

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 773

(Senator Edwards)

Judicial Proceedings

Environment - Gas and Oil Leases - Requirements

This bill requires, after January 1, 2013, a person that enters into a gas or oil lease to record the lease in the land records of the county in which the land affected by the lease is located within three months of executing the lease. The bill specifies the information that must be contained in the lease. An oil or gas lease is not valid unless it meets the bill's requirements.

Fiscal Summary

State Effect: Special fund revenues may increase for the Circuit Court Real Property Records Improvement Fund due to the requirement to record an oil or gas lease within three months of execution; however, to the extent that the bill's requirements represent a significant disincentive to engage in development of shale gas resources, special fund revenues may actually decrease. In the event that the bill results in a decrease in the future development of shale gas resources, other State revenues associated with general economic activity may also decrease.

Local Effect: Workloads may increase for court clerks in Allegany and Garrett counties to process any additional recordation of oil or gas leases, although it is assumed that any additional workload can be handled with existing resources. To the extent that the bill results in a decrease in the future development of shale gas resources, workloads may actually decrease; further, any reduction in the rate of gas development would also result in a decrease in severance tax revenues and other revenues associated with general economic activity for Allegany and Garrett counties.

Small Business Effect: Potential meaningful impact on any small business engaged in oil or gas well drilling and related services to the extent that the bill results in any change in the demand for their services. Small business lessor in affected areas could benefit to

the extent the bill reduces their liability for any contamination or damage resulting from oil or gas exploration and production.

Analysis

Bill Summary: An oil or gas lease must contain (1) specified identifying information about the parties and the property; (2) the lease period; (3) a requirement that the terms of the lease be reevaluated before an extension or renewal of the lease period; (4) a statement that requires the lessee to comply with all local, State, and federal laws, regulations, policies, and court orders; (5) a statement that holds the lessee strictly liable for any contamination of air, water, or soil that results from the lessee's operations on the leased property; (6) a statement that will indemnify and hold harmless a property owner against any claims related to the lessee's operations on the leased property, including claims of injury or death, damage to property, or violations of environmental laws or regulations; and (7) a requirement that the lessee pay any attorneys' fees and costs to a lessor related to claims related to the lessee's operations.

Current Law: As a general rule of property law, no estate of inheritance or freehold, declaration or limitation of use, estate of more than seven years, or deed may pass or take effect unless the deed granting it is executed and recorded. This requirement generally does not apply to a lease for an initial term of up to seven years. If a lease that is required to be recorded is not recorded, the lease is valid and effective between the original parties, against their creditors, and against and for the benefit of specified persons claiming by, through, or under an original party. In lieu of recording a lease, a memorandum of lease containing specified information may be recorded. However, Maryland law is silent as to the contents or period for recording an oil or gas lease, except with respect to preserving or terminating a mineral interest under the Maryland Dormant Mineral Interests Act.

Background:

The Marcellus Shale

The Marcellus Shale formation is a geologic feature in the Appalachian Range which has recently attracted significant attention from the energy industry for its rich natural gas deposits contained within 117 counties in seven states. Geologists have long known about the natural gas resources contained within the formation but had considered the gas to be not economically recoverable until the recent development of new drilling technologies including horizontal drilling and high-volume hydraulic fracturing, which have led to a boom in domestic energy production in the United States.

The Marcellus Shale primarily underlies New York, Ohio, Pennsylvania, Virginia, West Virginia, and Western Maryland, with a negligible share also found in Kentucky. Production wells have been drilled in New York, Ohio, Pennsylvania, and West Virginia, and several companies have expressed interest in drilling into the formation in Maryland. In Maryland, the formation is located in Allegany, Garrett, and Washington counties; however, the only anticipated areas of gas production are in Garrett and Western Allegany counties. Applications for permits to produce gas from the Marcellus Shale in Maryland using horizontal drilling and high-volume hydraulic fracturing were first filed in 2010. As of December 2011, the Maryland Department of the Environment (MDE) has received seven permit applications, of which only two are still active.

Concerns Regarding High-volume Hydraulic Fracturing

As the use of hydraulic fracturing has increased, so has concern about its potential impacts. MDE advises that, although accidents are relatively rare, exploration for and production of natural gas in nearby states have resulted in injuries, well blowouts, releases of fracturing fluids, releases of methane, spills, fires, forest fragmentation, road damage, and evidence of water contamination.

In 2010, the U.S. Environmental Protection Agency (EPA) raised several concerns regarding the impact of hydraulic fracturing on water supplies, water quality, and air quality, among other issues, and is currently examining the practice more closely. Other states, academic organizations, environmentalists, and the industry are also conducting research into the impacts of hydraulic fracturing on the public health, safety, and the environment.

General Regulation of Oil and Gas Development

In Maryland, MDE is authorized to issue permits for oil and gas exploration and production and is required to coordinate with the Department of Natural Resources (DNR) in its evaluation of the environmental assessment of any proposed oil or gas well. Specifically, a person must obtain a permit from MDE before drilling a well for the exploration, production, or underground storage of gas or oil in Maryland. A permit is also required for the disposal of any product of a gas or oil well. An applicant who wants to extract gas from the Marcellus Shale may also be required to apply for a number of other State permits, such as a water appropriation permit or a National Pollutant Discharge Elimination System permit.

