

Shale Gas Drilling: Case Law Update

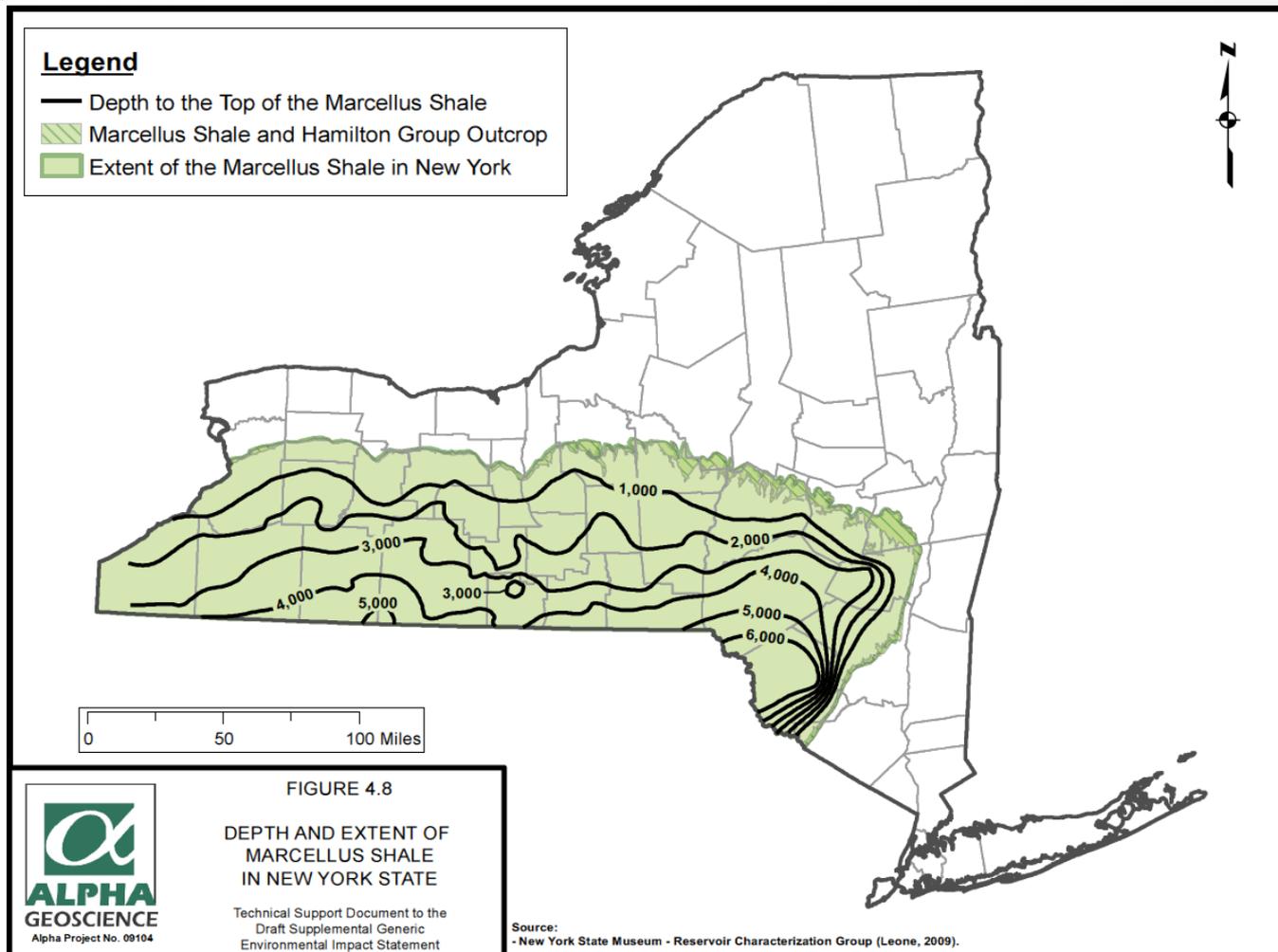
David Everett, Esq.
Robert Rosborough, Esq.

