

**Department of Legislative Services**  
Maryland General Assembly  
2012 Session

**FISCAL AND POLICY NOTE**

Senate Bill 798 (Senator Frosh)  
Education, Health, and Environmental Affairs

**The Marcellus Shale Safe Drilling Study Fee**

This bill generally requires the owner of a gas interest in real property in Allegany or Garrett counties underlain by the Marcellus Shale to file a notice with specified information and pay a fee of \$10 per acre by specified dates, depending on when the interest was acquired. The bill extends application of existing enforcement provisions to violations of the bill and establishes a new administrative penalty. The fee and administrative penalty revenues collected are to be paid into the Oil and Gas Fund within the Maryland Department of the Environment (MDE) and used only to fund the cost of conducting a specified ongoing study of the Marcellus Shale. The bill requires MDE to provide refunds to owners if the fee revenue exceeds the cost of the study. Finally, the bill alters the current amounts of performance bond coverage that a holder of a permit to drill for gas or oil must maintain.

The bill takes effect June 1, 2012.

**Fiscal Summary**

**State Effect:** Special fund revenues for MDE increase by about \$1.6 million in both FY 2013 and 2014 due to the fees established by the bill. Special fund expenditures may increase minimally in FY 2013 and 2014 to more fully fund the study than would otherwise occur. Special fund expenditures increase by about \$972,700 in FY 2015 to provide refunds to the owners of gas interests that paid fees under the bill, based on the estimated fee revenue and study costs. Although the bill takes effect June 1, 2012, it is assumed that State finances are not materially affected in FY 2012.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
SF Revenue	\$1,550,000	\$1,600,000	\$0	\$0	\$0
SF Expenditure	-	-	\$972,700	\$0	\$0
Net Effect	\$1,550,000	\$1,600,000	(\$972,700)	\$0	\$0

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** The bill is not anticipated to materially affect local operations or finances.

**Small Business Effect:** Minimal.

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## Analysis

**Bill Summary:** The bill establishes fee and filing requirements that apply to any gas interest in real property underlain by the Marcellus Shale that was acquired between January 1, 2007, and either August 1, 2014, or before the completion of the study required by Executive Order 01.01.2011.11.

By July 1, 2012, or within 30 days after acquiring a gas interest, whichever is later, an owner that acquires a gas interest in Allegany or Garrett counties for the purpose of drilling for natural gas must file a notice with MDE that identifies (1) each parcel, described by metes and bounds, on which the owner has a gas interest; (2) a statement of the total acreage of the parcels; and (3) a map showing the parcels. Failure to file the notice when due may be grounds for denial of a permit to explore for or produce gas from formations under the parcel.

An owner of a gas interest that was acquired between January 1, 2007, and July 1, 2012, must pay a fee of \$10 per acre to MDE by the later of August 1, 2012, or within 60 days of acquiring the interest. By August 1, 2013, each such owner must pay a second fee of \$10 per acre. The owner of a gas interest acquired *after* July 1, 2012, must pay an *annual* fee of \$10 per acre to MDE by the later of August 1, or within 60 days following the date of acquisition of the interest. Failure to pay the fee when due may be grounds for denial of a permit to explore for or produce gas from formations under the parcel.

Generally, a fee may not be assessed after August 1, 2014, or after the completion of the study required by Executive Order 01.01.2011.11. An owner of a gas interest may not pass the payment of fees to, or recover them from, a person that owns the surface rights of the property. The fee may not be assessed on a subsequent person that acquires an interest in a parcel for which a fee has already been paid.

A person who violates the fee or filing provisions of the bill is subject to existing enforcement provisions applicable to water pollution control violations, as well as to a newly established administrative penalty of up to \$10,000 per day. The administrative penalty must be assessed with consideration given to the size of the parcel, the extent of the knowledge of violation, and whether the violation was part of a recurrent pattern. An owner may not pass the penalty to, or recover a penalty from, a person that owns the surface rights of the property.

MDE must deposit all fees and administrative penalties collected under the bill into the existing Oil and Gas Fund.

After the earlier of August 1, 2014, or the completion of the study required under Executive Order 01.01.2011.11, MDE must compare the actual costs of the study with the fees collected under the bill. If the actual cost of the study is less than the amount of fees paid, then MDE must refund the difference, prorated by acreage, to the owners who paid a fee. However, if the actual cost of the study is more than the fees paid, then each owner that filed a notice required by the bill must pay, within 90 days after receipt of written notice by MDE, a prorated amount determined by MDE that is needed to fully fund the cost of the study.

The bill requires that any fees or penalties paid into the Oil and Gas Fund under the bill be used by MDE to pay for the study required by Executive Order 01.01.2011.11. The money may be used to reimburse past MDE and Department of Natural Resources (DNR) expenses related to the study. The bill also authorizes MDE and DNR to enter into sole source agreements for goods or services in order to expedite completion of the study.

The bill alters the amount of a performance bond, from *up to* \$100,000 to *at least* \$50,000, which a holder of a permit to drill for gas or oil must post for each gas or oil well. The bill repeals the \$500,000 maximum for a blanket bond for all of a permit holder's oil or gas wells. The bill also specifies that the performance bond is conditioned on ensuring proper sealing and plugging of the gas or oil well and reclamation of the site in addition to the other generally applicable compliance provisions specified in current law. The bill authorizes MDE to adopt regulations to increase the minimum amount of a performance bond or liability insurance coverage that a permit holder must keep in effect.