Among other things, current oil and gas regulations outline application requirements and procedures, criteria for permit approval, drilling and operating requirements and permit conditions, and requirements for the plugging of an oil or gas well upon abandonment or ending of operation. Current regulations apply to all gas wells in Maryland and are not

specific to the practice of hydraulic fracturing. However, under current law, MDE has broad authority to impose conditions on permits to protect the State's natural resources and to provide for public safety. Further, MDE may deny a permit based on a substantial threat to public safety or a risk of significant adverse environmental impact.

Although MDE regulates gas exploration and production, the regulations were written prior to the use of hydraulic fracturing and have not been revised since 1993. Further, MDE advises that a complete understanding of the risks of hydraulic fracturing and consensus about how to protect against those risks is lacking. Due to these concerns, a number of bills were introduced during the 2011 session that would have required further study and the development of regulations prior to the issuance of a permit for gas exploration and production from the Marcellus Shale. None of the bills was enacted, however.

Marcellus Shale Safe Drilling Initiative

In response to the failure of legislation in the 2011 session, Governor Martin O'Malley established the Marcellus Shale Safe Drilling Initiative by executive order in June 2011 to ensure that, if drilling for natural gas from the Marcellus Shale proceeds in Maryland, it is done in a way that protects public health, safety, natural resources, and the environment. The executive order directs MDE and DNR to assemble and consult with an advisory commission in the study of specific topics related to horizontal drilling and hydraulic fracturing in the Marcellus Shale. Specifically, the executive order tasks MDE and DNR, in consultation with the advisory commission, with conducting a three-part study and reporting findings and recommendations.

Part I of the study, a report on findings and recommendations regarding sources of revenue and standards of liability, was released in December 2011. In consultation with the advisory commission, MDE and DNR examined the current liability structure in Maryland and problems and gaps in this structure. The study offered several potential recommendations, including that Maryland create a statutory presumption that certain types of damage are caused by a drilling activity or operation if resulting damage occurred close in time and place to the gas operations. Although the advisory commission recommended the establishment of a presumption of liability in certain "presumptive impact areas," a strict liability standard was not recommended. Strict or "no fault" liability is typically applied to certain activities that are considered inherently or abnormally dangerous; it allows a plaintiff to carry a claim without proving negligence or the failure to exercise another standard of care, which may be difficult in complex cases against industrial actors. The advisory commission was concerned that imposing a strict liability standard may establish negative precedent that could have consequences for other legitimate business activities; a court may still be free to impose a strict liability standard in any future actions involving shale gas drilling in the absence of a statute.

The study also examined current laws in Maryland that might serve as a guide in determining standards of liability for drilling in the Marcellus Shale. For example, under the Natural Resources Article a 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. In addition, a similar law exists in the Environment Article that applies to surface mines established within certain geological areas (known as Karst terrain).

MDE's Oil and Gas Division currently oversees about 95 permits. According to MDE, many of the oil and gas sites covered by these permits are not in active production, and no new wells were drilled in fiscal 2011.

State/Local Expenditures: Workloads may increase for court clerks in Allegany and Garrett counties to process the additional recordation of oil and gas leases under the bill's requirement to record such leases within three months of execution. However, Garrett County advises that the bill is not anticipated to have a fiscal impact, and it is assumed that the additional workload can be handled with existing resources.

It is unclear whether the strict liability standard established by the bill would result in greater overall workloads for the District Court and circuit courts in Allegany, Garrett, or Washington counties. While the number of cases may increase, the average duration could decrease. The bill is not anticipated to have a fiscal or operational impact on the Judiciary.

State/Local Revenues: Special fund revenues may increase for the Circuit Court Real Property Records Improvement Fund to the extent that the bill's requirement to record an oil or gas lease within three months of execution results in a greater number of leases being recorded. Presumably, the majority of oil and gas leases are currently recorded as it is to the benefit of the contracting parties to record their interest. However, Legislative Services advises that the overall number of leases could also decline to the extent that the bill results in a reduction in the future development of the State's shale gas deposits.

Generally, additional legal or regulatory restrictions could create a disincentive for the energy industry to explore development of the State's shale gas resources. As noted above, a strict liability standard was not recommended by the Marcellus Shale Safe Drilling Initiative Advisory Commission, due to several concerns and because other liability standards were considered preferable. To the extent that the industry is unfamiliar with the use of a strict liability standard, this additional uncertainty could result in a significant barrier to drilling in the State.

Any impact on the future extraction of shale gas resources in the State would directly affect future severance tax revenues in Allegany County, and to a greater extent, Garrett County; other sources of State and local revenue from general economic activity may also be indirectly impacted. The State does not currently impose a severance tax on oil or gas production.

Additional Information

Prior Introductions: None.

Cross File: HB 732 (Delegate Beitzel) - Environmental Matters.

Information Source(s): Garrett County, State Department of Assessments and Taxation, Department of Natural Resources, Maryland Department of the Environment, Judiciary (Administrative Office of the Courts), Marcellus Shale Safe Drilling Initiative, U.S. Energy Information Administration, Department of Legislative Services

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