Association of Towns of the State of New York
2013 Training School and Annual Meeting

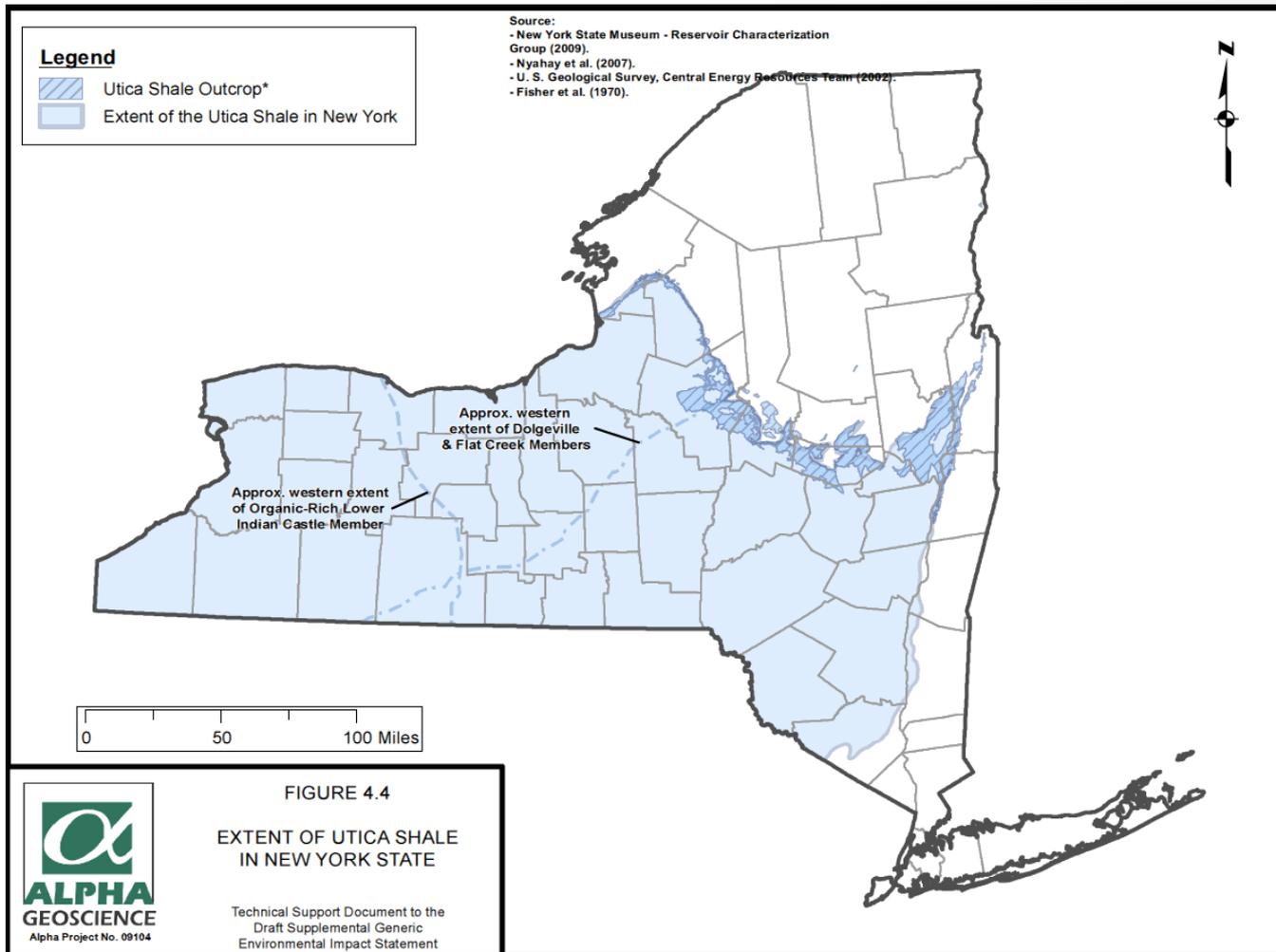
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DISCLAIMER: This is an outline of issues and potential issues and is not intended as legal advice; this presentation is no substitute for legal advice and analysis from experienced counsel for your municipality.

Marcellus Shale



Utica Shale



Horizontal Drilling

This graphic shows the curved "L" shape of a horizontal wellbore.

