 300 to 500 Tcf.<sup>32</sup>

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<sup>27</sup> Pennsylvania Department of Community and Economic Development, *More Applicability of Local Land Use Regulations*, [www.dep.state.pa.us](http://www.dep.state.pa.us).

<sup>28</sup> *Huntley & Huntley, Inc. v. Borough Council of the Borough of Oakmont*; *Range Resources-Appalachia, LLC v. Salem Township*.

<sup>29</sup> Cooley, Seth, *Wiggle Room for Local Regulation of Marcellus Gas Drilling, or Potentially Reversible Error?*, LexUniversal, August 11, 2010, [www.lexuniversal.com](http://www.lexuniversal.com).

<sup>30</sup> KDKA, "Drilling Companies Reduce Investment In Pennsylvania," January 24, 2011, [pittsburgh.cbslocal.com](http://pittsburgh.cbslocal.com).

<sup>31</sup> Baker Hughes, "Rigs by State - Current & Historical data," Feb 18, 2011, [investor.shareholder.com/bhi/rig\\_counts/rc\\_index.cfm](http://investor.shareholder.com/bhi/rig_counts/rc_index.cfm).

<sup>32</sup> Barnett Shale Energy Education Council, *How is the Barnett Shale similar to or different from the Marcellus Shale*, [www.bseec.org/stories/BarnettShale](http://www.bseec.org/stories/BarnettShale).

Regulation of natural gas drilling in Texas is primarily the responsibility of the Oil and Gas Division (OGD), part of the Texas Railroad Commission (RRC). It oversees all oil and gas activities except for air pollutant emissions overseen by Texas Commission on Environmental Quality (TCEQ).

The RRC is responsible for produced water and its disposal into deep underground designated wells, but does not issue water withdrawal permits.<sup>33</sup>

Surface water in Texas is regulated by the TCEQ, which issues temporary water withdrawal permits for drilling. However, the majority of water used for drilling comes from groundwater. Groundwater withdrawal can be granted by individual landowners or local groundwater conservation districts (GCDs).<sup>34</sup>

To streamline the process, the RRC has entered into a Memorandum of Understanding (MOU) with other state agencies<sup>35</sup> to clarify each agencies jurisdiction over natural gas exploration—preventing confusion and overlap between state agencies.

Under Texas’ local government code for safety, local governments are allowed to enact ordinances on natural gas drilling activities on top of RRC requirements such as sound level restrictions, distance requirements, water usage and permitting; these ordinances vary by local government.<sup>36</sup> Texas has 1,209 municipal<sup>37</sup> governments, but no township governments.

### *Oklahoma*

The Woodford Shale spans more than 11,000 square miles, reaches depths up to 11,000 feet, and is estimated to have a natural gas reserve of 23 Tcf.<sup>38</sup> The Oklahoma Corporation Commission (OCC) regulates natural gas exploration, production and waste operations through its Oil and Gas Conservation Division (OGCD). The OCC is the sole permitting agency for oil and gas drilling. The OCC is not responsible for water withdrawal used for hydraulic fracturing operations; however it does ask for the planned source of water on permit applications. The Oklahoma Water Resources Board issues temporary permits for surface water and groundwater withdrawal.

The OCC is responsible for surface management of produced water and chemicals. Nearly all the produced water, often after being recycled and reused, is disposed underground in disposal wells.

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<sup>33</sup> Nye, Ramona, e-mail correspondence with Texas Railroad Commission, January 25, 2011.

<sup>34</sup> Texas Railroad Commission, *Water Use in Association with Oil and Gas Activities Regulated by the Railroad Commission of Texas*, [www.rrc.state.tx.us/barnettshale/wateruse.php](http://www.rrc.state.tx.us/barnettshale/wateruse.php).

<sup>35</sup> Nye, Ramona, e-mail correspondence with Railroad Commission, January 25, 2011.

<sup>36</sup> Barnett Shale Energy Education Council, “Legislation.”

<sup>37</sup> U.S. Bureau of the Census, “Census of Governments,” [www.census.gov/govs](http://www.census.gov/govs).

<sup>38</sup> Eagle Energy Company of Oklahoma, “Woodford Shale Overview,” [www.eagleenergyok.com](http://www.eagleenergyok.com).



In 2005, to prevent overlap between the Department of Environmental Quality (DEQ) and the OCC, a Jurisdictional Guidance Document was developed; this clarifies OCC authority over drilling waste.<sup>39</sup>

Local governments have zoning authority over drilling production. Each municipality can enact separate restrictions and fees such as application and permitting fees on drilling operations. Oklahoma only has 594 municipal governments<sup>40</sup> and no township governments, which greatly reduces the variation that drillers experience across locations.

Pennsylvania could look to improve its Marcellus Shale operations by:

- Enacting a Memorandum of Understanding between DEP and the river basin commissions, along with other agencies, to eliminate regulatory overlap.
- Sharing best practices between municipalities and townships, learning from the experience of other local governments where gas drilling has occurred, and developing model ordinances. For example, counties could establish minimum and maximum local ordinance requirements to give drilling companies a level of predictability, a key consideration for businesses deciding where to invest capital.
- Having DEP should work with Pennsylvania's Conservation Districts (as Texas does), which are already inspecting local waterways, to eliminate duplication of effort. Conservation Districts were already authorized by the state and staffed for environmental impact monitoring before expanding the DEP's Bureau of Oil and Gas Management.

### **Streamlining Efforts in Other States**

The case studies, in just three areas out of the hundreds Pennsylvania's regulatory agencies oversee, demonstrate the need for a systematic process of streamlining state government.

