

Briefing Memorandum

To: Members of the Marcellus Shale Advisory Commission

Through: David Vanko, Chair

**From: Brigid Kenney, Senior Policy Advisor, MDE
Joseph Gill, Deputy Secretary, DNR**

Date: September 29, 2011

Re: Liability Issues

Disclaimer: This briefing memorandum is intended to provide background information and assist the Advisory Commission in focusing its discussions; it is not a legal analysis of the topic. In attempting to be concise and understandable, we have omitted refinements, qualifiers and details that would be necessary for a legal analysis. This memorandum is not a position statement of the State of Maryland, including any State agency, and the Office of the Attorney General.¹

Introduction

Under Governor O'Malley's Executive Order, the Departments, in consultation with the Advisory Commission, are to report their findings and recommendations on the issue of the desirability of enacting State legislation to establish standards of liability for damages caused by gas exploration and production. To help the Commission focus its discussion, this memorandum describes the legal remedies that are available in Maryland today to a person who suffers damage because of gas exploration or development. The memorandum also describes what types of bills the legislature could enact if these remedies are not considered to be sufficient and fair.

Background

A person may own both the surface rights and the mineral rights to land. A person may own one but not the other. A person who owns mineral rights may lease those rights to another. "Split estate" is a term that refers to situation where the surface rights and subsurface rights (for example, mineral rights) for a piece of land are owned by different parties. In many states, mineral rights are considered the dominant estate, meaning those rights are considered legally superior to, and take precedence over, the rights of the surface owner. Even in those states, however, the mineral owner is not free to completely disregard the rights of the surface owner and must limit his interference to what is reasonably necessary to develop the mineral estate.

¹ We acknowledge the assistance of Erin Fitzsimmons, Special Assistant to the Attorney General, and numerous Assistant Attorneys General who performed research and provided the attachment to this memo. Neither this memorandum nor the attachment is legal advice or an official opinion of the Attorney General.

A person who owns both the surface rights and mineral rights of land can, by contract or lease provisions at the time the person sells or leases the mineral rights, incorporate protections against damage or include provisions for compensation. For example, the location for an access road could be specified to avoid cropland, or payment for crop damage could be stipulated. For a variety of reasons, however, some landowners fail to secure these protections at the time of sale or lease. Some may have willingly surrendered their rights in exchange for payment, but others may have been unaware of their rights, influenced by false statements by landmen, or unable to negotiate successfully with experienced and sophisticated purchasers or lessees. Other landowners who own surface rights never owned the mineral rights to their land because a past owner retained, sold, or leased those rights.

In addition, there are persons who may suffer damage from exploration and drilling that take place on land in which they have no ownership interest. For example, a person may believe that his well water has been contaminated by drilling or hydraulic fracturing activities on neighboring land; or that the truck traffic, noise, and air emissions associated with drilling have damaged his health or his business. In addition, incidents may occur at the drill site that result in releases of pollutants to land or water, threatening or damaging neighboring property.

Lastly, there is the issue of who is responsible for damage if it occurs. The owner or lessee of the mineral rights may not be the entity actually performing the work that allegedly causes the damage. Other entities may render service or products to a well or well site.²

Current Maryland Law

Statutory Law

In a subtitle of the Natural Resources Code dealing with oil and gas leases on State land, a section states: “Any person who drills for oil or gas on the lands or in the waters of the State is strictly liable for any damages that occur in exploration, drilling, or producing operations or in the plugging of the person’s oil or gas wells, including liability to the State for any environmental damage.” Md. Nat. Res. Code Ann. § 5-1703. Maryland has no other statute specifically addressing liability for damages allegedly caused by gas drilling or production. Instead, the laws in place require bonds to assure regulatory compliance or specify levels of liability insurance coverage.