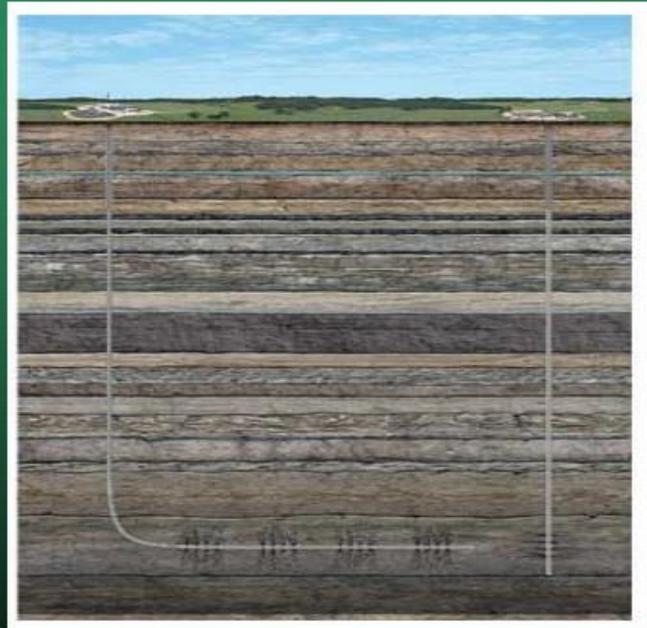


Photo credit: John Perez
http://www.dec.ny.gov/docs/materials_minerals_pdf/GWPCMarcellus.pdf



Shale Gas Drilling: Legal Issues

- Four Legal Issues In Recent Case Law
 - 1) Preemption under the Environmental Conservation Law
 - 2) The Legality of a Moratorium on Drilling
 - 3) Regulatory Takings of Property
 - 4) Valuation of Gas Leases for Real Property Tax Purposes

Shale Gas Drilling: Legal Issues

- Preemption under ECL 23-0303(2)
 - Anschutz Exploration Corp. v. Town of Dryden (Sup. Court Tompkins County)
 - Cooperstown Holstein Corporation v. Town of Middlefield (Sup. Court Otsego County)
 - Matter of Envirogas, Inc. v. Town of Kiantone (Sup. Court Erie County)

Shale Gas Drilling: Legal Issues

- The Legality of a Moratorium on Drilling
 - Jeffrey v. Ryan (Sup. Court Broome County)
 - Lenape Resources, Inc. v. Town of Avon (Sup. Court Livingston County)

Shale Gas Drilling: Legal Issues

- Regulatory Takings of Property
 - Lenape Resources, Inc. v. Town of Avon (Sup. Court Livingston County)

Shale Gas Drilling: Legal Issues

- Valuation of Gas Leases for Real Property Tax Purposes
 - Matter of Micha v. Town of Richford, 2012 WL 6929876, 2012 N.Y. Slip. Op. 33130(U) (Sup Ct, Tioga County 2012)

ECL Preemption

- ECL § 23-0303(2) states:

“The provisions of this article shall supersede all local laws or ordinances relating to the regulation of the oil, gas and solution mining industry; but shall not supersede local government jurisdiction over local roads or the rights of local governments under the real property tax law.”

