Governments' Roles in Natural Gas Development

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I. Introduction

Hello. My name is Ross Pifer, and I am the Director of the Agricultural Law Resource and Reference Center at the Penn State Dickinson School of Law. The Agricultural Law Center is a collaborative initiative between Penn State's Dickinson School of Law and College of Agricultural Sciences together with the Pennsylvania Department of Agriculture. The mission of the Center is to provide educational programs and materials to a variety of audiences within Pennsylvania on topics in the areas of agricultural law and policy. Certainly, the recent flurry of activity to extract natural gas from the Marcellus Shale formation has had, and continues to have, a tremendous impact upon agricultural landowners and rural communities throughout most of Pennsylvania. A number of legal issues have arisen as a result of this recent activity, and these legal issues continue to evolve along with the industries' development in the state.

Today, I am going to talk with you about various roles of government in the extraction of natural gas. Specifically, I will provide a brief overview of some of the federal and state agencies involved with natural gas operations in Pennsylvania. I then will discuss provisions of two major statutes governing activity in Pennsylvania – the Oil and Gas Act and the Oil and Gas Conservation Law. The third topic that I will discuss is Oil and Gas Act preemption of

municipal regulation. Finally, I will discuss the impact of natural gas activities upon land enrolled in the preferential tax assessment program commonly referred to as "Clean and Green." This list of topics does not address all of the issues that are – or that must be – addressed by governments, but it provides basic background and highlights some of the timely issues.

For consideration of a wider range of governmental issues than is permitted in our time today, I direct you to a Penn State Extension publication entitled, *Marcellus Shale: What Local Government Officials Need to Know*. This publication is available from Penn State Extension's Natural Gas Impacts Web site at the address indicated on your screen: http://naturalgas.extension.psu.edu/Publications.htm.

II. Federal and State Regulatory Agencies

Governmental responsibilities for natural gas activities encompass a wide range of agencies and commissions at both the state and federal levels. Most of these entities have responsibility for a very specific aspect of the field. Some of these agencies and commissions have a tremendous impact on the overall industry while others have a minor or tangential impact. I will highlight entities at both ends of this spectrum as well as many points in between.

On the federal side, the two most recognizable entities, and those with arguably the greatest impact on the day-to-day regulation of the industry, are the Susquehanna River Basin Commission and the Delaware River Basin Commission. Each of these commissions is a federally-created interstate commission charged with responsibilities pertaining to water quantity and water quality. The SRBC regulates a wide swath through the central region of Pennsylvania, and the DRBC regulates activities in the Eastern-most counties of the state. It is important to note that there is not a comparable river basin commission for the Ohio River watershed, which

drains the majority of Western Pennsylvania. The primary role of each river basin commission with regard to natural gas drilling is the regulation of the activity as a consumptive water use. Generally speaking, permits or approvals must be obtained from the appropriate river basin commission before a natural gas company can obtain water for use in the drilling process.

The Federal Energy Regulatory Commission or FERC is an independent federal agency that regulates the interstate transmission of natural gas. It approves the siting of interstate gas transmission lines and gas storage facilities. The Environmental Protection Agency or EPA, through authority under the Safe Drinking Water Act, has administrative responsibility for the underground injection control program in Pennsylvania.

The Forest Service within the Department of Agriculture has responsibility to manage drilling activities within the Allegheny National Forest. The Forest Service is a frequent litigant over decisions that it makes with regard to natural gas activities through the implementation of its forest management plan or through the issuance of Notices to Proceed permitting drilling operations to commence. At times, it seems that regardless of the decision made by the Forest Service – whether it permits, imposes conditions, or prohibits activity – it will be sued, either by industry or by environmental groups. Although it does not have the amount of available acreage as does the Forest Service, the National Park Service within the Department of the Interior also has management responsibilities over natural gas drilling affecting park land.