Maryland laws and regulations require that a person who holds a permit to drill for gas or oil must post a performance bond to the State in an amount *not to exceed* \$100,000 for each oil or gas well, and not to exceed \$500,000 as a blanket bond for all the permit holder’s oil or gas wells. The bond is conditioned on compliance with applicable laws,

² For example, the Pennsylvania Oil and Gas Act mandates that the well operator protect groundwater. It further provides that a person other than the well operator, such as a company that provides services or products to a well or well site, is liable with the well owner or operator for violations connected with that company’s actions. 58 P.S. § 601.511.

regulations, permits, orders of the Department, and regulations of the Critical Area Commission. The Department must approve the plugging of the well, reclamation of the site, submission of required records and logs, and performance of all obligations under the regulations and the permit before the permittee may apply for release of the bond.

In addition, the statute requires each permittee to obtain and keep in effect liability insurance coverage in an amount *not less than* \$300,000 for each person and \$500,000 for each occurrence or accident to pay damages for injury to persons or damage to property caused by the drilling, production operations, or plugging of all the permit holder's gas or oil wells in the State. By regulation, MDE requires a certificate of liability insurance showing personal injury and property damage liability coverage in the name of the permittee of at least \$1,000,000 for each person and \$5,000,000 for each occurrence or accident, or proof of self-insurance that is in a form acceptable to the Department.

Common Law³

Common law recognizes that people can be harmed by acts that do not amount to crimes, and that they should have some remedy if they suffer this harm. Unless the acts are violations of contracts, they are referred to as "torts." A tort is an act that injures someone in some way, and for which the injured person may sue the wrongdoer for damages. The following are torts that Maryland recognizes that may apply if someone is harmed by gas exploration or production.

1) Trespass

A person who owns land generally has the right to exclude others from the land. If someone intentionally or negligently enters onto that land (either on the surface or subsurface) without authority, he has committed trespass. The essential element of trespass is the entry, regardless of whether harm has occurred, although the existence of harm will affect the award of damages. The "entry" need not be by a person; in some circumstances the movement of pollutants onto property could be a trespass.

2) Negligence

A person can be liable if he negligently causes harm to another.⁴

3) Private Nuisance

If a person intentionally causes unreasonable, substantial interference with another person's right to use and enjoy his land, he can be liable for nuisance. A court might order the person to stop the interference, award money damages, or both. Nuisance is different from trespass in that there is no physical entry onto land.

³ Common law is the system of law based on custom and judicial precedent rather than laws enacted by a legislature.

⁴ If a person has a duty to act in a certain way, *e.g.*, to exercise reasonable care, and fails to do so, and that failure causes damage that is natural, probable, proximate, and not too remote, the person may be liable for the damage. A familiar example would be an automobile accident caused by momentary inattention.

4) Strict Liability and Liability for Abnormally Dangerous Activity

Strict liability means liability without fault. The basis for strict liability is the creation of an undue risk of harm to other members of the community, regardless of how much care was exercised in undertaking an abnormally dangerous activity (ADA). In the absence of a statutory definition of ADA, the issue of whether an activity is an ADA is a fact-intensive inquiry involving the consideration of multiple factors, including whether the activity is inappropriate to the place where it is carried on and the value of the activity to the community. The person seeking damages under strict liability must still prove the cause and effect between the action and the harm.

Relationship between Common Law and Statutory Law

Common law can be altered by statutes. Sometimes the statutory rights completely replace common law rights. Often, however, the common law remedies (trespass, negligence, nuisance) are left intact. For example, the Pennsylvania Oil and Gas Act does not limit the rights of third parties to bring common law claims against the well owner or operator. Section §208(f).

Options Available to the Legislature If It Wishes to Alter the Law

Surface Owners Protection Acts

These acts seek to protect the person who owns the surface rights to land against damages caused by activities conducted on that land by the entity that has the legal right to conduct oil and gas operations on that land. Under the New Mexico statute, for example, the operator and the landowner are encouraged to enter into a mutually acceptable agreement that sets forth the rights and obligations of the parties with respect to the surface activities conducted by the operator. Under the law, however, an operator must compensate the surface owner for damages sustained by the surface owner such as loss of agricultural production and income, lost land value, lost use of and lost access to the surface owner's land and lost value of improvements caused by oil and gas operations. The operations include exploration, drilling and production of oil or gas, through final reclamation of the affected surface.

The language of these Acts varies by state (see attachment) and Maryland could select from among the “best of the best” to craft an Act applicable to Marcellus Shale extraction specifically or to any form of oil or gas extraction.

