

Minutes, December 12, 2011, meeting of the Marcellus Shale Advisory Commission
Approved January 27, 2012

The Commission held its fourth meeting on December 12, 2011 at Rocky Gap State Park in Flintstone, MD. In attendance were Chairman David Vanko and Commission members Peggy Jamison, George Edwards, William Valentine, James Raley, Shawn Bender, Jeffrey Kupfer (by conference call), Dominick Murray, Paul Roberts, Nick Weber, and Harry Weiss. Also in attendance were staff of state agencies and members of the public.

Dr. Vanko called the meeting to order at 9:00 am. The draft minutes of the November 15 meeting were approved unanimously, subject to minor corrections noted by Commissions Kupfer and Weiss.

Brigid Kenney gave a brief summary of the changes in the redraft of the report, which was circulated in advance of the meeting. The executive summary and the appendices were added to the redraft, including the "Consultation with the Advisory Commission" section in Appendix E. The redraft also incorporated suggestions made during the November 15 meeting. The calculations for the cost to remediate a hypothetical damage caused by drilling were moved to an appendix and a statement was inserted clarifying that no decision has been made about whether drilling can be done safely. Additional research reports about the economic impacts of a severance tax were cited on page 10.

Dr. Vanko then moderated a discussion of the redraft. Several comments were raised with respect to Section I - Overview. Commissioner Weiss noted that in the previous meeting, Commissioners had discussed broadening the emphasis in the first paragraph of the report to include safe drilling in general, rather than only hydraulic fracturing. Chairman David Vanko stated that he preferred leaving the emphasis on hydraulic fracturing in the introduction, since the necessity of transporting and storing fracturing fluid is a main component of the safety inquiry. Commissioner Roberts noted that the report currently states that, when burned, natural gas produces less greenhouse gas (GHG) emissions than coal or oil. He requested that it be stated that production of natural gas could require significant energy and produce significant GHG emissions. The Departments will consider adding a footnote to that effect. Commissioner Kupfer requested that on page 1, the mention of energy independence should be replaced with the phrase "could enhance energy security." He also suggested that, on page 2, the word "nonetheless" appear in the third paragraph before "Maryland law allows MDE..." He also noted that the report currently states that applications for Marcellus Shale drilling were received beginning in 2010, while there were applications in 2009 as well.

With respect to section I.C, Commissioner Kupfer commented that the Commission has not yet had a substantive discussion about whether drilling could be done without unacceptable risks. The report currently states that the Departments and the Commission "have not yet made any determination" on the issue. To clarify, he requested that the phrase "not yet considered" be used instead.

The Commission moved on to a discussion of the revenue section of the report. A Commissioner raised the question of what is meant by “mapping data” within the list of items to be included in a pre-drilling baseline study. Representatives from the Departments explained that mapping data would consist of maps showing where mineral rights have been severed from public lands and where mineral leases have occurred on non-state land.

Commissioner Kupfer commented that, with respect to additional state expenses for increased site presence during drilling and production, the language should be qualified to include only “reasonable” site presence. The purpose of this change would be to avoid the assumption that on-site presence would be continuous during drilling and production, especially since this does not occur in other jurisdictions. Commissioner Weber commented that it might not be inappropriate to have continuous presence of an inspector during some phases of the activity. There was brief discussion of how the presence of an inspector during drilling and production would be funded. It was noted that if the permittee directly pays the inspector there may be concern of a conflict of interest. However, staff from the Departments explained that direct payment from the permittee to the third-party inspector is not unprecedented and that the MDE mining department prefers that the payment not pass through the State. This method avoids unnecessary transactions costs.

Commissioner Weber commented that regional air quality should be mentioned as one of the baseline studies to be undertaken before drilling. Staff from MDE explained that MDE’s air program has been consulted on this point and that a regional air quality baseline would be difficult and costly to obtain. Varying topographies, microclimates, and migration of out-of-state pollutants would need to be taken into account and are important factors in the relevant region. There is currently one air quality monitoring station in Western Maryland. Addition of another station would cost \$174,000, and would probably still be insufficient. For these reasons, it would be more practical to identify a potential drilling site and do a site-specific baseline study. Commissioner Weiss added that last week Pennsylvania’s DEP ordered operators in Pennsylvania to submit air monitoring data.