At the state level, the Department of Environmental Protection or DEP has primary regulatory responsibility over natural gas activities. These duties are carried out by DEP's Bureau of Oil and Gas Management. Some other state agencies with responsibilities related to natural gas include the Department of Conservation and Natural Resources which has authority under the Conservation and Natural Resources Act to lease state forestland for natural gas

exploration and natural gas storage, the Department of Agriculture which has authority for the administration of the Clean and Green preferential tax assessment program, the Pennsylvania Emergency Management Agency which has emergency preparedness responsibilities, and the Department of Transportation which has municipal road bonding oversight.

III. Major Statutes Governing Activity in Pennsylvania

DEP has obtained its role as the primary regulator over natural gas activities in Pennsylvania via statute authority. I will now discuss the major Pennsylvania oil and gas statutes providing DEP with this authority.

Title 58 of Purdon's Pennsylvania Statutes contains Pennsylvania's oil and gas laws. Of these laws, the Oil and Gas Act and the Oil and Gas Conservation Law are the two primary statutes regulating the industry. In addition to the listed statutes, there are other Pennsylvania laws outside of Title 58 that impact natural gas operations, such as the Clean Streams Law which is located in Title 35 – the Health and Safety title and the Dam Safety and Encroachment Act which is located in Title 32 – the Forests, Waters, and State Parks title. The Oil and Gas Act, however, is the foundation for regulation of the industry in Pennsylvania. Since the Act provides this foundation, I think that it is important to understand the basics of this law in order to be able to put the overall regulatory system into perspective.

The Oil and Gas Act is organized into six chapters comprised of Preliminary Provisions, General Requirements, Underground Gas Storage, Eminent Domain, Enforcement and Remedies, and Miscellaneous Provisions. Most of the substantive requirements are contained within chapter 2's General Requirements so I will focus on some of these provisions.

Before I begin with Chapter 2, however, I want to highlight one of Chapter 1's provisions, section 102, which outlines the purposes of the Oil and Gas Act. This provision will be important in our later discussion of Oil and Gas Act preemption. As stated in section 102, the Oil and Gas Act has a two-fold purpose: to permit development of the natural gas resource but also to offer a number of protections from developmental activities. The Act aims to protect workers in the industry. It aims to protect the public from personal harm or property damage. It also aims to protect the environment and the Commonwealth's natural resources.

Let's now move on to some of the General Requirements identified in Chapter 2. Prior to drilling a well, a gas company must obtain a permit from DEP. The permit application must include a map indicating exactly where drilling activity will take place. At the time of permit application, the company is required to send notification to certain interested parties who have a limited opportunity to object to the grant of the permit. Generally, DEP has 45 days to grant the permit, and the permit will expire if a well is not drilled within one year. Once drilling occurs, this permit will remain in force for the duration of the life of the well unless revoked.

Section 205 contains locational restrictions on wells. A well cannot be drilled within 200 feet of a building or water well. Likewise, a well cannot be drilled within 100 feet of a spring, stream, body of water, or wetland larger than one acre. It is possible for DEP to grant the gas company a waiver of these minimum distances under certain circumstances and with appropriate conditions imposed to protect people, property, and waters.

Sections 207 and 208 address water protection. The use of casing is required when drilling through the fresh water strata to prevent the contamination of ground water. If a water supply is polluted or diminished as a result of the drilling process, the gas company is required to restore or replace that water supply. Upon receipt of a water-related complaint, DEP is required

to investigate the claim within ten days. There is a presumption of responsibility that applies to water supplies that are polluted within 1000 feet of a well within six months of completion of drilling activity. Under this rebuttable presumption, the gas company is determined to be responsible for the pollution unless they can demonstrate that they are not responsible. Gas companies generally will conduct a pre-drill water test of wells within 1000 feet of the well in order to rebut this presumption of responsibility. The presumption also is rebutted if the landowner refuses permission to perform the pre-drill test.

Section 206 requires that the gas companies restore the surface estate from disturbances caused by drilling activities. Generally, all equipment must be removed and the well site restored within nine months after the completion of activity. Well operators must be in compliance with an erosion and sediment control plan at all times during drilling. Some authority over erosion and sediment control plans had been delegated to county conservation districts, but in March of this year, DEP pulled back this authority so that the DEP regional offices now handle all matters relating to E&S plans.

