

***Highlights of Hydraulic Fracturing  
Insurance Coverage and  
“Fracking” in New York State***

Hydraulic Fracturing Whitepaper

**Kevin G. Mescall, Esq.**

Senior Counsel

[kgmescall@lewisjohs.com](mailto:kgmescall@lewisjohs.com)

212.233.7195

**Tara M. Darling**

Legal Intern

[tdarling@lewisjohs.com](mailto:tdarling@lewisjohs.com)

631.755.0101

## Background

Hydraulic Fracturing, commonly known as hydrofracking or simply fracking, is a process used to recover natural gas from underground shale deposits. A combination of fresh water and chemicals are pumped under high pressure into wells in the underground shale formations. After the wells are drilled and the water and chemicals are injected the shale fractures forcing the methane gas to be released and to rise to the surface.<sup>i</sup> As of 2012, fracking was estimated to provide 25% of the United States' natural gas supply.<sup>ii</sup>

## Hydraulic Fracturing Insurance Coverage

The availability of insurance coverage is a paramount concern for those engaged in or entering the fracking industry especially in light of the extensive negative public reaction to same. The main issue confronting a potential insured is whether the policy written by the underwriter will indemnify the insured if an unintended consequence results from the intended act of fracking. More specifically, if a plaintiff or a class of plaintiffs alleges that a local drinking water supply has been contaminated as the result of fracking activity will an insurer defend and indemnify the insured or will the insurer refuse to do so based upon the pollution exclusion contained in most CGL policies. While insured will argue that the contamination is an unintended consequence of their intentional activity it remains uncertain whether the courts will agree.

The case of *Warren Drilling Co., Inc. v. ACE American Ins. Co.*<sup>iii</sup> addresses this exact issue. The case involves an insurer's (ACE American Insurance) refusal to extend coverage to its insured (Warren Drilling Company) for claims arising out of Warren's fracking operations. In 2008, a homeowner claimed that his water was contaminated by pollutants from Warren's fracking. Warren eventually settled its case with the homeowner but then sought to recover its legal fees from ACE for its refusal to defend and/or indemnify. The case is still working its way through the litigation process in the State of Ohio. In order for Warren to prevail and to obtain a favorable ruling obligating ACE to indemnify it and to pay its legal fees, it will have to show:

- (1) The fracking resulted in an *unexpected* and *unintended* discharge of pollutants; and
- (2) The discharge of pollutants was *abrupt* and *instantaneous*.<sup>iv</sup>

The court's decision in *Warren* is likely to guide other courts in proceedings involving fracking liability and insurance coverage.

### a. New York Insurance Coverage

General liability policies that were issued between the early 1970s and mid-1980s usually include the "qualified pollution exclusion." This exclusion bars coverage for pollution related injuries to persons and property. There are exceptions to this exclusion. Some courts have interpreted the exception to include coverage for injuries that were "sudden and accidental" while other courts have interpreted it as barring coverage for injuries that were "expected or intended."<sup>v</sup> Under either interpretation, the insurer will submit documents that consider the potential risks of the fracking technique as discussed in journals, trade publications, and in regulatory or legislative settings.<sup>vi</sup>

An insurer's duty to defend is broader than its duty to indemnify.<sup>vii</sup> The insurer's duty to defend arises when a complaint against the insured gives rise to any potential liability covered by the terms of the policy.<sup>viii</sup> The duty to defend exists even if the alleged claims are false or groundless.<sup>ix</sup> Additionally, the insured does not need to provide concrete evidence that the injuries were sudden and accidental; instead, the insured need only provide evidence of a *reasonable possibility* that the injuries were sudden and accidental.<sup>x</sup>

In New York, individual insurance policies may be scrutinized by the court to determine whether the insurer had a duty to defend its insured. The insurer's duty to defend could turn on the definition of the word "suit" as found in the insuring agreement.<sup>xi</sup> For example, the word "suit" could mean "a complaint has been filed" in court.<sup>xii</sup> A complaint is the document used by plaintiff's to commence a lawsuit seeking monetary damages. Therefore, if an individual state's Environmental Protection Agency (EPA) initiates an administrative proceeding, the insurer would have no duty to defend because "the action [does not] involve actual court proceedings."<sup>xiii</sup> Nonetheless, an insured may be required to pay extensive sums of money for the defense of the administrative proceeding and any fine imposed by the administrative agency.

