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WEST VIRGINIA DIVISION OF ENERGY

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M E M O R A N D U M

To: President Jeff Kessler, Chair
Speaker Richard Thompson, Chair
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cc: Jason Pizatella, Legislative Director
Keith Burdette, Cabinet Secretary, West Virginia Department of Commerce
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From: Jeff Herholdt, Director
West Virginia Division of Energy

Date: January 7, 2013

Re: Quarterly Report Ending December 31, 2012
Legal Challenges Potentially Impacting the Energy Industry

As mandated by West Virginia Code §5B-2F-2(s), the following information presents legal challenges with the potential to impact the state's energy industry. This submission has been summarized by the West Virginia Chamber of Commerce's Energy Committee. Future reports will be submitted on a quarterly basis.

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REPORT ON LITIGATION RELATED TO

ENERGY AND NATURAL RESOURCES IN WEST VIRGINIA

FOURTH QUARTER 2012

(Ending December 31, 2012)

1. Statute Does Not Provide for Surface Owner Appeal of Well Work Permits

The eagerly-awaited decision in *Martin v. Hamblet* was released late on Thanksgiving eve, with the Court holding that surface owners have no right to appeal the issuance of a well work permit by the West Virginia DEP's Office of Oil and Gas. This decision is a significant win for the oil and gas industry.

The Court issued two new syllabus points, which are its binding precedent:

> 6. The right of judicial review with regard to the issuance or refusal of a well work permit as provided by W. Va. Code §22-6-41 (1994) (Repl. Vol. 2009) does not extend to owners of the surface rights of the property upon which the proposed well is to be drilled. To the extent that State ex rel. Lovejoy v. Callaghan, 213 W. Va. 1, 576 S.E.2d 246 (2002), indicates otherwise, it is overruled.
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> 7. The right of judicial review with regard to the issuance or refusal of a well work permit as provided by W. Va. Code §22-6-40 (1994) (Repl. Vol. 2009) does not extend to owners of the surface rights of the property upon which the proposed well is to be drilled.

In *Martin*, EQT was the lessee of a "valid oil and gas lease executed in 1905 that encompasses 2,654 acres of mineral estate located in Doddridge County, West Virginia." Hamblet was the surface owner of "a 442.6-acre parcel of property included within EQT's leasehold." EQT applied for a permit with the Office of Oil and Gas of the West Virginia Department of Environmental Protection ("DEP"), for "a shallow well targeting the Marcellus formation with a 'horizontal leg into the Marcellus.'" EQT notified all of the surface owners, including Hamblet, about the application. Hamblet hired counsel and submitted surface owner comments centering on issues with four other wells, and complained of property damage and "failed attempts at revegetation and irresponsible handling of timber", lack of erosion control, and concerns regarding waste water. EQT responded. After the DEP inspected the property, it issued the permit.

Hamblet filed a "Petition for Appeal of Issuance of a Well Permit" in the Circuit Court of Doddridge County and EQT and the DEP moved to dismiss, arguing "Hamblet did not have the right to appeal the issuance of the permit under any relevant statutory authority." After a hearing, the Circuit Court denied the motion, agreeing with Hamblet's argument that under a

prior case, *State ex rel. Lovejoy v. Callaghan*, 213 W. Va. 1, 576 S.E.2d 246 (2002), surface owners had the right to appeal the issuance of permits. The circuit court agreed to certify the question to the Supreme Court of Appeals of West Virginia.

Examining the applicable statutory provisions, the Court first noted that under W. Va. Code §22-6-41, "[a]ny **party** to the proceedings under … [§22-6-16] of this article adversely affected by the order of issuance of a drilling permit or to the issuance of a fracturing permit or the refusal of the director to grant a drilling permit or fracturing permit **is entitled to judicial review** thereof." The Court then examined the plain language of W. Va. Code §22-6-16 and found the **parties** to a proceeding are the coal seam owner, operator, or lessee. Since surface owners were not included as parties in the statute, the Court concluded they were not entitled to appeal rights.

> W. Va. Code §22-6-16 is clear and unambiguous with regard to who may object to the well proposed to be drilled. Notably absent from the statute is any mention of the surface owner of the subject property. Therefore, in accordance with our rules of statutory construction, it must be concluded that the Legislature intended to deny surface owners the right of judicial review with respect to the issuance of a well work permit as provided in W. Va. Code §22-6-41.

Hamblet also argued a right to appeal under W. Va. Code §22-6-40 (1994) (Repl. Vol. 2009), because the well at issue was "a horizontal Marcellus well as opposed to a deep discovery well" which was at issue in the *Lovejoy* case.