Shifting the Burden of Proof

The Maryland legislature has altered the common law with respect to damage caused by specific activities relating to surface mining.⁵ The General Assembly recognized that in regions of the State with karst terrain,⁶ pumping water out of surface mines (“dewatering”) may significantly interfere with water supply wells and may in some instances cause sudden subsidence of land, known as sinkholes. In order to protect

⁵ Md. Env. Code, Title 15, Subtitle 8.

⁶ Karst terrain is an area of irregular limestone in which erosion has produced fissures, sinkholes, underground streams, and caverns.

affected property owners where karst terrain is found⁷, the legislature directed the Department of the Environment to establish zones of dewatering influence around surface mines in karst terrain and to administer a program requiring permittees to mitigate or compensate affected property owners in these counties. Within the zone of dewatering influence established, the permittee must:

(1) replace, at no expense to the owner of real property that is affected by the surface mine dewatering, a water supply that fails as a result of declining ground water levels; and

(2) under certain circumstances, pay monetary compensation to the affected property owner or repair any property damage caused as a result of the sudden subsidence of the surface of the land.

In this statute, the Legislature created a *presumption* that damage that occurred within the zone of dewatering influence was, *in fact*, caused by the dewatering. In effect, it relieves the landowner of the obligation to prove cause and effect. The mine operator is not left without protection, however. If the permittee demonstrates to the Department by clear and convincing evidence that the real cause of the loss of water supply was not dewatering⁸, the Department may not require a permittee to replace water supplies.

Some states have adopted similar provisions for gas wells. For example, Pennsylvania's laws establish a statutory presumption that a well operator is responsible for the pollution of a water supply that is within 1,000 feet of the oil or gas well, where the pollution occurred within six months after the completion of drilling or alteration of such well. 58 P.S. § 601.208 (2011). The act specifies a number of ways the well operator can refute the presumption, including by producing the results of a pre-drilling or pre-alteration survey. *Id.* Any well operator who affects a public or private water supply by pollution or diminution must restore or replace the affected supply with an alternate source of water adequate in quantity or quality for the purposes served by the supply. *Id.*

Maryland could extend the presumption of liability for surface mining in the karst terrain to resource impacts resulting in a Marcellus Shale drilling "zones," *e.g.*, an area within a specified distance from the well site.

Expanding Strict Liability

As noted above, in a subtitle of the Natural Resources statutes dealing with oil and gas leases on State land, a section states: "Any person who drills for oil or gas on the lands or in the waters of the State is strictly liable for any damages that occur in exploration, drilling, or producing operations or in the plugging of the person's oil or gas wells, including liability to the State for any environmental damage." Md. Nat. Res. Code Ann. § 5-1703. The scope and applicability of this law have not been tested. The legislature could clarify or expand the law.

⁷ Karst terrain is found in Baltimore, Carroll, Frederick, and Washington counties.

⁸ This is usually referred to as "rebutting the presumption."

SUMMARY - Surface Owner Protection Acts (SOPAs)

	<u>NOTICE BY DRILLER</u>	<u>OFFER/ NEGOTIATION/ OBJECTION</u>	<u>IF NO AGREEMENT IS REACHED . . .</u>	<u>DRILLER'S LIABILITY</u>	<u>BONDS POSTED BY DRILLER</u>	<u>COMMON LAW</u>
<p style="text-align: center;"><u>Alaska</u></p> <p style="text-align: center;"><i>Alaska Stat.</i> §§27.21.010 to 27.21.999</p>	30 days of public notice before drilling	“may file written comments or objections to the permit or revision with the commissioner within 30 days after” notice	surface owner “may commence a civil action” after giving driller 60 days’ notice	damages and attorney’s fees	at least \$10K per well	common law remedies preserved
<p style="text-align: center;"><u>Illinois</u></p> <p style="text-align: center;"><i>225 ILCS</i> §§720/1.01 to 720/9.09</p>	4 weeks in newspaper	N/A	<p>surface owner “may file written objections to a permit application and may request an informal conference with the Department”</p> <p>surface owner “may commence a civil action”</p>	damages and attorney’s fees	Amount determined by Dept. of Natural Resources (no more than \$600 per acre or \$10K total)	common law remedies preserved
<p style="text-align: center;"><u>Kentucky</u></p> <p style="text-align: center;"><i>KRS</i> §§ 353.500 to 730</p>	before drilling	driller’s notice must include “offer to discuss with the surface owner” placement of roads, point of entry, etc.	“The surface owner's remedy shall be an action for compensation in the Circuit Court”	“damages to growing crops, . . . improvements, & livestock”	depends on well’s depth (\$500 - \$5K per well)	common law remedies preserved