Furthermore, New York courts faced with coverage issues arising out of fracking operations may base their decisions on whether the claims asserted are barred by the pollution exclusion clause contained in the comprehensive general liability (CGL) policies issued by insurers. The clause quoted below appears almost identically in all insurance policies.

This insurance does not apply...to bodily injury or property damage arising out of the discharge, dispersal, release or escape of ... toxic chemicals, liquids or gases, waste materials, or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; *but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.*<sup>xiv</sup>

Many involved in the fracking industry are anxiously awaiting the court's decision in *Warren*. They hope that the decision will give some guidance regarding the insured's right to coverage for fracking claims. As for now, it is important for each individual to understand the specific wordings in its own policy in order to understand what to reasonably expect from its insurer.

### Hydraulic Fracturing in New York State

The Marcellus Shale is an underground rock formation extending from Ohio and West Virginia into Pennsylvania and New York. It is approximately 7,000 feet deep. Estimates show that the Marcellus Shale may hold more than 489 trillion cubic feet of natural gas.<sup>xv</sup> There are two large regions in New York located within the Marcellus Shale.<sup>xvi</sup> One is the Southern Tier Region, including eight counties: (1) Allegany; (2) Broome; (3) Cattaraugus; (4) Chautauqua; (5) Chemung; (6) Delaware; (7) Steuben; and (8) Tioga. The second region is the Finger Lakes Region and is comprised of nine counties: (1) Orleans; (2) Genesee; (3) Wyoming; (4) Monroe; (5) Livingston; (6) Wayne; (7) Ontario; (8) Yates; and (9) Seneca.

Current New York Governor, Andrew Cuomo, is considering a plan that would permit fracking in the counties bordering Pennsylvania.<sup>xvii</sup> If the plan goes forward, fracking will be allowed in the following counties: (1) Broome; (2) Chemung; (3) Chenango; (4) Steuben; and (5) Tioga.<sup>xviii</sup>

In New York State, gas drilling is governed by the Environmental Conservation Law.<sup>xxix</sup> The State Environmental Quality Review Act (SEQRA) requires all agencies, including the Department of Environmental Conservation (DEC), to prepare an Environmental Impact Statement (EIS) for actions that may have a significant impact on the environment. If the impacts from separate actions are predictable, a generic EIS (GEIS) is prepared. The GEIS provides a comprehensive report of the potential environmental impacts of an activity. If the GEIS does not adequately address a separate activity, a supplemental GEIS (SGEIS) is prepared.

In 1992, a GEIS was issued that addressed environmental impacts associated with oil and gas exploration. In 2008, Governor David Paterson requested that the DEC update its 1992 GEIS. The update included hydraulic fracturing in the Marcellus Shale. The 2008 GEIS prompted a SGEIS. The SGEIS is currently underway. It is to be released at the end of 2014.<sup>xx</sup> When the SGEIS began, no new permits were to be granted until July 2011. Due to the restrictions imposed by the SGEIS as well as an extended comment period issued by the DEC, the moratorium, or temporary delay, has thus far discouraged and prevented fracking.<sup>xxi</sup>

In addition to obstacles imposed by the DEC, the fracking industry in New York must also deal with local municipal legislative activity aimed at banning fracking. The New York Constitution grants local governments the power to adopt and amend local laws that are not inconsistent with the provisions of the constitution or any general law.<sup>xxii</sup> Under this umbrella, local governments are able to regulate the land use through zoning laws.<sup>xxiii</sup> Recently, many municipalities have created local ordinances which ban or limit fracking within their boundaries. Out of the nine hundred thirty two municipalities in New York State, over one hundred fifty have passed zoning ordinances which ban or restrict fracking<sup>xxiv</sup> while one hundred five municipalities have moratoria in place.

