



FRACKING LITIGATION REPORT

VOL. 1 Filling in the Structural Cracks of Fracking Regulation

November 20, 2012

Beyond the necessary water quality and property rights regulations that desperately need strengthened, the actual legal and regulatory structure, itself, also needs an overhaul. During the 130th Ohio General Assembly, beginning in January, lawmakers need to create a set of rules that can quickly and cost-effectively adjudicate disputes surrounding the harms caused by fracking. Lawmakers should also try to create a set of rules that gives the people who know the most about the industry—the fracturing companies themselves—the proper incentives to avoid harms by forcing them to internalize all of the costs of their activities.

Because the drilling companies have so much more knowledge about their operations than regulators, lawmakers, or landowners, it is the industry that is thus better situated to minimize and remedy the associated harms. In order to create socially desirable outcomes, then, it is proposed that the industry should be made to bear as much of the costs of their activity as possible. This will give the industry the proper incentive to minimize impacts to the environment and the public in order to save itself money. This incentive, of course, must be in the form of a significant monetary disincentive that will be felt in the oil and gas operator's bottom line and in the Big Oil Board Rooms.

Below are the Ohio Environmental Law Center's five recommendations for how lawmakers (and the courts) can prepare the legal system to “fill in the cracks” in our regulatory scheme.

1. Learn a lesson from coal: require pre-drilling baseline and continual monitoring

With the passage of Senate Bill 315 earlier this year, Ohio law now requires a company planning to drill for natural gas to conduct baseline water quality monitoring of any water wells within 1,500 feet of their proposed drilling operation. This is a start, but there is no requirement for ongoing water monitoring, or for post-drilling monitoring.

By contrast, the State of Ohio requires an applicant for a permit to mine coal to conduct a thorough inventory of the proposed mining area's surface water flow as well as the water quality for both surface and ground water. Ohio also requires ongoing monitoring as the mining continues, and post-mining monitoring for two years after mining is complete.

All of this monitoring makes the question of what caused water contamination much easier to answer because the underlying data is agreed upon. In fact, the parties to lawsuits alleging that coal mining affected a water supply can often stipulate as to causation, saving the parties the costs of hiring expert witnesses, and saving the court the costs of unnecessarily

frequent and prolonged trials. Just as importantly, the cost of hiring experts is often prohibitively expensive for a landowner.

Since natural gas wells can remain productive for many years, the landowner at the time of impact may be different from the landowner at the time that drilling commenced. Thus requiring the monitoring data to be collected by the company and filed with DNR would ensure that it is preserved even if the land changes hands during drilling.

2. Strict liability for impacts caused by fracking

When an industry operates on such a large scale as fracking, accidents with widespread consequences are bound to happen even if the companies exercise reasonable care. And the jury is still out on the potential for fracking fluids to migrate up to contaminate surface and groundwater over a 50 or 100 year time span, regardless of any precautions that companies might take. Nonetheless, these injuries should still be compensated by the drilling companies—especially if they have widespread health or environmental concerns.

A strict liability regime will ensure that there is no need to engage in fact-specific and costly litigation as to proper standard of care in the oil and gas industry, and whether a given company lived up to that standard in a particular case. It is time consuming and expensive for the parties to hire experts to battle it out in court as to the appropriate standard of care on a particular point. Combined with administrative requirements mentioned in part 1 to ensure that causation is easy to prove, this will drastically reduce the administrative burden of what is likely to be a large amount of litigation over fracking-related incidents.

Subjecting companies to strict liability will also encourage them to seek to locate their activities in less populated, less sensitive areas where any mistakes will cause less harm—at least until the potential impacts are better understood. This is an important development, especially while there are still so many unknowns about the potential impacts.

Finally, it is extremely difficult to determine the proper level of precaution required to avoid negligence at a fracking site for three reasons. First, the large amount of variance from one site to another makes generalization difficult. Industry representatives repeatedly assert that each well site is different, and it is inappropriate to place a ‘one size fits all’ regulatory solution on to fracking operations. Thus, it would be undesirable to adopt a negligence regime that would eventually result in the establishment of case law as to what kinds of precautions are required to avoid negligence liability. A strict liability regime, by contrast, will provide proper incentives for each operator to take the precautions that are cost-justified at each particular well site and ignore those that are not cost-justified without being held to a somewhat nebulous and probably inapplicable negligence standard.