The Court rejected this argument, again finding the applicable statutes were clear and unambiguous, and finding the only parties to the permit issuance proceeding were coal seam operators, owners or lessees. "Neither statute mentions the owner of the surface rights of the subject property. "Accordingly, as with W. Va. Code §22-6-41, it must be concluded, and we now so hold, that the right of judicial review with regard to the issuance or refusal of a well work permit as provided by W. Va. Code §22-6-40 does not extend to owners of the surface rights of the property upon which the proposed well is to be drilled."

The Court also addressed the position of DEP and EQT that since the EQT well, a horizontal Marcellus well, was a shallow well, objections were governed by W. Va. Code §22-6-17 (1994). Examining the statute, the Court again noted it provided appeal rights only to coal seam owners and not to surface owners. "Surface owners may only file comments as to the location or construction of the applicant's well as provided in W. Va. Code §22-6-10."

On appeal, Hamblet and his supporting amicus, the West Virginia Surface Rights Owners, conceded that the statutes, by their terms, did not provide surface owners with appeal rights. Nonetheless, they made a constitutional argument, that "under the safeguards of due process, surface owners are entitled to an appeal that provides meaningful review of a government decision that affects their lands."

The Court noted the constitutional argument was based upon surface owners having "an unrestricted right to enjoyment in their property." But "[a] surface owner's rights, however, are

subject to the mineral owner's rights. A mineral owner generally has the right to utilize the surface for 'purposes reasonably necessary for the extraction of the minerals.'"

> Here, EQT has a legally binding lease that grants it explicit rights of access to the oil and gas underlying Mr. Hamblet's property. It is this contractual obligation burdening Mr. Hamblet's surface estate that deprives him of an unrestricted right to enjoyment of his property, not the issuance of the well work permit at issue. As such, the constitutional guarantees of due process and equal protection do not apply.

Importantly, the Court stated:

> As explained above, in this case, EQT has a contractual right to extract the gas from the subject property. Thus, any infringement upon the property interests of Mr. Hamblet is a result of the manner in which EQT is exercising its contractual rights. The permit issued by the DEP does not authorize EQT to interfere with Mr. Hamblet's property rights; rather, the permit merely allows EQT to exercise its existing rights and controls the manner in which it does so. As such, the permitting process arguably encroaches upon EQT's rights, but does not infringe upon Mr. Hamblet's property rights. Thus, there is no merit to Mr. Hamblet's constitutional arguments.

Finally, the Court recognized that surface owners have protection under The Oil and Gas Production Damage Compensation Act which "affords surface owners the right to receive compensation for property damages related to oil and gas production…" as well as the "common law remedies are available to Mr. Hamblet to the extent that EQT exceeds its rights as a lessee of the oil and gas."

The Court suggested the Legislature take a look. "Nonetheless, given the fact that the statutes granting the right of judicial review discussed herein, W. Va. Code §22-6-40 and -41,were enacted prior to the extensive development of Marcellus shale in this State, this Court urges the Legislature to re-examine this issue and consider whether surface owners should be afforded an administrative appeal under these circumstances."

2. D.C. Circuit Court Denies Request to Rehear Greenhouse Gas Cases

On December 20, 2012, the United States Court of Appeals for the District of Columbia Circuit, set the stage for an appeal to the United States Supreme Court by denying the petitions of various energy industry advocates and states for a rehearing "en banc" in the case styled *Coalition for Responsible Regulations, Inc., et al. v. Environmental Protection Agency,* No. 09-1322.

The petitions for rehearing stemmed from the D.C. Circuit Court's June 26, 2012 decision which upheld the Environmental Protection Agency's ("EPA") finding that greenhouse gases endanger human health and welfare, thereby triggering coverage under the Clean Air Act ("CAA"). The Circuit Court's *per curium* decision focused predominantly on four rules

promulgated by the EPA under the CAA: (1) the Endangerment Finding, (2) the Tailpipe Rule, (3) the Timing Rule, and (4) the Tailoring Rule. In upholding the rules set forth by the EPA, the Court dismissed challenges to the "Endangerment Finding" and the "Tailpipe Rule" on their merits and further found that petitioners lacked standing to challenge the Timing and Tailoring Rules. *See Coalition for Responsible Regulations, Inc., et al.*, 684 F.3d 102, 113-14 (C.A. D.C. 2012)

