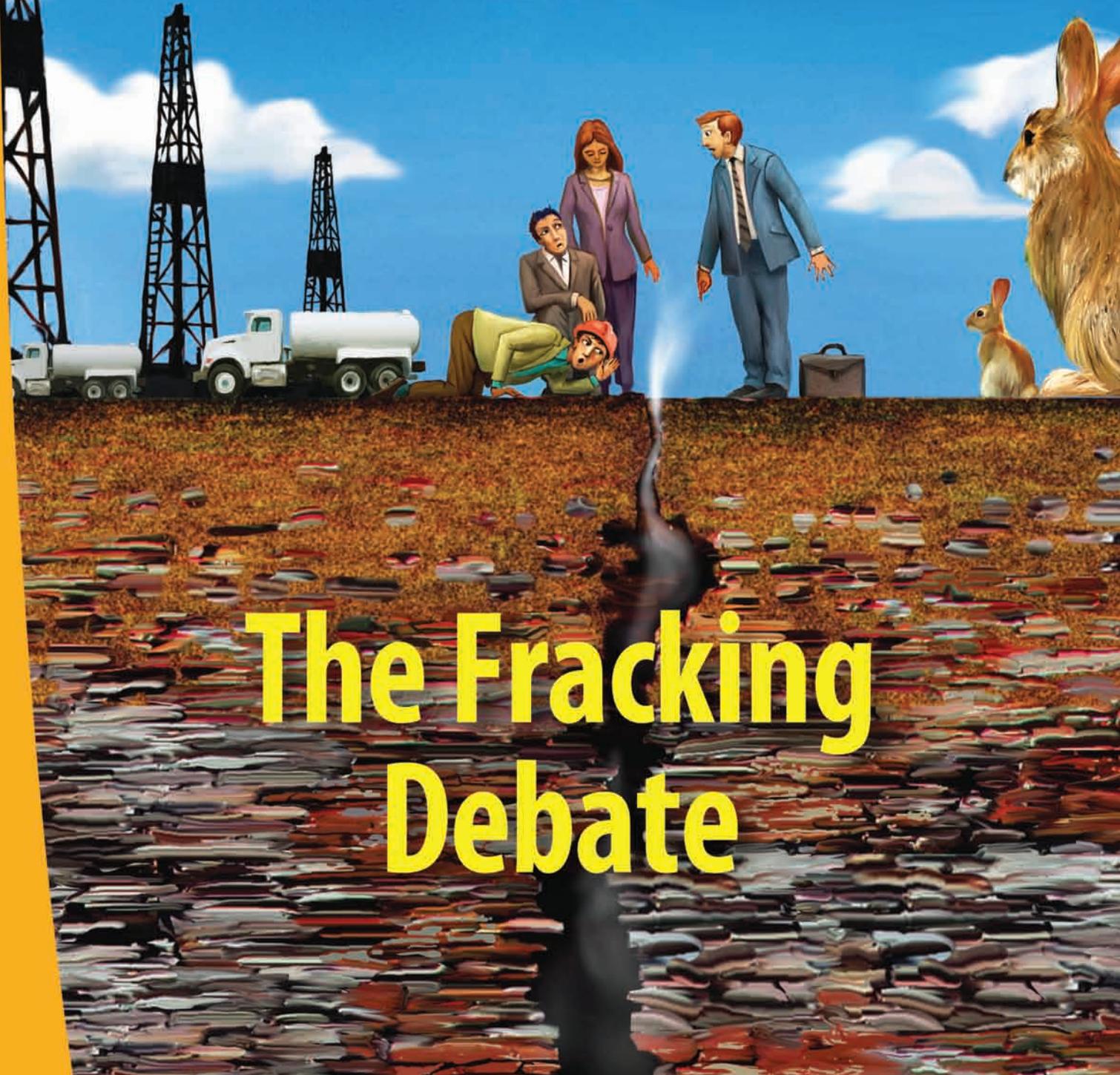


AIRROC matters

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The Fracking Debate

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Hydraulic Fracturing

A Retrospective of Key Legal Disputes in 2014 and Predictions for the Future

In 2014, hydraulic fracturing (“fracking”) remained a hot national topic. Often making headlines, fracking also made its mark in litigation where key battles wound their way through the courts. Reviewing just some legal developments confirms the industry faces unique, sometimes prejudicial, challenges despite continued growth.

