



JONES DAY  
**COMMENTARY**

## MARCELLUS UPDATE: PENNSYLVANIA AND FEDERAL COUNTERPARTS SEEK BROADER REGULATION

The Marcellus Shale presents a tremendous opportunity for natural gas producers in Pennsylvania. Despite a challenging economic climate, investment and production in the Marcellus Shale continues to expand. The Pennsylvania Department of Environmental Protection (“DEP”) reports that it has issued more than 600 Marcellus permits through June 5 of this year compared to 476 issued for all of 2008.<sup>1</sup> As producers consider this significant natural gas resource, they must also consider the region’s current regulatory environment along with emerging federal proposals. In 2008, DEP began responding to increased activity in the region by requiring gas production entities to submit additional information with drill permit applications. DEP’s work in 2008 led to much uncertainty and to what the industry deemed to be onerous reporting requirements, not to mention a torturous permitting process.

DEP, however, is making efforts to understand the Marcellus and to streamline the application process, making it more predictable. But DEP has not, and will not, completely abandon its close attention to any and all Marcellus Shale activities.<sup>2</sup> Pennsylvania’s permitting experience still stands in stark contrast to other oil- and gas-rich and experienced states, such as Texas and Louisiana, where permitting takes hours not weeks. This *Commentary* briefly discusses DEP’s recent initiatives and highlights areas of potential interest for oil and gas activities in the region.

### CHANGES TO MARCELLUS SHALE PERMITTING REQUIREMENTS

The Marcellus Shale application addendum released in July 2008 initially required each operator to

<sup>1</sup> Peter Lattman and Ben Casselman, “KKR Invests in Gas Explorer,” *The Wall Street Journal* (June 9, 2009), Pennsylvania Bureau of Oil and Gas Management, *Weekly Workload Report* (June 5, 2009).

<sup>2</sup> Permit Application for Drilling or Altering a Well, *found at* <http://www.elibrary.dep.state.pa.us/dsweb/GetRendition/Document-74140/html>.

develop a pollution prevention and control plan (“PPC Plan”) prior to commencing site preparation or drilling. DEP now requires each operator to demonstrate a plan for erosion and sedimentation control (“E&S Plan”) in addition to the PPC Plan.<sup>3</sup> Also, an application for a Marcellus Shale gas well where the operator proposes to use water from Pennsylvania water sources for water fracing activities must be done in accordance with a Water Management Plan approved by DEP.<sup>4</sup>

Earlier this year, DEP implemented higher application fees, comprising permit fees and surcharges. DEP computes surcharges differently depending on the type of well or activity being permitted. The new permit fee for all wells, excluding Marcellus Shale gas wells, is \$100. Application fees including the new permit fee and surcharges are as follows:

- \$350 for gas wells.
- \$250 for oils wells.
- \$150 for injection or disposal wells.
- \$100 to redrill, deepen, or alter an existing well.
- \$100 for a change in the use of an existing well.

Notably, there are no application fees for rehabilitation of orphaned wells.

The application fee for Marcellus Shale gas wells must include the new permit fee as well as surcharges for abandoned and orphaned wells. The new permit fee for a Marcellus Shale gas well increases in accordance with the total wellbore length. For example, the permit fee for a well with a wellbore length of 0–1,500 feet is \$900. The applicant must indicate whether drilling will be conducted horizontally or vertically. The surcharge for an orphaned well is \$200, and the surcharge for an abandoned well is \$50.<sup>5</sup>

DEP considers the location of a proposed well in approving permits. No site work may proceed within 100 feet of a

wetland larger than one acre, or spring, stream, or body of water unless DEP has approved a waiver. Applicants must file for a waiver along with an E&S Plan. DEP may also require a waiver if the well site, access road, or pipeline encroaches on a watercourse, body of water, or wetland. A new well may not be drilled within 200 feet of an existing building or water well, without the written consent of the owner.<sup>6</sup> DEP will consider the impact of the well on public resources, including parks, forests, gamelands, and other areas.<sup>7</sup> The applicant must also indicate whether the proposed well location sits in a High Quality or Exceptional Value watershed.<sup>8</sup>

Along with DEP’s significant regulatory initiatives, Pennsylvania state as well as federal legislators are turning their attention to gas drillings potential effects.