The second reason that it is difficult to determine the appropriate standard of care for a negligence regime for fracking is that the technology involved in fracking is rapidly changing and little understood, leaving little time for a set of rigid “industry standard” practices to evolve. Third, many of the chemicals involved in the fracturing process are trade secrets, not available to the general public or in the course of litigation. In short, it is practically impossible to establish

reasonable standards of care for such a little-understood process. The best course of action, then, is to require operators to “pay as they go” for harms caused by their activities. This will give those who best understand the process the proper incentive to use that understanding in the most socially beneficial way without the need for the judiciary to expend resources overseeing the process ex-post by developing a negligence standard.

3. Latent harms

One of the issues that Ohio has faced with coal mining and with conventional oil drilling is that when resource extraction companies go bankrupt or otherwise cease to exist, they often leave problems behind. For conventional oil drilling, one such problem is the thousands of uncapped abandoned oil wells that provide a potential conduit for fracking fluids to reach the surface today. For coal mining, it is abandoned, un-reclaimed mine land that continues to poison our waterways with acid mine drainage. We should anticipate that there will be problems revolving around inadequate reclamation, and that the companies responsible may no longer exist by the time the problem becomes apparent.

Ohio law currently requires drilling companies to post a surety bond prior to drilling. The bond is in the amount of \$5,000 for an individual well, or \$15,000 for a blanket bond covering all wells operated by the company in the state. OAC 1501:9-1-03(A). But the bond is discharged once the operator has met the reclamation requirements according to Ohio regulation. ORC 1509.07(B)(1) as amended by SB 315. Thus, there is nothing to cover harms that are not apparent until after the company has left the site.

But consider even more latent harms. For example, if a drilling company stored flowback water in a lined pit, but failed to properly pump out and cap that pit during their reclamation process, it could take years for the toxic remnants to leak out or be uncovered. Likewise, if they capped the well improperly, it could take decades before any fluids actually leak into an aquifer.

In the context of coal, ORC 5749.02 imposes a severance tax on coal mining operations to pay for the reclamation of old coal mines that were not adequately reclaimed in the past. The severance tax imposed by RC 5749.02 on natural gas extraction is minuscule. And yet we still have not reclaimed all of those old abandoned mines. Likewise, we have not plugged all of the old abandoned wells from our last oil rush—these are potential conduits for fracking fluids to migrate to the surface. Ohio should raise its severance tax on gas extraction to keep up with other states. The money should be spent plugging abandoned oil wells and hold the balance in trust to pay for impacts that are yet to occur.

4. Potential catastrophic harms

Imagine a worst case scenario. Suppose a fracking company completely loses control of a well for a week or more and the fluids escape the well pad. Thousands of gallons of hazardous chemicals leach into the groundwater aquifer is the water source for municipal well that supplies drinking water to a town of 50,000 people. Thousands of people could become sick from such a disaster. The costs of such an event would far exceed \$5 million. While the odds of something

like this happening are slim, it is better for the costs of rare disasters to be borne by industry and insurance companies that are well-equipped to understand and mitigate these risks than by regular citizens who were not in a position to protect themselves.

Current law tries to get at these problems with bonding and insurance requirements. R.C. 1509.07(A)(2) requires a fracking company to have \$5 million of insurance for harms to persons or property for their operations in the state. That isn't nearly enough to cover a worst case scenario problem, and the large companies that are operating fracking wells are sophisticated enough to know how to structure their enterprise to avoid paying anything out of pocket.

[This paper](#) from the Beacon Hill Institute at Suffolk University, a research institute dedicated to applying rigorous economic research methods to current public policy issues, suggests that well-capitalized and financially sophisticated Wall Street firms could easily underwrite the low percentage chance of a large disaster, and the re-insurance industry would be more than capable of supporting those firms in any eventuality.

Requiring a sophisticated insurer to pay for catastrophic harms is good policy because it moves risks away from those who are not well-positioned to protect themselves—the general public—and puts the risk on parties who are well-positioned to protect themselves—the fracking, actuarial, and insurance industries.

5. Provide for attorneys fees

Attorney's fees and court costs are a major barrier that prevents people with meritorious claims from pursuing them. Modern fracturing techniques can reach gas—and potentially pollute water—over a mile away from the drilling site. Trucks hauling waste or other chemicals to or from the drilling site can get into accidents miles from the drilling site. This means that the people impacted will not necessarily be made rich from the bonus payments and royalties of the drilling, and will not necessarily be able to afford attorneys fees and court costs necessary to advance their claims.

While the strict liability regime and the administrative requirements to ease the burden of court should lower attorneys fees and court costs, the drilling company is better situated to bear these costs for successful suits. These costs could often ease the burden of court should lower attorneys fees and court costs, the drilling company is better situated to bear these costs for successful suits. These costs could often eat up the claims of small land owners.