For example, the Eighth Circuit’s decision in *Hiser v. XTO Energy*, 768 F.3d 773, illustrates how extraneous, prejudicial information in the media comes to the jury’s attention and influences litigation. A drilling company appealed an award for damages allegedly caused by vibrations from drilling. During deliberations, the jury asked whether the company was “drilling only or were they also fracking?” One juror stated that earthquakes and other negative impacts “caused” by fracking were also discussed. The jurors largely agreed that a pre-instruction fracking discussion occurred but disagreed about its scope and significance. Finding the trial court’s instruction eliminated the risk of prejudice, the Court of Appeals upheld the verdict.

It is not just negative press causing legal headwinds. High volume natural gas extraction involves a combination of risks and rewards that are ripening into various forms of legal disputes. Most commonly, disputes involve land use, contract and tort-based law¹ and, in 2014, various courts addressed several major issues. Our retrospective aims to provide insight into recent litigation trends and preview remaining, unresolved issues.

Contract Litigation

Numerous contracts are involved in natural gas extraction, such as landowner-energy company leases, contractor-subcontractor agreements and insurance contracts. Unsurprisingly, contract disputes dominated 2014 fracking litigation.

For example, in *Warren Drilling v. Equitable Production*, 2014 WL 1512699, an indemnification provision in a production company-drilling company contract was applied to an underlying water contamination claim advanced by certain landowners. The court determined the contract’s language wherein the producer’s duty to indemnify was plain and consequently was triggered by the contamination claim against the drilling company. The language at issue provided that the production company

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“shall assume full responsibility for and shall defend, indemnify, and hold Contractor harmless from and against any loss, damage, expense, claim, fine and penalty, demand, or liability for pollution or contamination.”

The contract’s language was not restricted to “loss” or “liability” but extended the producer’s obligation to indemnify any “claim” or “demand.” Based on expert reports that subsurface chemicals caused contamination, the court determined the producer was contractually required to defend and indemnify the drilling company. The court held the provision’s broad language covering “any claim or

demand” evidenced intent to expand Pennsylvania’s triggering rule to include potential liability rather than actual legal liability.

Lease length provisions in older landowner-energy company leases were commonly litigated. In fact, New York, Ohio, and Kansas courts each addressed *habendum* and/or *force majeure* provisions. These cases illustrate a potential for myriad disputes and the need for unambiguous contract provisions.

The Second Circuit certified questions on both clauses. *Beardslee v. Inflection Energy*, 761 F.3d 221. Due to unclear contract language, the court asked two “fundamental questions” of New York law: (1) “whether, in the context of an oil and gas lease, [New York’s] Moratorium [on fracking] amounted to a *force majeure* event”; (2) “if so, whether the *force majeure* clause modifies the *habendum* clause and extends the primary terms” of gas leases.

In *DeRosa v. Hess Ohio Resources*, 2014 U.S. Dist. LEXIS 119587, the *habendum* clause was found to be clear and, as such, extended the lease despite a lack of infrastructure near a shut-in well. The court held a shut-in well was “capable of production” under the *habendum* clause notwithstanding a lack of nearby pipelines. The court did, however, release a section of land for failure to develop that portion.

Meanwhile, the Kansas Court of Appeals refused to cancel a contract due to alleged failure to develop, even though the energy company refused to drill for over 30 years and even though any well would be commercially unviable. *Novy v. Woolsey Energy*, 2014 Kan. App. LEXIS 68. The court refused to cancel the contract, reasoning that the lack of viability and drilling were insufficient to establish a breach of contract.

Future contract disputes are expected, particularly where older contracts

are viewed through the prism of new fracking technology.

Legislation and Regulation

As nearly 20 states have permitted fracking, governments at various levels responded by passing statutes and regulations to govern the industry. Some governments, however, have not updated existing laws on gas extraction. Regardless, various legal challenges were made to new and existing laws.

One decision concerned the issue of “local rule” or, stated otherwise, whether municipalities could prohibit or limit fracking activities within their borders without running afoul of state and federal law. In a highly publicized case, *Wallach v. Town of Dryden*, 16 N.E.3d 1188, the New York Court of Appeals determined that localities were empowered to do so without preempting state law.

The decision was observed by many as critical because shale-rich New York was, at the time, in its final decision-making process on applicable state fracking laws and regulations. Following that decision, however, New York’s administration surprised many by announcing a ban on fracking,² becoming the only shale-rich state to outright ban the practice. The ban will likely result in litigation, including questioning whether bans constitute a “taking” under the U.S. Constitution.