## PROPOSED STATE AND FEDERAL OIL AND GAS REGULATION EXPANDING

In Pennsylvania, state law may soon subject gas producers to increased responsibility for damage to local roads.<sup>9</sup> Where state law currently allows local municipalities to require owners of overweight vehicles to post bonds up to \$12,500, costs of repairing one mile of roadway may total up to \$100,000. Because equipment used in drilling operations often weighs more than 100 tons, well over the posted limits for rural roads and bridges, state officials are contemplating more expansive bonds. One measure proposed in May by Rep. Mark Longiotti of Sharon, would require PennDOT to set a new bond amount by 2011 based on maintenance costs and to update that bond amount every three years. The measure includes a presumption that overweight vehicles cause road damage unless the vehicle owner can prove otherwise.<sup>10</sup>

<sup>3</sup> Instruction for Completing an Application for a Permit to Drill or Alter an Oil or Gas Well, p. 1.

<sup>4</sup> *Id.* at 3.

<sup>5</sup> *Id.* at 2-3.

<sup>6</sup> *Id.* at 4.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*; Pennsylvania sets forth water quality standards “based upon water uses which are to be protected and will be considered by the Department in implementing its authority under The Clean Streams Law and other statutes that authorize protection of surface water quality.” 25 Pa. Code § 93.2, *et seq.*

<sup>9</sup> Robert Swift, “Marcellus Drilling Spurs Road Bond Debate,” *The Times-Tribune*, found at <http://www.scrantontimes.com/news/1.34569> (May 25, 2009).

<sup>10</sup> *Id.*

The federal government's interest in drilling, particularly water quality and hydrofracturing water ("frac water") and its effect on drinking water supplies continues to grow. Lisa Jackson, head of the Environmental Protection Agency, recently stated that the agency should review "the risk that fracturing poses to drinking water in light of various cases across the country that raise questions" about the process.<sup>11</sup>

Some members of Congress would also require more transparency from drillers. U.S. Representatives Diana DeGette of Colorado and Maurice Hinchey of New York introduced legislation that would repeal the oil and gas industry's exemption from disclosure obligations in the Safe Water Drinking Act. The act would require energy companies to "disclose the contents and concentrations of chemical solutions they inject into bedrock to stimulate production of natural gas."<sup>12</sup> Senator Bob Casey sponsored companion legislation entitled, "The Fracturing Responsibility and Awareness of Chemicals (FRAC) Act" that would require that "any person using hydraulic fracturing disclose to the state (or to the Administrator in any case in which the Administrator has primary enforcement responsibility in a state) the chemical constituents (but not the proprietary chemical formulas) used in the fracturing process."<sup>13</sup> Representative Degette is still seeking a hearing on the proposed legislation.<sup>14</sup>

Industry representatives are skeptical of any further regulation on oil and gas activities. On June 9, 2009, the American Petroleum Institute ("API") released a study indicating that "US oil and gas production would drop 20.5% over 5 years if federal regulation of hydraulic fracturing becomes law."<sup>15</sup> The API president, Jack Gerard, stated that "More than 1 million wells have been completed using this technology. Unnecessary regulation of this practice would only hurt the nation's energy security and threaten our economy."<sup>16</sup>

In an effort to curb the prospect of increased federal regulation, various holders of private oil, gas, and mineral rights recently brought suit against the United States Forest Service challenging a settlement between the Service and Sierra Club that subjects any new oil and gas project to required environmental impact assessments.<sup>17</sup> The group cited Pennsylvania's long-standing law giving mineral right holders priority over surface right holders and stating that "no permission or consent is required from the surface owners prior to going on the land to mine."<sup>18</sup> Plaintiffs have stated that delay mandated by environmental assessments "deprives the Plaintiffs reasonable and timely access to their oil, gas and minerals, in violation of their constitutionally-protected property rights."<sup>19</sup> The lawsuit petitions the court to set aside the Forest Service's settlement and a declaration that oil and gas activities may proceed after a 60-day notice to the Forest Service.<sup>20</sup>