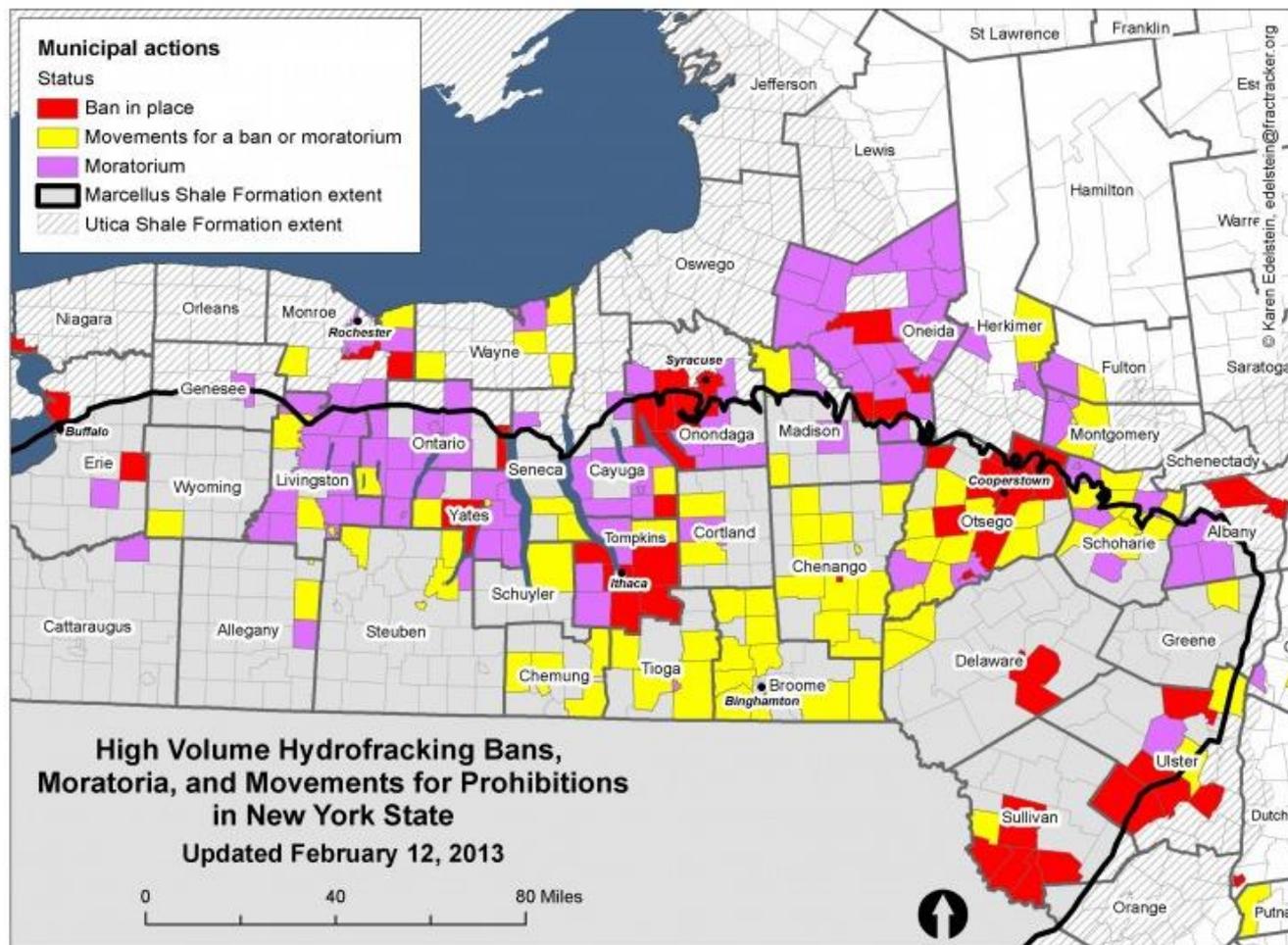
Zoning Bans

- Approximately 45 municipalities have adopted zoning bans prohibiting natural gas drilling (approximately 14% of municipalities in Marcellus Shale play; approximately 7% of municipalities in Utica Shale play)
- Some municipalities classified natural gas drilling as a heavy industrial use and prohibited it. DEC considers gas drilling to be a heavy industrial use
- Two zoning bans have been challenged in court
 - Town of Dryden
 - Town of Middlefield

Zoning Moratoria

- Approximately 100 municipalities have adopted moratoria on natural gas drilling pending further study (approximately 30% of municipalities in Marcellus Shale play; approximately 15% of municipalities in Utica Shale play)
- Two zoning moratoria have been challenged in court
 - City of Binghamton
 - Town of Avon

Zoning Bans/Moratoria



ECL Preemption

- (1) Anschutz Exploration Corp. v. Town of Dryden, 35 Misc. 3d 450 (Sup. Court, Tompkins County 2012)
 - Town amended its Zoning Ordinance to clarify that the exploration and extraction of natural gas and petroleum in the Town was prohibited.
 - Anschutz is a driller of natural gas wells who held oil and gas leases covering 22,200 acres in the Town.
 - Anschutz had invested \$4.7 million in acquiring leases and \$400,000 in geological assessments and seismic evaluations.

ECL Preemption

(2) Cooperstown Holstein Corporation v. Town of Middlefield, 35 Misc. 3d 767 (Sup. Court, Otsego County 2012)

- Middlefield enacted a new zoning law which prohibited heavy industrial uses (including oil and gas drilling) in the Town.
- Holstein owns and leases almost 400 acres of land in the Town to natural gas drilling companies.