Section 210 requires that wells be plugged prior to abandonment. The well operator must provide DEP with a notice of plugging to afford DEP with the opportunity to be present at the time of plugging.

Pursuant to section 215, the gas company must file a bond with DEP prior to drilling. This bond is payable to the Commonwealth and is conditioned upon compliance with all requirements of the Oil and Gas Act. If these provisions are violated, the bond proceeds are forfeited into the Commonwealth's Well Plugging Restricted Revenue Act.

Gas companies are required to report certain information to DEP. A completion report is required within thirty days after the completion of drilling. Annual reports containing production

data are required to be submitted to DEP each year although the production data remains confidential for five years.

The second major oil and gas statute that I will discuss is the Pennsylvania Oil and Gas Conservation Law. The Conservation Law, in a nutshell, provides DEP with a role in the establishment of drilling units for wells drilled into certain geologic formations. The purpose of the Conservation Law is somewhat different than the Oil and Gas Act in that the Conservation Law is focused on efficiently extracting natural gas. It is not focused on protecting people, property, and natural resources as is the Oil and Gas Act. The specific statutory purposes of the Conservation Law are to "foster, encourage, and promote the development, production, and utilization" of Pennsylvania's oil and gas resources; to prevent the waste of oil and natural gas, and to permit the Commonwealth to "realize and enjoy the maximum benefit of these natural resources." As defined in the Conservation Law, waste includes physical waste as well as the inefficient spacing of wells.

The Conservation Law does not apply to all wells that are drilled in Pennsylvania. Generally, it only applies to wells that penetrate the Onondaga horizon. As the graphic indicates, the Marcellus Shale formation is located above the Onondaga formation. Thus, Marcellus wells are not subject to the Conservation Law. There has been legislation introduced, House Bill 977, that would expand the Conservation Law to encompass wells drilled into the Marcellus Shale formation, but under current law, Marcellus wells are not subject to the Conservation Law.

When a well is drilled into, or below, the Onondaga horizon, any person directly affected by this drilling can petition DEP for a spacing order. In ruling on the petition, DEP will ascertain the extent of the pool of gas impacted by the well and will divide that pool into a number of drilling units to drain the pool of gas in the most efficient manner. Essentially, DEP is putting a

grid on the surface where one well and only one well can be drilled within each space on the grid. Again, to reiterate, DEP's role in establishing drilling units is only for those wells that are drilled into the Onondaga Horizon. Marcellus Shale wells are not within the Conservation Law, and thus, at the present time, DEP does not have a role in determining the area of land contained within a Marcellus drilling unit.

IV. Oil and Gas Act Preemption of Municipal Regulation

Having reviewed the major sources of statutory authority for state regulation of natural gas activities, let's turn our attention to local regulation of the same. Municipalities have an interest in ensuring that natural gas activities are performed in a manner so as to minimize their impact upon the municipalities' citizens and resources. In acting to regulate these impacts, municipalities must understand the general principles of preemption and of the specific statutory provisions and judicial interpretations of the Pennsylvania Oil and Gas Act. Under general principles of preemption, broadly stated, there are limitations on a municipality's ability to regulate an activity that is the subject of state regulation.

In addition to these general principles of preemption, the Pennsylvania Oil and Gas Act contains a specific provision addressing the topic of preemption. Section 602 of the Oil and Gas Act states:

> Except with respect to ordinances adopted pursuant to the . . . Municipalities Planning Code, and the . . . Flood Plain Management Act, all local ordinances and enactments purporting to regulate oil and gas well operations regulated by this act are hereby superseded.

Under this first sentence of the section, a municipality can enact an ordinance regulating natural gas operations only through its authority under the MPC or the Flood Plain Management Act. Municipalities are prohibited completely from regulating natural gas operations except through these two statutes.

The second sentence of the section imposes limitations on ordinances adopted pursuant to these two statutes.