The issues in *Coalition for Responsible Regulations, Inc.*, originated following the United States Supreme Court's decision in *Massachusetts v. EPA*, 549 U.S. 497 (2007) "that greenhouse gases unambiguously may be regulated as an air pollutant under the Clean Air Act ("CAA"). *Id.* at 114 (internal quotations omitted). As a result of the directives set forth by the Supreme Court in *Massachusetts*, the EPA issued an Endangerment Finding for greenhouse gases [74 Fed. Reg. 66, 496 (Dec. 15, 2009)] and promulgated the Tailpipe Rule which "set greenhouse gas emissions standards for cars and light trucks as part of a joint rulemaking with fuel economy standards issued by the National Highway Traffic Safety Administration." *Id.* at 114-15. Additionally, "under the EPA's longstanding interpretation of the CAA, the Tailpipe Rule automatically triggered regulation of stationary greenhouse emitters" under the Prevention of Significant Deterioration of Air Quality (PSD) Program and Title V. Accordingly, the EPA promulgated the Timing Rule and the Tailoring Rule in an effort to "phase in" the stationary source greenhouse gas regulation. *Id.* at 115-16.

In what will perhaps set the stage for a Petition for Writ of Certiorari to the Supreme Court, both Judge Brown and Judge Kavanaugh wrote lengthy and impassioned dissents to the denial of the petitions for rehearing. Judge Brown first argues that the Supreme Court decision in *Massachusetts* was incorrectly decided. Recognizing she is, however, bound by the decision, Judge Brown provides a statement of the case's "shortcomings in the hope that either Court or Congress will restore order to the CAA." *Id.* at p. 2 (*Brown, J. dissenting*). Alternatively, Judge Brown further stated that even under *Massachusetts*, the EPA did not have the authority to regulate greenhouse gases under the PSD and Title V programs. In short, Judge Brown wrote, "we need not follow *Massachusetts* off the proverbial cliff and apply its reasoning to the unique Title V and PSD provisions not considered in that case. The cascading layers of absurdity that flow from that interpretive exercise make clear that the plain language of the CAA compels no such result." *Id.* at p. 12 (*Brown, J. dissenting*).

Judge Kavanaugh focused much of his dissent on the EPA's broad interpretation of the term "air pollutant," indicating that he would interpret the PSD provision of the CSA as only applying to the six pollutants set forth by the National Ambient Air Quality Standards ("NAAQS"). Judge Kavanaugh wrote,

> In my view, the statutory issue here is reasonably straightforward. The Prevention of Significant Deterioration statute's definition of "majority emitting facility" subjects a facility to the permitting requirement based on the facility's emissions of "air pollutants." *See* 42 U.S.C. §§ 7475(a)(1), 7479(1). In the context of the Prevention of Significant Deterioration program as a whole, it

> seems evident that the term "air pollutant" refers to the NAAQS air pollutants.
>
> To begin with…interpreting "air pollutant" in this context to refer to the NAAQS air pollutants would avoid the absurd consequences that EPA's broader interpretation creates…

Id. at p. 6 (*Kavanaugh, J. dissenting*). In short, "EPA chose an admittedly absurd reading over a perfectly natural reading of the relevant statutory text. An agency cannot do that." *Id.* at p. 17 (*Kavanaugh, J. dissenting*).

The parties have 90 days to file a Petition for Writ of Certiorari to the Supreme Court.

3. West Virginia Natural Resource Watch Group Hold First Meeting

The first meeting of the newly formed West Virginia Natural Resource Watch Group was held December 13, 2012. The new task force was announced by U.S. Attorney William Ihlenfeld of the Northern District of West Virginia on December 3, 2012 after announcing the resolution of criminal charges brought against Chesapeake Appalachia for violations of the Clean Water Act.

> "It's critical that we keep a close eye on the energy extraction that is going on all around us," said Ihlenfeld. "The economic impact that it's having on our area is wonderful but we must make sure that our natural resources are not compromised and that future generations have clean water to drink and clean air to breathe."

Details regarding the makeup of the task force are limited at this time, but the announcement stated that the task force will be comprised of as-yet unnamed representatives of federal, state, and local government agencies. From the U.S. Attorney's press release:

> The agencies making up the group will work together to promote consistent communication, information sharing and good working relationships among law enforcement and regulatory agencies. It will also identify suspected violations of local, state, and federal environmental laws, coordinate prosecution efforts, and provide training.
>
> The group expects to focus on violations of the Clean Water Act, the Clean Air Act, and the Resource Conservation and Recovery Act (RCRA), as well as illegal disposal of hazardous waste, tampering with drinking water supplies, and other federal criminal violations that have an impact on the environment.