Throughout the last several years, a number of states have requested government-wide reviews to identify areas for consolidation and cost savings. These reviews have been initiated by statute, creation of citizen and bipartisan commissions, and gubernatorial request. States beginning streamlining or restructuring efforts include Alabama, Arizona, Iowa, New Mexico, New York, North Carolina, Utah, Virginia, and Washington.<sup>41</sup>

Three states stand out in their extensive efforts to create a plan to streamline state government agencies and regulatory bodies: Michigan, Louisiana, and Virginia.

#### *Michigan*

In 2009, in response to severe economic distress and dramatically reduced revenues, Gov. Jennifer Granholm tasked Lt. Gov. John Cherry with forming a working group to identify the core functions of state government and reduce the number of state departments, calling for a re-examination of the fundamental purposes of the state.

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<sup>39</sup> Wrotenbery, Lori, email correspondence with Director of Oil and Gas Conservation Division for Oklahoma Corporation Commission Division, February 2, 2011.

<sup>40</sup> U.S. Bureau of the Census, "Census of Governments," [www.census.gov/govs](http://www.census.gov/govs).

<sup>41</sup> National Governors Association, "Redesigning State Government," [www.nga.org](http://www.nga.org).

After soliciting feedback from legislators, state employees, academics, and the general public the working committee identified seven core functions of state government: public safety, education, public systems, well-being, sustainability, economic opportunity and prosperity, and effectiveness and efficiency.

Although formal recommendations for the governor were not completed by the target date, Michigan did reduce the number of state departments through an executive order for restructuring. This combined several departments' functions to create a more commonsensical regulatory structure. Specifically, the executive order eliminated the Department of Environmental Quality, Department of History Arts and Libraries, Department of Information Technology, and Department of Management and Budget. The order created the Civil Services Commission and Department of Technology, Management, and Budget, and turned the Department of Natural Resources into the Department of Natural Resources and the Environment.<sup>42</sup>

### *Louisiana*

Louisiana's attempt at streamlining state government began two years ago when Gov. Bobby Jindal created a government streamlining panel.

More than half the 238 recommendations submitted by the Government Streamlining Panel have either been implemented or are in the process of taking effect, according to an analysis released by the Chairman. Below are just a few examples of the 238 recommendations made to Gov. Jindal in December 2009:<sup>43</sup>

- Each state department is to prepare and provide a review or an analysis of what could be changed, modified, consolidated, eliminated, streamlined, improved, and/or enhanced to ultimately permanently reduce or eliminate continuation costs or expenses in their respective department, agency, board or commission. Provide financial incentives for implementation of permanent sustainable savings.
- The permitting teams of the departments of Natural Resources, Wildlife and Fisheries, and Environmental Quality should be co-located.
- Develop, plan and explore efficiency opportunities for consolidating/leveraging of the Department of Health and Hospitals and the Department of Environmental Quality drinking water programs for testing and monitoring and transfer Lead-based Paint Program from DEQ to DHH.
- Develop plans to further integrate services of the Department of Social Services and the Louisiana Workforce Commission, especially those services where shared clientele is realized.

### *Virginia*

In late 2010, the Governor's Commission on Government Reform & Restructuring reported to Gov. Bob McDonnell 133 recommendations and observations designed to make

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<sup>42</sup> Office of the Governor, Executive Order 2009-36.

<sup>43</sup> Louisiana State Senate, "Streamlining Government Commission," [senate.legis.state.la.us](http://senate.legis.state.la.us).

government “smaller, simpler, and more efficient.”<sup>44</sup> The commission members and staff spent six months studying ways to simplify operations, consolidate services, improve relations with local and federal government, and increase accountability through greater transparency. Recommendations include:

- Centralize business formation forms at the Virginia Business OneStop Web site so that entrepreneurs satisfy state and local requirements to form new business while entering information only one time.
- Eliminate the Rail Advisory Board.
- Increase the contract approval threshold to \$5 million and clarify that a locality does not need state approval for locally administered projects.
- Consolidate the administration of certain taxes into one central department. The Virginia Department of Taxation would assume the tax collection responsibilities of the DMV and State Corporation Commission.
- Establish a blanket permit process for transportation agencies for small improvement and construction projects that do not exceed a set amount.

## Conclusions

Pennsylvania needs to undergo a comprehensive streamlining process to reduce the regulatory burden on job creators, and reduce the cost to taxpayers of outdated regulations. The state has 343 state regulatory and advisory agencies. As demonstrated in the areas of the telecommunications industry, prevailing wage laws, and natural gas drilling, state regulations have been enacted without full consideration of the cost and complexity for those regulated and of the capacity of regulatory bodies to adapt to economic changes. Legislators and the Corbett administration must address the pressing need to streamline the structure of state agencies, boards, and commissions; review reporting requirements; and the costs of specific mandates.

Gov. Corbett should commission a panel to develop recommendations for reducing the convoluted regulatory process in the state as well as the number of regulatory bodies. Bringing business leaders, regulators, and experts to create a plan for cutting the burden of unnecessary regulations and eliminating duplicative regulatory bodies would help improve the economic competitiveness of the commonwealth.

To ensure the continued success of regulatory streamlining, the panel should develop guidelines for legislators before the creation of new boards and commissions and sunset all new regulations and regulatory bodies.

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<sup>44</sup> Commission on Government Reform and Restructuring, “Report to the Governor,” December 1, 2010, [www.reform.virginia.gov](http://www.reform.virginia.gov).

### **ABOUT THE COMMONWEALTH FOUNDATION**

The Commonwealth Foundation is an independent, non-profit research and educational institute that works every day to effectively demonstrate the societal benefits of individual liberty, free enterprise, and limited, accountable government so that key decision makers in Pennsylvania embrace them.

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