> No ordinances or enactments adopted pursuant to the aforesaid acts shall contain provisions which impose conditions, requirements or limitations on the same **features** of oil and gas well operations regulated by this act or that accomplish the same **purposes** as set forth in this act.

So there are two main prongs of section 602 preemption: features and purposes. Municipalities cannot regulate features of oil and gas operations that are addressed in the Oil and Gas Act, and they cannot regulate oil and gas operations to accomplish the same purposes as the Oil and Gas Act. Now, what does this legal standard mean on a practical level? Can a municipality regulate natural gas drilling activities? And if so, what specific ordinances can be enacted?

The recent Pennsylvania Supreme Court opinions in *Huntley & Huntley v. Borough of Oakmont* and *Range Resources v. Salem Township* provide guidance on this issue by providing one example of a permissible municipal ordinance and one example of an impermissible municipal ordinance. These cases were decided by the Supreme Court on February 19, 2009. They were considered by the court together as companion cases and should be reviewed together to determine the extent to which the Oil and Gas Act preempts municipal regulation. In these cases, a Borough of Oakmont ordinance addressing natural gas development was upheld, while a Salem Township ordinance was struck down.

In the Borough of Oakmont case, Huntley & Huntley sought to drill a well in order to extract natural gas from two parcels comprising a total of ten acres. Both of these 5-acre properties were located in an R-1 zoning district. DEP granted a permit for the drilling operation at the desired location, but the borough ordered that drilling operations cease until the borough had ruled on a conditional use application. The borough ultimately denied the conditional use. The issue presented to the Supreme Court was whether the borough could regulate the location of gas wells through its zoning ordinance or whether such a restriction had been preempted by section 205 of the Oil and Gas Act. The court analyzed both prongs of section 602 preemption – features and purposes – and found that neither had been violated. With respect to the location of a well being a prohibited feature, the court ruled that "'features of oil and gas well operations regulated by this act' pertains to technical aspects of well functioning and matters ancillary thereto, rather than the well's location." The court provided some examples of these preempted ancillary matters such as registration, bonding, and well site restoration. With regard to the second prong – purposes, the court found that the purposes of the zoning ordinance were different than the purposes of the Oil and Gas Act. The court noted that the purposes of zoning were to authorize uses that considered "the community's development objectives, its character, and the 'suitabilities and special nature of particular parts of the community.'"

In concluding, the court stated that the ordinance's "overall restriction on oil and gas wells in R-1 districts [was] not preempted" by the Oil and Gas Act. It is interesting to note the court's specific reference to the R-1 district. Would the ruling have been different if the drilling was proposed in a less restrictive zoning district? That is not clear from the opinion and undoubtedly will be the subject of debate and possibly future litigation. Nevertheless, the

Oakmont opinion establishes the proposition that municipalities do have some ability to regulate oil and gas operations within their borders.

The Salem Township opinion serves as a counterbalance to the Borough of Oakmont case in demonstrating the limitations of this ability to regulate. In Salem Township, the township enacted a subdivision and land development ordinance that contained a number of requirements regulating oil and gas drilling activities. Salem Township's ordinance was characterized by the court as a "comprehensive regulatory scheme" and contained provisions relating to permitting, bonding, location of facilities, groundwater protection, restoration of well sites, well casing, and plugging. In reviewing the two prongs of section 602, the court found that the ordinance violated both aspects of preemption – features and purposes. The ordinance regulated features of oil and gas operations addressed by the Oil and Gas Act through the various requirements that overlapped with – and in cases that were more restrictive than – Oil and Gas Act requirements. The court also found that the ordinance's purpose of "enabling continuing oil and gas drilling operations . . . while ensuring the orderly development of property" was also one of the purposes of the Oil and Gas Act.