## LIMITATIONS ON GOVERNMENT AGENCIES IN PLACING ADDITIONAL MANDATES ON THE PROPERTY RIGHTS OF OIL AND GAS ESTATE OWNERS

The Pennsylvania Supreme Court recently limited the opportunity for state agencies to infringe on the rights of property owners. In *Belden & Blake Corp. v. Pennsylvania*, Belden & Blake owned or leased oil and natural gas estates on three properties and submitted proper permit applications to develop gas wells on the properties on which the Commonwealth owned surface rights.<sup>21</sup> Pennsylvania's Department of Conservation and Natural Resources ("DCNR") wanted to impose a "coordination agreement" on Belden & Blake Corporation, which required additional fees and conditions.<sup>22</sup>

11 "Jackson Likes Idea of EPA Reviewing 'Fracking,'" found at [http://www.watertechnonline.com/news.asp?N\\_ID=71947](http://www.watertechnonline.com/news.asp?N_ID=71947) (May 22, 2009).

12 "Lawmakers want drillers to disclose fracking info," found at <http://www.stargazette.com/article/20090605/NEWS01/906050387/1117/Lawmakers+want+drillers+to+disclose+fracking+info> (June 5, 2009).

13 Senator Bob Casey, Proposed Bill to amend the Safe Drinking Water Act to repeal a certain exemption for hydraulic fracturing, and for other purposes (June 2009).

14 Judith Kohler, "Rep. DeGette pursues hearing, study on 'fracking,'" *Silicon Valley Mercury News*, found at [http://www.mercurynews.com/breakingbusiness/ci\\_12809715?nclick\\_check=1](http://www.mercurynews.com/breakingbusiness/ci_12809715?nclick_check=1) (Jul. 10, 2009).

15 "Study finds U.S. production would dip under hydraulic fracturing bill," found at [http://www.pennenergy.com/index/articles/display/5330562442/s-articles/s-oil-gas-journal/s-drilling-production/s-production-operations/s-articles/s-study-finds\\_us\\_production.html](http://www.pennenergy.com/index/articles/display/5330562442/s-articles/s-oil-gas-journal/s-drilling-production/s-production-operations/s-articles/s-study-finds_us_production.html) (June 9, 2009).

16 *Id.*

17 Complaint, *Minard Run Oil Co. v. United States Forest Service* (W.D. Pa. June 1, 2009).

18 *Id.* (citing *Clearfield Bank & Trust Co. v. Shaffer*, 553 A.2d 455, 457-58 (Pa. Super. 1989)).

19 *Id.* at ¶ 74.

20 *Id.* at 39.

21 969 A.2d 528, 529 (Pa. 2009).

22 *Id.*

The Pennsylvania Supreme Court affirmed the Commonwealth Court's grant of partial summary judgment in favor of Belden & Blake Corporation.<sup>23</sup> The *Belden* court limited the power of the DCNR by holding that the DCNR had no more power to impose additional mandates on Belden & Blake Corporation than any other surface owner would have.<sup>24</sup> The court asserted that "[a] property owner's interests and rights cannot be lessened, nor their reasonable exercise impaired without just compensation, simply because a governmental agency with a statutory mandate comes to own the surface."<sup>25</sup>

The enhanced attention to and regulation of Marcellus activities will affect costs and prospects of doing business in the Marcellus Shale. We will continue to monitor all relevant legislative and regulatory developments as they occur.

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<sup>23</sup> *Id.* at 533.

<sup>24</sup> *Id.* at 532-33.

<sup>25</sup> *Id.* at 533.

## LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com](http://www.jonesday.com).

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