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<p style="text-align: center;"><u>Montana</u></p> <p style="text-align: center;"><i>Mont. Code Anno., §§ 82-10-501 to 82-10-511</i></p>	<p style="text-align: center;">at least 20 days before surface disturbance</p>	<p style="text-align: center;">surface owner must notify driller of injury within 2 years</p> <p style="text-align: center;">within 60 days of surface owner’s notice, driller must offer compensation</p>	<p style="text-align: center;">if surface owner rejects offer, surface owner may sue</p>	<p style="text-align: center;">“damages to real or personal property caused by oil and gas operations”</p>	<p style="text-align: center;">\$200 per acre</p>	<p style="text-align: center;">common law remedies preserved</p>
<p style="text-align: center;"><u>New Mexico</u></p> <p style="text-align: center;"><i>N.M. Stat. Ann. §§ 70-12-1 to 70-12-10</i></p>	<p style="text-align: center;">at least 5 days before nonsurface disturbance; at least 30 days before surface disturbance</p>	<p style="text-align: center;">driller’s notice must include offer of compensation</p>	<p style="text-align: center;">If surface owner doesn’t agree, driller must post bond</p> <p style="text-align: center;">surface owner may mediate/ arbitrate/ litigate</p>	<p style="text-align: center;">“loss of agricultural production and income, lost land value, lost use of and lost access to the surface owner's land and lost value of improvements”</p> <p style="text-align: center;"><u>triple damages</u> if driller violated knowingly & willfully</p>	<p style="text-align: center;">\$10K per well</p> <p style="text-align: center;"><u>or</u></p> <p style="text-align: center;">\$25K blanket bond for whole state</p>	<p style="text-align: center;">common law remedies preserved</p>

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<p><u>North Dakota</u></p> <p><i>N.D. Cent. Code §§ 38-18-01 to 38-18-08</i></p>	<p>30 days before driller applies for drilling permit</p>	<p>Surface owner must consent to drilling</p>	<p>If surface owner doesn't consent, driller may sue</p>	<p>“entire cost of the surface reclamation necessitated by [driller]'s mining operation”</p> <p>“loss of agricultural production caused by mining activity”</p>	<p>at least \$10K</p>	<p>common law remedies preserved</p>
<p><u>Oklahoma</u></p> <p><i>52 Okl. St. §§ 291 to 318.10</i></p>	<p>Before entering site</p>	<p>“it shall be the duty of the [driller] and the surface owner to enter into good faith negotiations to determine the surface damages”</p>	<p>“If agreement is not reached . . . the [driller] shall petition the district court . . . for appointment of appraisers to make recommendations . . . concerning the amount of damages, if any. Once the [driller] has petitioned for appointment of appraisers,” the driller may enter the site</p>	<p>“diminution of fair market value”</p> <p><u>triple damages</u> if driller violates willfully & knowingly</p> <p>\$25-\$500 fine</p>	<p>\$25K blanket bond</p>	<p>nuisance remedies preserved</p>

SUMMARY - Surface Owner Protection Acts (SOPAs)