Outside of New York, existing laws, as applied to new technologies, were also challenged. The Michigan Court of Appeals interpreted the regulatory definition of “injection well” as applied to modern fracking. *Hughes v. Department of Environmental Quality*, 44 ELR 20036. In relevant part, an injection well is defined as one in which fluids are injected for increasing hydrocarbon recovery. Finding that the word “increasing” meant injected fluids

were used for secondary recovery, the court held frac wells are not injection wells and thus not subject to injection well environmental regulations.

In short, challenges continue under existing and new laws relating to fracking.

Private Rights and Claims

Along with contract disputes and legislation challenges, tort-based (e.g., property damage, personal injury and environmental) claims are repeatedly advanced by landowners and others. Creative plaintiffs assert various types of actions on traditional and unique damages theories.

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In a Pennsylvania environmental/property damage case, plaintiffs seeking to impose strict liability argued that fracking is an “ultra hazardous” activity. Using Pennsylvania’s six factor test, the court, however, found that plaintiffs failed to demonstrate that the practice was ultra-hazardous. *Ely v. Cabot Oil & Gas*, 2014 WL 4071640. The court’s decision notwithstanding, we predict plaintiffs in other states will seek to advance this theory given its potential reward, if successfully proven.

Furthermore, defendants are asserting various affirmative defenses in an effort to limit exposure. For example, in *Chesapeake Appalachia v. Cameron International*, 2014 U.S. Dist. LEXIS 123307, defendant, a drilling equipment supplier, sought to limit liability under the “economic loss rule.” The court found the rule inapplicable under

Oklahoma law because the service agreement at issue created a “special relationship” with the drilling company. As a result, claims for negligence, products liability, and negligent misrepresentation were allowed to proceed.

Meanwhile, Texas courts addressed two types of damages that plaintiffs seek in fracking cases. First, the Texas Supreme Court refused “stigma” damages for lost property value after property contamination had subsided. *Houston Unlimited Metal Processing v. Mel Acres Ranch*, 443 S.W.3d 820. After expressing doubts about recoverability of stigma damages in general, the court found evidence of such damages was insufficient where plaintiff’s expert’s methodology was determined flawed.

Next, an appellate court in *Crosstex North Texas Pipeline v. Gardiner*, 2014 Tex. App. LEXIS 12343, remanded a nuisance action’s high jury award. In the underlying case, a noisy compressor station was built next to plaintiffs’ property. The jury awarded plaintiffs \$2 million in damages. The court remanded the damages amount where evidence demonstrated the defendant chose an isolated location for the compressor station, relied on expert reports, employ-ed sound mitigation technologies and continually sought to limit the sound.

Finally, private claims are sometimes asserted outside the tort system. As an interesting example, a Pennsylvania court decided a matter involving First Amendment free speech rights versus the fracking industry’s rights to maintain trade secrets. Specifically, frac fluid includes certain additives recognized by many state governments as trade secrets. A doctor, called upon to treat patients exposed to said fluids, challenged a so-called “gag rule” prohibiting disclosure of the fluids’ contents outside the confines of treatment. The court dismissed

Hydraulic Fracturing (continued)

the doctor's challenge essentially on lack of standing. *Rodriguez v. Abruzzo*, 2014 WL 2940450. The court also rejected an argument that the inability to treat chemical exposure patients constituted a cognizable injury.

Conclusion

Hydraulic fracturing's national controversy and rapid growth in recent years has created an environment ripe for various legal disputes, many of which

remain undecided. For example, few cases have addressed the role of insurance in the context of fracking. Given the number and types of lawsuits being filed against various industry players, however, we predict insurance-based and risk-shifting-based disputes will ripen within the next year and beyond.

For updates and developments on legal challenges faced by the industry, please refer to Goldberg Segalla's blog, www.shalewatchblog.com. ●

Endnotes

- 1 Thomas F. Segalla, Andrew J. Scholz, and Matthew D. Cabral, A First Look at the Coverage Implications of Hydraulic Fracturing, 22:34 Ins. Coverage (Jun. 1, 2012).
- 2 Thomas Kaplan, Citing Health Risks, Cuomo Bans Fracking in New York State, New York Times (Dec. 17, 2014); available at <http://www.nytimes.com/2014/12/18/nyregion/cuomo-to-ban-fracking-in-new-york-state-citing-health-risks.html?ref=nyregion&r=0>.



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