Presumably, the task force's work will be limited to the thirty-two counties located in the Northern District of West Virginia. No similar announcement has been made by Booth Goodwin, U.S. Attorney for the Southern District of West Virginia.

4. Patriot Coal Corporation Settles Selenium Claims

Patriot Coal Corporation and the Ohio Valley Environmental Coalition, Inc., the West Virginia Highlands Conservancy, Inc. and the Sierra Club have reached a proposed settlement regarding claims under the Clean Water Act relating to surface mining activities in West Virginia. The proposed settlement will delay compliance dates at 44 outlets subject to lawsuits filed against Patriot and the company expects the savings to assist it in reorganizing its business.

In exchange, Patriot will agree to certain restrictions on large-scale surface mining activities. Notably, these restrictions are consistent with the company's business plan. As Patriot President & Chief Executive Officer Bennett K. Hatfield explained: "this proposed settlement allows Patriot to continue mining according to existing permits and is consistent with our long-term business plan to focus capital on expanding higher-margin metallurgical coal production and limiting thermal coal investments to selective opportunities where geologic and regulatory risks are minimized."

At least one coal industry commentator echoed Patriot's assessment, noting that the proposed settlement will not disrupt Patriot's existing operations and preserves Patriot's ability to pursue its low-cost Huff Creek Surface Mine.

The settlement remains subject to approval by the Federal District Court for the Southern District of West Virginia following a public comment period, as well as approval by the Bankruptcy Court for the Southern District of New York.

5. Federal District Court Upholds Applicability of CWA Permit Shield to General Permits for Coal Industry

In a case which has implications for West Virginia, on September 30, 2012, Judge Van Tatenhove of the Eastern District of Kentucky issued an order that held that dischargers operating pursuant to a National Pollutant Discharge Elimination System ("NPDES") General Permit enjoy the protections of the Clean Water Act ("CWA") permit shield. In this case, the Sierra Club argued that discharges from ICG Hazard's Thunder Ridge Mine in Leslie County contained pollutants which ICG Hazard was not authorized to discharge under the terms of its NPDES permit. It also claimed that the discharges were causing violations of in-stream water quality standards (for selenium and of the narrative water quality standard) in violation of SMCRA.

ICG Hazard is discharging water pursuant to Kentucky's General NPDES Permit issued for the coal industry. Discharges under that General Permit have limits on certain pollutants, but none on either selenium or conductivity. The Court ruled that the CWA "permit shield" protects ICG Hazard from claims that it was discharging selenium or conductivity without a permit. Although Kentucky's General Permit applicable to mining did not place express limits on either selenium or conductivity, the Court found that those pollutants were within the permitting authority's reasonable contemplation and, therefore, fell within the Section 402(k) permit shield. The operative concept being that if the permit authority had some reason to understand the nature of the discharge and chose not to impose limits on particular pollutants in an NPDES permit, the

permittee cannot be charged with discharging without a permit or for violating water quality standards for those pollutants. The Court also ruled that, where there is an NPDES permit in place for a point source discharge, SMCRA cannot be used to circumvent the CWA permit shield to enforce the same water quality standards. The opinion contains a thoughtful review of the NPDES permit shield and the interplay between the CWA and SMCRA with respect to "point source" discharges.

However, the Court denied both parties' motions for summary judgment with respect to other counts in Sierra Club's complaint. The Court was not clear that the allegations (of violations of water quality standards) were tied to "point source" discharges. The Court suggested that there may be contributions to violations of water quality standards caused by non-point sources which are not regulated under the NPDES program and which, as a result, could be susceptible to a SMCRA-based citizens suit. Here, the Court noted that SMCRA probably does allow a citizens suit for violations of water quality standards caused by non-point sources which are not regulated by the NPDES program. The Court, on its own, notes that there are at least several locations identified as discharging selenium in violation of water quality standards, but which are not clearly identified as "point sources." The Court observed that since the nature of these discharges is unclear, the "evidence suggests that nonpoint discharges may provide a basis for this claim." Accordingly, the Court denied summary judgment on SMCRA-based claims that both selenium and conductivity are causing violations of in-stream water quality standards to the extent the discharges are not "point sources."

The Court's concern that some of the samples identified in the Complaint or the Sierra Club's motion for summary judgment are of non-point sources is the apparent result of confusion in reviewing the record. The Sierra Club has never alleged that there are any non-point source discharges subject to the lawsuit, but in its thorough review of the record the Court identified some sampling data which were not clearly identified by the type of discharge they represented.