<p style="text-align: center;"><u>Pennsylvania</u></p> <p style="text-align: center;"><i>58 P.S. §§ 601.201 to 601.216</i></p>	<p style="text-align: center;">before applying for drilling permit</p>	<p style="text-align: center;">surface owner may object within 15 days of notice</p> <p style="text-align: center;">surface owner may, “at any time, request that a conference”</p>	<p style="text-align: center;">surface owner may sue; in addition “the Environmental Hearing Board, after hearing, may assess a civil penalty upon” driller, maximum \$25K + \$1K for each day of violation</p>	<p style="text-align: center;">in addition to civil liability, driller is criminally liable</p>	<p style="text-align: center;">\$2.5K per well</p> <p style="text-align: center;">or</p> <p style="text-align: center;">\$25K blanket bond</p>	<p style="text-align: center;">nuisance remedies preserved</p>
<p style="text-align: center;"><u>South Dakota</u></p> <p style="text-align: center;"><i>S.D. Codified Laws §§ 45-5A-1 to 45-5A-11</i></p>	<p style="text-align: center;">at least 30 days before operations</p>	<p style="text-align: center;">surface owner must notify driller within 2 years</p> <p style="text-align: center;">within 60 days notice, driller must offer</p>	<p style="text-align: center;">surface owner “may bring an action for compensation”</p>	<p style="text-align: center;">“loss of agricultural production, lost land value, and lost value of improvements caused by mineral development”</p>	<p style="text-align: center;">N/A</p>	<p style="text-align: center;">common law remedies preserved</p>
<p style="text-align: center;"><u>Tennessee</u></p> <p style="text-align: center;"><i>Tenn. Code Ann. §§ 60-1-601 to 60-1-608</i></p>	<p style="text-align: center;">N/A</p>	<p style="text-align: center;">surface owner must notify driller of damages within 3 years</p> <p style="text-align: center;">within 60 days of surface owner’s notice, driller “shall make a written response to the person seeking compensation for the damages”</p>	<p style="text-align: center;">surface owner must sue</p>	<p style="text-align: center;">“lost income or expenses incurred,” crops destroyed, “any damage to a water supply,” “repair of per- sonal property,” & “diminution in value, if any, of the surface lands”</p>	<p style="text-align: center;">N/A</p>	<p style="text-align: center;">common law remedies preserved</p>

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<p style="text-align: center;"><u>Texas</u></p> <p style="text-align: center;"><i>Tex. Nat. Res. Code §§ 134.001 to 134.188</i></p>	<p>when applying for permit, driller must put notice in newspaper for 4 weeks</p>	<p>within 45 days of last newspaper, “an affected person may request a hearing on the [driller’s permit] application”</p>	<p>driller may proceed without objectors’ consent if, among other requirements, “proposed operation has been designed to prevent material damage to the hydrologic balance outside the permit area”</p>	<p>driller must obtain public liability insurance policy</p>	<p>at least \$10K bond per permit</p>	<p>common law remedies preserved</p>
<p style="text-align: center;"><u>West Virginia</u></p> <p style="text-align: center;"><i>W. Va. Code §§ 22-7-1 to 22-7-8</i></p>	<p style="text-align: center;">N/A</p>	<p>surface owner must notify driller of damages within 2 years</p> <p>within 60 days, driller must either reject claim or offer settlement</p>	<p>“compensation to be awarded to the surface owner shall be determined by a panel of three disinterested arbitrators”</p>	<p>“lost income or expenses incurred,” “crops destroyed,” “any damage to a water supply,” “cost of repair of personal property,” & “diminution in value, if any, of the surface lands”</p>	<p style="text-align: center;">N/A</p>	<p>common law remedies preserved</p>

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<p style="text-align: center;"><u>Wyoming</u></p> <p style="text-align: center;"><i>Wyo. Stat.</i> §§ 35-11-401 to 35-11-437</p>	<p>within 15 days of pre-approval for permit, driller must put notice in newspaper for 4 weeks & mail notice to all surface owners within a half-mile of the site</p>	<p>driller must request surface owner's consent</p>	<p>driller must "request a hearing before the environmental quality council;" driller may proceed without surface owner's consent if, among other findings, the council decides that drilling would "not substantially prohibit the operations of the surface owner"</p>	<p><u>surface owners:</u> "any damages to the surface estate, to the crops and forage, or to the tangible improvements of the surface owner"</p> <p><u>water rights owners:</u> "pollution, diminution, or interruption of such water supply"</p>	<p>at least \$10K bond per well</p>	<p>not specified</p>
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