The court summarized its ruling by stating, "[n]ot only does the Ordinance purport to police many of the same aspects of oil and gas extraction activities that are addressed by the Act, but the comprehensive and restrictive nature of its regulatory scheme represents an obstacle to the legislative purposes underlying the Act." The court went on to conclude, "Furthermore, [the ordinance's] stated purposes overlap substantially with the goals as set forth in the Oil and Gas Act, thus implicating the second statutory basis for express preemption of MPC-enabled local ordinances." Salem Township requested that the court rule on each of its requirements individually, but the court refused to do so. The court invalidated the entire ordinance. It is

possible that some of the requirements contained in the ordinance would have been upheld individually, but as a whole these requirements violated the preemption provisions of the Oil and Gas Act.

Viewed together, what guidance do these cases provide to municipalities? Based on the Borough of Oakmont opinion, we have authority permitting zoning restrictions in an R-1 district. Based on the Salem Township opinion, we have authority invalidating a comprehensive regulatory scheme. It is likely that future court decisions will provide additional guidance on the gray area between these two ordinances. Moving forward, as municipalities enact or discuss ordinances that will impact drilling operations, they must consider the two prongs of section 602 preemption – features and purposes. Specifically, they cannot regulate **features** of oil and gas operations that are addressed in the Oil and Gas Act, and they cannot regulate oil and gas operations to accomplish the same **purposes** as the Oil and Gas Act.

V. Impact of Natural Gas Activities upon Land Enrolled in "Clean and Green" Program

The final topic that I will discuss today is the impact of natural gas drilling upon properties enrolled in the Clean and Green Program. The official name of the Clean and Green Program is the Pennsylvania Farmland and Forest Land Assessment Act of 1974. This is a preferential tax assessment program whereby certain land devoted to agricultural use, agricultural reserve, or forest reserve can be taxed at a use value rather than at its fair market value. This preferential assessment can result in significant property tax savings for the landowner. When enrolled land is used for an ineligible purpose, seven years of roll-back taxes plus interest must be repaid to the county assessor.

The statute is silent on whether natural gas development activities are an ineligible use that would trigger the roll-back requirement. Although Clean and Green is a statewide program, it is administered at the county level. The lack of statutory clarity has resulted in uneven application throughout the state as to whether a roll-back is imposed, what acreage is affected by the roll-back, and when the roll-back is triggered. A survey conducted by the Pennsylvania Department of Agriculture Bureau of Farmland Preservation last year revealed four general patterns of resolving this issue. In some counties, primarily in the western portion of the state, natural gas development activities had no impact on the status of enrolled land. Some counties, primarily in Northeastern Pennsylvania triggered a rollback penalty on the entire enrolled parcel when drilling occurred. Other counties triggered a rollback penalty only on the acreage affected by drilling activities. One county triggered a rollback penalty on the entire acreage at the time that the lease was signed before any activity took place on the ground.

Legislation has been introduced in both chambers of the General Assembly to amend the statute to specify how natural gas drilling will impact enrolled land. On June 2, the House of Representatives Agriculture and Rural Affairs Committee is scheduled to vote on House Bill 1394. This legislation will impose roll-back penalties, but not on the entire parcel. It will impose the roll-back taxes at the time of the filing of the well site restoration report and limit the acreage rolled-back to that affected by drilling after the well site restoration has been completed. On June 9, the Senate Agriculture and Rural Affairs Committee is scheduled to vote on Senate Bill 298. This legislation also would impose a roll-back penalty only on land utilized for natural gas activities. The legislation does not define exactly how land “utilized for gas and oil drilling” will be measured. It also does not specify when the roll-back penalty will be imposed.

VI. Conclusion

In conclusion, there are a variety of roles that governments at all levels play in the current natural gas development activities in Pennsylvania. Although many agencies, commissions, and departments have some regulatory role, the Pennsylvania Department of Environmental Protection is the governmental entity most responsible for regulatory oversight. Similarly, although there are many laws regulating natural gas activities, the Pennsylvania Oil and Gas Act provides the foundation for regulation. Local municipalities have some ability to regulate natural gas activities, but they must be careful that they are not regulating features or purposes of the Oil and Gas Act.

I thank you for your time, and we will now open the floor for questions.