6. Pennsylvania Releases Final Air Aggregation Guidance for Oil and Gas Drilling Activities

On October 6, 2012, the Pennsylvania Department of Environmental Protection ("PA DEP") finalized guidance on air quality permitting decisions for oil and gas operations. The guidance emphasizes the issue of physical proximity in determining whether emissions from oil and gas operations come from a single source. In doing so, Pennsylvania is following in the footsteps of other states who have adopted guidance on air aggregation, including West Virginia, Texas, Oklahoma and Louisiana. Critically, the guidance also follows a ruling from the Sixth Circuit Court of Appeals, *Summit Petroleum Corporation v. EPA*, Nos. 09-4348:10-4572 (6th Cir. Aug. 7, 2012, finding that, in determining whether air emissions come from a single source, the terms "adjacent" and "continuous" should be interpreted according to their plain meanings.

PA DEP regulates the air emissions from oil and gas industry through air quality plan approvals and permits, including PSD, Non-attainment NSR, and Title V Permits. When a company operates several stationary sources or sites in the same vicinity or location, a single-source determination is completed to determine if those two or more contamination sources should be aggregated as a single source for the purposes of air permitting. The PA DEP applies a three-

part regulatory test and states that a stationary source is a "building", "structure", "facility" or "installation", which "(1) belong to the same industrial grouping; and (2) are located on one or more contiguous or adjacent properties; and (3) are under the control of the same person". If a facility meets this three-part test, multiple contamination sources may be aggregated.

EPA has considered that the facilities are "belong to the same industrial grouping" when they have the same first two-digits of the Standard Industrial Classification ("SIC") code. The definition of the terms "adjacent" and "contiguous", as established in the *Summit Petroleum* case, "mean and relate to spatial relationship or spatial distance or proximity". PA DEP has adopted a quarter mile rule of thumb to determine when sites are "adjacent" or "contiguous". However, PA DEP notes that properties beyond the quarter mile range may still be considered "adjacent" or "contiguous" but only on a case-by-case basis. PA DEP provides an example:

> Because of the nature of the oil and gas extraction industry, wells are scattered across a large resource area creating duplicate facilities that perform identical functions. For instance, well production pads and compressor stations are dispersed across a wide area that could encompass many square miles so that the leased properties can be accessed and natural gas can be extracted, compressed, and conveyed via pipeline to a nearby processing facility. Such expansive operations would not generally comport with the "common sense notion of a plant." Additionally, two aggregate stationary sources located on properties spread throughout a large geographical area would not be consistent with the plain meaning of the terms contiguous or adjacent properties. Consequently, only sources that are in close proximity should be considered contiguous or adjacent properties for single source determination purposes.

In providing this air permitting guidance, PA DEP has stated that its air permitting staff should make a single source determination based upon a five-step analysis.

1. Air emission sources may be treated as a single source for air permitting purposes if they meet the two- to three-part regulatory test;

2. Each of the elements must be met in order to treat separate emission units as a single stationary source;

3. While federal guidance may be instructive, it is not dispositive;

4. The aggregation test must be applied on a case-by-case basis to the specific facts of the matter before the agency; and

5. The plain meaning of the terms "contiguous" and "adjacent", particularly in the context of the "common sense notion of a plant," and the terms "building," "structure," "facility," or "installation," are appropriate considerations in the application of the aggregation test.

7. Sierra Club Cites Health Studies as Basis for Objections to Permits for Coal Mines

On October 17, 2012, the Sierra Club and other groups sued the U.S. Army Corps of Engineers in both the Southern District of West Virginia and the Western District of Kentucky challenging the issuance of Clean Water Act §404 "fill" permits issued for mines by the Huntington and Louisville Districts of the Corps of Engineers. The complaint in West Virginia challenges a fill permit issued to Raven Crest Contracting, LLC, and the complaint in Kentucky challenges a permit issued to Leeco, Inc.

Both complaints challenge the issuance of a Corps permit for excess spoil valley fills. Both contain the by-now-familiar claim that the valley fill will cause violations of downstream water quality standards. Both complaints, however, include claims that have not yet generally been advanced against the Corps concerning health effects. Both complaints allege that recent studies have shown a correlation between health effects and proximity to surface mines, and that the Corps should have considered such effects in reviewing the permit applications. The Sierra Club attempted to add similar claims to an earlier challenge to a §404 permit issued to Highland Mining, but a federal district court in West Virginia ruled that the studies had not been presented to the Corps during the permit process and that the Corps had no obligation to revisit the permit decision after the studies became available.