ECL Preemption

Court Decisions in Dryden and Middlefield

The Courts upheld the Towns' Zoning Bans for the following reasons:

- Nothing in ECL § 23-0303 or its legislative history was intended to prohibit municipalities' constitutional right to adopt generally applicable land use laws.
- ECL § 23-0303 does not contain a clear expression of legislative intent to preempt local control over land use and zoning.
- The Legislature intended NYSDEC to establish uniform State-wide standards related to the operations of natural gas drilling.

ECL Preemption

- ECL § 23-0303 eliminates local laws that interfere with the State's goal of establishing uniform State-wide regulations of gas drilling operations.
- NYSDEC maintains control over the operational details of gas drilling (the "how") and municipalities maintain control over the "where" gas drilling can occur.
- Local laws regulating the operational details of natural gas drilling are preempted. Local land use laws that do not regulate drilling operations are not preempted.

ECL Preemption

- The Towns' Zoning Laws have only an incidental impact on natural gas drilling and don't conflict with the State's interest in regulating the operational details of drilling.
- When the State Legislature wanted to preempt local zoning it has done so expressly in statutes for siting hazardous waste facilities and group homes and provided a mechanism for considering local concerns. ECL 23-0303 does not contain any such express intent.
- The courts also relied upon the Court of Appeals holdings in Frew Run Gravel Products, Inc. v. Town of Carroll and Gernatt Asphalt Products, Inc. v. Town of Sardinia interpreting an almost identical preemption statute under the Mined Land Reclamation Law.

ECL Preemption

Interpreting Almost Identical Preemption Statutes—

(1) Mined Land Reclamation Law (1974-1991):

“This title shall supersede all other State and local laws relating to the extractive mining industry”. ECL § 23-2703

(2) Oil, Gas and Solution Mining Law (1972-present):

“This article shall supersede all other local laws or ordinances relating to the regulation of the oil, gas and solution mining industries.” ECL § 23-0303

ECL Preemption

Frew Run Gravel Products, Inc. v. Town of Carroll, 71 N.Y.2d 126 (1987) (a miner challenged the Town's zoning code which permitted mining only in certain areas of the Town).

- The Court of Appeals made 7 critical holdings:
 - (1) The supersession of all “local laws relating to the extractive mining industry” was not intended to preempt the Town's zoning law establishing zoning districts where mining was permitted or prohibited.

ECL Preemption

- (2) Zoning laws relate not to the regulation of the mining industry but to the regulation of land uses generally—an entirely different subject matter.
- (3) By regulating land use, a zoning ordinance inevitably exerts an incidental control over any of the particular uses or businesses which may be allowed in some districts but not others.
- (4) Local laws of general application – which are aimed at legitimate concerns of a local government – will not be preempted if their enforcement only incidentally infringes on a preempted field.

ECL Preemption

- (5) There is nothing in State mining law that was intended to preempt the Town's zoning law.
- (6) Allowing such an intent would drastically curtail the Town's Municipal Home Rule Law powers to adopt zoning laws in the best interest of the Town.
- (7) The purpose of the mining preemption was to prevent local governments from enacting laws that would conflict and frustrate the State's encouragement of mining through standardized regulations. Zoning laws do not conflict with this purpose.

ECL Preemption

Gernatt Asphalt Products, Inc. v. Town of Sardinia, 87 N.Y.2d 668 (1996).

- Sardinia's zoning law prohibited mining anywhere in the Town. A mining company challenged the ban.
- The mining company argued that if land within the Town contained extractable minerals, State law obliges the Town to permit them to be mined somewhere in the Town.
- Court of Appeals made 2 critical holdings:
 - (1) the State mining law does not preempt the Town from adopting a zoning law that completely bans mining as a land use in the Town.
 - (2) a Town is not obliged to permit the exploitation of any and all natural resources within the Town as a permitted use if limiting the use is a reasonable exercise of its police powers to prevent damage to its citizens and to promote the interests of its community.