The bill exempts any MDE action pursuant to the fee and filing provisions of the bill from the generally applicable rehearing rights for parties that are adversely affected by a rule, determination or order of MDE, as well as from specified rights to appeal and for a court to impose injunctive relief.

The bill defines a "gas interest" as the right to explore for gas on, or produce gas from, real property. A gas interest does not include a fee simple interest in the surface rights of real property regardless of whether the fee interest includes the mineral rights.

### **Current Law/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, 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 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.

### *The Oil and Gas Fund*

Chapter 383 of 2010 established an Oil and Gas Fund to support MDE's administration of a regulatory program that oversees the drilling, development, production, and storage of oil and gas wells in the State. Under Chapter 383, MDE is required to set and collect permit and production fees related to oil and gas well drilling. Fees must be set at a rate necessary to (1) review, inspect, and evaluate monitoring data, applications, licenses, permits, and other reports; (2) perform and oversee assessments, investigations, and research; (3) conduct permitting, inspection, and compliance activities; and (4) develop and implement regulations to address the risks to public safety, human health, and the environment from oil and gas well drilling and development. MDE advises that the regulations to establish such fees have been drafted but are being held pending the work of the Marcellus Shale Safe Drilling Initiative and related studies.

### *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 01.01.2011.11 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. The completed study will include (1) findings and related recommendations regarding sources of revenue and standards of liability for damages caused by gas exploration and production; (2) recommendations for best practices for all aspects of natural gas exploration and production in the Marcellus Shale in Maryland; and (3) findings and recommendations regarding the potential impact of Marcellus Shale drilling in Maryland. Part I of the study, a report on findings and recommendations regarding sources of revenue and standards of liability, was released in December 2011. Parts II and III of the study are expected to be completed by August 1, 2012, and August 1, 2014, respectively.

**State Fiscal Effect:** According to land records data from Garrett County, which have recently been examined by the county to avoid double-counting of leases, there are 691 recorded leases or memoranda of leases, representing 126,927 acres. Similar data could not be obtained from Allegany County, although the extent of oil or gas leasing activity is expected to be relatively low in Allegany County. Additionally, some leases may not have been recorded, but they may be recorded in the future. Finally, some of these leases may have been recorded prior to July 1, 2007. Thus, while the actual number of acres contained in oil and gas leases acquired between July 1, 2007, and July 1, 2012, is unknown, it may be about 150,000 acres. Thus, special fund revenues increase by about \$1.5 million in fiscal 2013 and 2014 from these leases due to payment of the \$10 per acre fee.

The bill also requires leases acquired after July 1, 2012, to pay an annual \$10 per acre fee. Assuming another 5,000 leases are acquired and result in the payment of the fee, then special fund revenues increase by an additional \$50,000 in fiscal 2013 and by an additional \$100,000 in fiscal 2014, bringing the total fee revenues to an estimated \$1.55 million in fiscal 2013 and \$1.6 million fiscal 2014. This estimate assumes that all leaseholders pay the fee due to the significant incentives established by the bill, including the denial of a permit and the imposition of penalties. This analysis also assumes that all fees are collected in fiscal 2013 and 2014.

Based on information provided by MDE and DNR, the estimated cost to complete all necessary work related to the study is \$2,177,270 in fiscal 2013 and 2014. This reflects an estimated \$838,950 in costs for MDE and an estimated \$1,338,320 in costs for DNR (including costs to hire four contractual employees). It also reflects costs of \$138,950 for the University of Maryland Center for Environmental Science, which has already been funded by MDE through the State Used Tire Cleanup and Recycling Fund to conduct initial phases of the study; the bill authorizes fees collected to be used to reimburse past expenses related to the study.

Although the bill establishes a funding source for the study, it does not require additional expenditures for that study beyond those which would already be incurred due to the executive order. The bill does, however, require refunds of excess fee revenue to the owners who paid the fee, prorated by acreage. Even so, this estimate assumes special fund expenditures may increase minimally in fiscal 2013 and 2014 to ensure the study is fully funded. It also assumes that special fund expenditures increase by approximately \$972,730 in fiscal 2015 when MDE is expected to refund excess fee revenues to owners. This estimate is based on the bill generating total special fund revenues of \$3.15 million between fiscal 2013 and 2014 and a \$2.18 million study cost as described above. To the extent actual fee revenue or the cost of the study varies from these estimates, the amount of any refunds will vary accordingly.

This analysis assumes that the establishment of a fee will not significantly reduce the future rate of oil or gas resource development relative to what would occur in the absence of the bill. It also assumes that the application of existing enforcement provisions and the establishment of administrative penalty authority does not materially affect State finances.

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### **Additional Information**

**Prior Introductions:** HB 852 of 2011, a similar bill as amended, passed the House and was referred to the Senate Education, Health, and Environmental Affairs Committee, but no further action was taken. Its cross file, SB 634, was heard by the Senate Education, Health, and Environmental Affairs Committee, but no further action was taken.

**Cross File:** Although HB 1204 (Delegate Mizeur, *et al.* - Environmental Matters) is designated as a cross file, it is different.

**Information Source(s):** Garrett and Washington counties, State Department of Assessments and Taxation, Department of Budget and Management, Department of Natural Resources, Maryland Department of the Environment, Marcellus Shale Safe Drilling Initiative Advisory Committee, Department of Legislative Services

**Fiscal Note History:** First Reader - March 2, 2012  
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