With respect to the baseline studies on the economy and the community, Commissioner Edwards asked for the definition of “community.” It was explained that the study would attempt to cover the entire area where drilling is likely to occur, but impacts might be different for different municipalities within that area. The study would seek to take into account variations in available infrastructure. Commissioner Edwards noted that much of this information is already available in county and municipal plans. Several Commissioners agreed that Appendix B should state explicitly that existing county plan information on housing, transportation, etc. will be used where available.

Commissioner Edwards noted that on page 7, the report lists repair of state roads as a potential cost to the State during and after production. He commented that the report should explain the differences in funding sources for different types of roads.

Commissioner Kupfer concurred, noting that companies engaged in gas development already incur some expense of repairing roads.

Commissioner Kupfer noted that income and sales tax were left out as potential sources of revenue in section II.C, and he requested that these options be moved from footnote 3 to the body of the report because in other jurisdictions and presumably in Maryland as well, these constitute significant contributions. There was also brief discussion about the statewide severance tax rates listed on page 9. Commissioner Kupfer raised the point that the statutory tax rate is often misleading because many states have credits and other provisions that lower the actual severance tax paid. He suggested that this section state the difference between statutory and effective tax rates.

On page 10, with respect to the conclusion from the Headwaters study that tax rates had no negative impact on energy investment in several Western states, a Commissioner questioned whether this statement included coal. It was noted that Wyoming has better quality coal than Montana, so Wyoming might be expected to have greater energy development than Montana, even if severance taxes depressed energy investment. Commissioner Roberts asked whether the three studies cited are comprehensive on this topic or how they were chosen. Staff from the Departments explained that there exist other studies on the topic and that these studies show a range of opinions on the subject. Commissioner Kupfer suggested mentioning explicitly that there are other studies that were not cited and inserting a sentence stating that “studies have reached differing conclusions.” Commissioner Weiss suggested mentioning the potential impact of a severance tax on landowner income, since this was an issue discussed by the Commission in earlier meetings.

The Commissioners moved to a discussion of the recommendations for the revenue section. In general, some Commissioners noted that the recommendations in this section were too buried in the text and difficult to pull out. With respect to the recommendation R-1, which recommends a fee to fund baseline studies, Commissioners generally agreed that the studies should be done. However, Commissioners disagreed on how much responsibility the industry should have in funding the studies. Commissioner Edwards stated that it would be unfair to require the industry to pay for the cost of the studies without being reimbursed and that no other industry is required to fund a study before developing. He also commented that the industry should be reimbursed for the cost of the study regardless of whether they are ultimately permitted to drill. If they are, the reimbursement could come in the form of severance tax credits. If they are not, the State should reimburse them, possibly over time. He also stated that the study fee should be one year rather than two and that existing data should be used where available to accelerate the study. Commissioner Kupfer commented that the body of the report should state that there is no precedent for the study fee in other jurisdictions. Some other Commissioners noted that the State would benefit from the studies and believed it would be unfair to require the industry to be wholly responsible for funding them. Other Commissioners disagreed, stating that the information in the studies is necessary and because of the industry’s size and the money to be realized by development, it makes sense for the industry to fund the studies itself.

Next the Commissioners discussed recommendations R-2 and R-3, which suggest imposition of a statewide severance tax and the creation of a Marcellus Shale Environmental Fund. The purpose of the fund was discussed and it was clarified that the fund would be used for immediate remediation of damage caused by drilling where the party at fault cannot pay. This may be either because the damage cannot be traced back to a particular party or because the party has since become insolvent or otherwise unavailable. In some cases, the State can later attempt to recover from the party to reimburse the fund for the cost of cleanup. It was also clarified that even after a bond is released, a party remains liable for damages that can later be attributed to it. Commissioners expressed general support for a statewide severance tax, but several Commissioners commented that the amount of the tax must be reasonable and should take into account other states' rates as well as the rates of counties. In addition, several Commissioners thought the recommendation should state that most of the severance tax revenue will go toward the counties in which the drilling takes place rather than general environmental activities. Commissioner Kupfer stated that he did not support the recommendation as worded because there was no amount specified for the severance tax and because it was premature to make such a recommendation without knowing about other fees and operating constraints that companies may face in Maryland. Independent of the tax, Commissioners were supportive of the need for the fund and the proposed uses of the fund.