ECL Preemption

- Courts in Dryden and Middlefield upheld home rule authority to permit municipalities to decide what types of land uses are permissible within their borders
 - Middlefield's Zoning Law was upheld in its entirety
 - Dryden's Zoning Law was upheld, but the portion of it that attempted to invalidate any drilling permits lawfully issued by local, state, or federal governmental entities was stricken as impermissibly regulating the operations of the oil and gas industry

ECL Preemption

Final Thoughts:

- Lower court decisions have been appealed to the Appellate Division. Appeals have been briefed, and will be argued in March 2013.
- Whether or not a municipality can adopt zoning laws to control natural gas drilling is now in the hands of the appellate courts. Appellate Court decisions are expected approximately four to eight weeks after argument.

ECL Preemption

- Only one other case addressing preemption under ECL 23-0303(2) before Dryden and Middlefield
 - Matter of Envirogas, Inc. v. Town of Kiantone, 112 Misc. 2d 432 (Sup Ct, Erie County 1982), affd 89 A.D.2d 1056 (4th Dept 1982), lv denied 58 N.Y.2d 602 (1982)

ECL Preemption

- Matter of Envirogas, Inc. v. Town of Kiantone
 - Town of Kiantone zoning ordinance imposed a \$25 permit fee and a requirement to post a \$2,500 compliance bond prior to construction of any oil or gas well within the Town
 - A corporation in the oil and gas industry challenged the Kiantone zoning ordinance as preempted under ECL 23-0303

ECL Preemption

Court's Decision in Envirogas

- Supreme Court struck down the law, holding that the supersession provision preempts any law which purports to regulate gas and oil well drilling operations.
- The Court recognized that the Town's zoning ordinance was not a generally applicable land use restriction, but instead impermissibly interfered with oil and gas operations.
 - "The Town of Kiantone, however, singled out oil and gas drillers for special treatment. The \$2,500 compliance bond and \$25 permit fee are requirements unique to oil and gas well drilling operations and do not apply to any other business or land use. This is precisely what the State amendment to ECL article 23 was designed to prevent."

Envirogas, 112 Misc. 2d at 434

ECL Preemption

- Plaintiffs in Dryden and Middlefield relied on Envirogas heavily, arguing that the Court had decided that ECL 23-0303 supersedes all local laws, including generally applicable zoning ordinances
- However, Supreme Court in Dryden distinguished Envirogas, noting that the permit fee and compliance bond required by the Kiantone zoning ordinance did not relate to land use and directly conflicted with the permit procedure administered by DEC

Zoning Moratoria

- Zoning moratoria operate in the same manner as a total ban on natural gas drilling, but only for a limited period of time
- Municipalities can use a moratorium as a temporary “stop gap” measure to ban a particular land use for a period of time while, for example, reviewing a comprehensive zoning law amendment or updating a comprehensive plan

Zoning Moratoria

- Jeffrey v. Ryan, 37 Misc. 3d 1204(A) (Sup. Court, Broome County 2012)
 - City of Binghamton enacted a local law on natural gas exploration and extraction that would sunset after two years
 - Intended to give Binghamton time to figure out whether or not to permit natural gas drilling within the City, but in the meantime ban exploration and extraction
 - Court noted transcript of Binghamton City Council Working Session indicated that there may not have been enough support on the Council for a zoning ban at the time

Zoning Moratoria

- Parties' Arguments
 - Petitioners (property owners, an unincorporated association whose goal was to foster natural gas exploration, and the owner of the Holiday Inn Binghamton) argued that the local law was invalid because:
 - (1) it was preempted by ECL 23-0303, and
 - (2) it was a zoning moratorium and the City failed to satisfy the requirements for a moratorium.
 - Binghamton argued that the local law was not preempted, and was enacted pursuant to its police powers and, thus, was not a zoning moratorium

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- ECL Preemption
 - Court noted that Judges Rumsey and Cerio, in “well reasoned, well founded” decisions in Dryden and Middlefield, determined that a local municipality’s rights to regulate land use are not superseded by ECL 23-0303
 - Court adopted the reasoning of Dryden and Middlefield and rejected the Petitioners’ preemption argument
 - Three Supreme Court justices have now held ECL 23-0303 does not preempt municipal home rule authority to enact generally applicable zoning laws

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- Moratorium
 - Court noted that whether or not Binghamton's local law was a zoning moratorium was the crux of the case
 - The Court held that the two-year "sunset" provision made the local law a zoning moratorium on natural gas exploration and extraction

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- The Court held that to be valid, Binghamton's two-year moratorium must satisfy three conditions:
 - (1) Moratorium must be enacted in response to dire conditions;
 - (2) Moratorium must be reasonably calculated to alleviate or prevent a crisis condition; and
 - (3) The municipality must be presently taking steps to rectify the problem.

Matter of Belle Harbor Realty Corp. v. Kerr, 35 N.Y.2d 507, 512 (1974)

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- Court ultimately held that Binghamton's two-year moratorium was invalid
 - No immediate threat to residents' health and safety or dire need for a moratorium
 - (1) DEC has not adopted new regulations on natural gas drilling, which must occur before any drilling can
 - In any event, Binghamton was not relying on DEC regulations because local law stated that regulations were incapable of protecting residents' health and safety
 - (2) No drilling permits have been granted

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- Binghamton did not provide evidence that, even if a dire threat existed, it would not exist after the two-year period
 - Moratorium was not reasonably calculated to alleviate a crisis condition
- Binghamton was not investigating, studying, or undertaking any activities in order to determine if there was a way to alleviate any harm to its residents that could result if drilling was permitted
 - Moratorium was not enacted to serve that purpose

Zoning Moratoria

Court Decision in Jeffrey v. Ryan

- Court noted that natural gas drilling is controversial and being debated throughout the State
 - Also recognized that certain members of the community may be fiercely opposed to natural gas drilling
- Nonetheless, Court held that a moratorium cannot be used as a means to satisfy community opposition
- Under Jeffrey v. Ryan, must satisfy the three legal requirements for a valid moratorium

Zoning Moratoria

- Lenape Resources, Inc. v. Town of Avon (Sup. Court Livingston County) (November 2012)
 - Lenape commenced proceeding challenging Town of Avon local law prohibiting natural gas exploration and extraction for a period of one year
 - ECL Preemption
 - Invalid Moratorium
 - Regulatory Taking
 - Also named DEC as a defendant to compel the agency to enforce the preemption provisions of ECL 23-0303 against Avon's Local Law

Zoning Moratoria

- Avon's Local Law
 - One year moratorium on natural gas exploration and extraction in the Town
 - Grandfathering provision that permits natural gas extraction from pre-existing vertical wells to continue in accordance with DEC permit
 - Hardship use variance procedure allows applicant to apply to Zoning Board for a use variance from the provisions of the moratorium
 - Provision invalidating any local or state permit authorizing drilling in the Town

Zoning Moratoria

- Lenape's Arguments
 - Moratorium does not satisfy legal requirements for a valid moratorium under Belle Harbor (citing Jeffrey v. Ryan)
 - No crisis condition because DEC has a de facto moratorium on horizontal drilling in place and has not issued any permits for what the moratorium prohibits
 - Avon does not have technical expertise to study potential effects of horizontal drilling
 - Moratorium impinges on Lenape's pre-existing, nonconforming uses of wells for 30 years
 - Portions of property not in use at time was enacted are protected by Lenape's intent to use the property for the pre-existing, nonconforming use

Zoning Moratoria

- Avon's Arguments in Support of Motion to Dismiss
 - Moratorium is valid exercise of Avon's zoning authority
 - Not a police power regulation and, thus, three prong test from Bell Harbor (relied on by Court in Jeffrey v. Ryan) does not apply
 - Proper test is whether the moratorium was enacted for a valid and reasonable purpose and is reasonably limited in duration
 - Moratorium is a reasonable attempt to permit the Town to study the effects of horizontal drilling on aquifers, traffic, roadways, open space, and the tourism industry
 - Limited to one year in duration
 - Does not affect Lenape's continued operation of vertical wells; only prohibits issuance of new permits for natural gas drilling and extraction

Zoning Moratoria

Final Thoughts:

- The distinction drawn by the Town of Avon (moratorium enacted pursuant to zoning authority vs. police power) is interesting
 - Under Jeffrey v. Ryan, many currently enacted moratoria could be at risk if construed as an act pursuant to the municipality's police powers, because the DEC de facto moratorium and refusal to issue permits until the regulations are promulgated obviates a claim of an emergency condition
 - As an enactment pursuant to zoning authority, however, a moratorium need only be rationally based to be upheld; much more deferential standard to the municipalities