The liability section was discussed next, beginning with recommendation L-1, which suggests a rebuttable presumption of causation. Commissioners Kupfer and Bunker noted that the study cited in footnote 22 was subject to a laboratory error and is currently being revised. The Commissioners discussed the types of damages that would be covered under the presumption. It was noted that while the report suggests leaving that question open to be decided by MDE, in Pennsylvania the presumption applies only to water contamination. For that reason, some Commissioners felt that the presumption available in Pennsylvania should not be used as a justification for making a recommendation for a broader presumption. A Commissioner raised particular concern with applying the presumption to other damages such as seismic damage. The group was generally supportive of a presumption of causation for water contamination, but not a presumption that would leave open types of damages to be determined by MDE. Commissioner Roberts asked whether the presumption would be applied through an administrative program or through lawsuits. It was noted that in the analogous law for karst region dewatering, an administrative program is used.

The Commission then discussed recommendation L-2, which endorses a Surface Owners' Protection Act (SOPA). Commissioners were generally supportive of this recommendation. Commissioner Weber raised the issue that the SOPA is aimed at addressing damages only to surface owners and not adjacent landowners. Instead, adjacent property owners would rely on currently available legal claims and, where the impacts are regional, community benefits agreements and mediation. Commissioner Roberts expressed concern with the fact that there is no mechanism for protection of "innocent bystanders" within the SOPA. It was discussed that attempting to include

innocent bystanders in the SOPA would likely be undesirable for lack of a workable and non-arbitrary way of determining who would be covered. Damage could potentially be felt by anyone in the county and by parties other than landowners.

The option of imposing strict liability on permittees for damage caused to residents, landowners, and business owners was discussed briefly. The report does not recommend pursuing this option. Commissioner Roberts commented that this option should be recommended. He argued that based on reports of water well contamination in Wyoming and Pennsylvania, the State should make a legislative determination that hydraulic fracturing is an “abnormally dangerous activity” subject to strict liability. It was clarified that even in the absence of legislative intervention, this theory would still be available for parties making a claim of damage from exploration or production. The determination would be made by the court on the particular circumstances of the case and factors such as the location of the drilling would be considered.

Recommendation L-3, that regional impacts be addressed through community benefits agreements (CBAs) or mediation, was discussed. It was clarified that the recommendation does not include a mandatory program. Some Commissioners noted that currently the counties do not have formal mediation in similar situations until after a lawsuit is brought. Commissioner Roberts expressed interest in working with industry on a voluntary program. Commissioner Kupfer stated that he was not supportive of a mandatory mediation or CBA process, but that he would be willing to discuss voluntary programs. It was also noted that in Pennsylvania, voluntary CBAs or mediation occurs with some companies already.

Finally the Commissioners discussed recommendation L-4, which suggests deleting the reference in the statute to an amount for the performance bond. Instead, MDE would be authorized to determine the amount of the bond based on the costs of complying with the permit, closing the well, and performing reclamation. Generally, Commissioners were supportive of the recommendation. Commissioner Edwards suggested that the legislature provide an amount in the statute as a starting point but authorize MDE to increase or decrease the amount from there. Commissioner Kupfer commented that there should be a maximum specified in the statute or MDE should recommend an amount, with the ultimate decision being made by the General Assembly. This approach would reduce the uncertainty of having the bond set entirely through regulation.

If it is feasible, a redraft of the report will be distributed to the Commissioners before being finalized. Two meetings were tentatively scheduled for:

Friday, January 27 at 1:00 pm in Annapolis

Monday, February 27 at 2:00 pm in Hagerstown

Chairman Vanko adjourned the meeting at 12:15 pm.