Regulatory Takings

- Regulatory Takings of Property
 - Fifth Amendment to U.S. Constitution and Article I, § 7 of N.Y. Constitution prohibit taking of private property for public use without just compensation
 - New legal theory pursued by landowners and lease holders seeking to recover damages if municipalities are permitted to enact zoning bans on natural gas drilling
 - Plaintiffs in Dryden and Middlefield threatened regulatory takings claims, but have not pursued claims

Regulatory Takings

- Lenape Resources, Inc. v. Town of Avon (Sup. Court Livingston County) (November 2012)
 - Lenape is the first plaintiff to pursue a regulatory takings claim with respect to natural gas bans and moratoria in New York courts

Regulatory Takings

- Lenape's Argument: if Avon's moratorium is enforceable, it is an unconstitutional regulatory taking of property
 - Lenape has property interests in gas leases in Avon
 - Moratorium takes Lenape's exclusive right to explore for and extract oil and natural gas and right to take possession of natural gas extracted as personal property
 - Lenape invested more than \$25 million in Livingston County
 - Moratorium prohibits any use of Lenape's property interest (gas lease)

Regulatory Takings

- Avon's Argument on Takings Claim
 - Lenape failed to exhaust administrative remedies/claim not ripe
 - Where law provides a procedure to apply for a variance from its provisions, the plaintiff must establish that it applied for the variance and was rejected
 - Lenape did not apply for a use variance as permitted under the moratorium or seek compensation for the alleged taking before pursuing the claim in court
 - No taking occurred because Lenape does not have a property interest in horizontal drilling or high volume hydraulic fracturing, which are not yet permitted by DEC, and can continue to use its gas leases for vertical drilling under the grandfathering provision of the moratorium

Regulatory Takings

Final Thoughts:

- Avon's motion to dismiss has been fully submitted, but the Court has not issued a decision
 - Decision is expected in late Spring 2013
- Like in Dryden and Middlefield, an appeal is likely from any decision that the Court makes, especially given that Lenape has asserted a regulatory takings claim in the event Avon's moratorium is upheld.
 - Appeal would go to the Appellate Division, Fourth Department.

Valuation of Gas Leases for Real Property Tax Purposes

- Matter of Micha v. Town of Richford, 2012 WL 6929876, 2012 N.Y. Slip. Op. 33130(U) (Sup Ct, Tioga County 2012)
 - Property owners in Tioga County commenced an RPTL Article 7 tax certiorari proceeding challenging the assessed values of their properties, one of which was subject to a gas lease
 - Because there was no recent arm's length sale for comparison, valuation of the property subject to the gas lease turned on competing appraisals submitted by the parties

Valuation of Gas Leases for Real Property Tax Purposes

- Petitioners' appraiser noted in his report that some properties in the county were being purchased by investors considering a potential return for natural gas leasing
- Petitioners' appraiser refused to consider these sales for valuation purposes as too speculative, but instead valued the parcel based on its actual agricultural use
- The Town's appraiser used comparable sales of other properties in Tioga County and Cortland County

Valuation of Gas Leases for Real Property Tax Purposes

Court's Decision in Micha v. Town of Richford

- Court accepted the valuation of Petitioners' appraiser
- Although noting that sales in Tioga County and the surrounding counties had likely been affected by natural gas speculation, the Court was "unwilling to value property based on any purchase that appears to be driven by natural gas."
 - State moratorium has been in place for at least three years
 - Whether Tioga County will have any gas drilling in near future is "uncertain"
 - Market for property based on natural gas speculation is "simply too volatile" to use those sales for valuation purposes

Valuation of Gas Leases for Real Property Tax Purposes

Final Thoughts:

- Court in Micha v. Town of Richford decided, without a real prospect of natural gas permits being issued in the near future, comparable parcels purchased by natural gas speculators do not provide an accurate representation of the true value of land
- Decision could have a large impact if numerous property owners challenge their assessments because they believe that their assessment was inflated due to signing a gas lease
- As long as assessments are completed based on non-speculative uses of land, Court's decision should not result in need to reassess

Comments or Questions?

Contact:

David Everett, Esq. (deverett@woh.com)

Robert Rosborough, Esq.
(rrosborough@woh.com)

Whiteman Osterman & Hanna LLP
One Commerce Plaza, Suite 1900
Albany, N.Y. 12260
518-487-7600
www.woh.com

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