In May 2013, in the case of *Norse Energy Corp. v. Town of Dryden*, an appellate court in New York addressed whether a town's zoning ordinance could be preempted by, and therefore superseded by, the Oil, Gas and Solution Mining Law (OGSML). The OGSML is a state law that "supersedes 'all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries.'"<sup>xxv</sup> The court held that the Legislature did not intend for local zoning ordinances to be preempted by the OGSML.<sup>xxvi</sup> The court reached its conclusion by holding that the purpose of the OGSML was to create a uniform statewide standard regarding the technical operational activities of oil and gas drilling, but was not to govern *where* the drilling occurred.<sup>xxvii</sup> Therefore, the ordinance withstood the challenge and remains viable.

As a result of the court's decision in *Norse*, other towns may now enact their own zoning laws which ban or regulate fracking. Many fracking proponents hope that the New York State Court of Appeals, the highest court in the State of New York, will resolve the fracking conflict in New York State and set a more uniform standard.<sup>xxviii</sup> Their hopes are not unfounded as not all court decisions thus far regarding fracking have been negative. In Brooklyn, U.S. District Judge Nicholas G. Garaufis, dismissed a case that sought a full environmental review of hydraulic fracturing.<sup>xxix</sup> The court held that the "development plans are in the early stages and the threat of harm is speculative."<sup>xxx</sup> Additionally, some municipalities that are in favor of fracking have passed resolutions to allow it.<sup>xxxi</sup> Fracking would boost local economies by yielding thousands of dollars in tax revenues as well as providing much needed employment opportunities.<sup>xxxii</sup>

## Recent Studies and Future Expectations

Fracking opponents largely focus on the potential environmental threats. Two of their major concerns are, (1) contamination of drinking water; and (2) methane gas contributing to global climate change.<sup>xxxiii</sup>

A study conducted on 200 wells located in the fracking regions of Pennsylvania revealed that the water quality of the wells remained the same before and soon after fracking, with the exception of one.<sup>xxxiv</sup> The study also revealed that some of the wells failed drinking water regulations before the drilling started. Another study showed that out of tens of thousands of fracking sites across the United States, only eight experienced “injection-induced earthquakes.”<sup>xxxv</sup> Most of the eight earthquakes were too weak to register and none resulted in significant damage. A federal study conducted by the Department of Energy showed no evidence that the chemicals involved in fracking contaminated drinking aquifers in Pennsylvania.<sup>xxxvi</sup> Drinking water is held at shallower depths than the drilling wells. Over a period of one year, the drilling liquids never made their way up to the drinking water.

Fracking is considered a substitute to coal mining.<sup>xxxvii</sup> Fracking adds greenhouse gases to the atmosphere; however, it is a “significant environmental advantage over coal mining.”<sup>xxxviii</sup> Gas from fracking is reported to release half the carbon dioxide per unit of energy as gas from coal does.<sup>xxxix</sup> According to Susan Brantley, a professor of geosciences and director of the Earth and Environmental Systems Institute at Pennsylvania State University, the global environment may benefit if fracking is used in place of coal burning.<sup>xl</sup>

The pending SGEIS report from the New York State Department of Environmental Conservation is expected to shed light on whether fracking is as dangerous as opponents believe it to be. If the report shows that fracking creates significant environmental impacts, opponents of the procedure may seek a statewide ban. If the report reveals that fracking does not pose a threat to environmental safety, local zoning ordinances banning and restricting fracking may be deemed unconstitutional. The report is scheduled to be released at the end of 2014. State Health Commissioner, Dr. Nirav R. Shah requested that Governor Andrew Cuomo postpone a decision on fracking until Dr. Shah’s report on the potential effects of fracking is complete.<sup>xli</sup> As fracking proponents bring their claims to the Court of Appeals, judges may be forced to decide the future of fracking in the State of New York before the DEC issues its report. Until such time as the issue reaches the Court of Appeals, an insured’s rights to a defense and indemnification under a CGL policy for allegations of damage and/or bodily injury arising out of fracking activity will remain uncertain.

## Endnotes

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<sup>i</sup> *Norse Energy Corp. USA v. Town of Dryden*, 964 N.Y.S.2d 714, 716 (3d Dep’t. 2013).

<sup>ii</sup> *Frack On*, THE ECONOMIST, Nov. 26, 2011, <http://www.economist.com/node/21540275>.

<sup>iii</sup> <http://ace-insurance-litigation.com/ace-ina-litigation/case/warren-drilling-co-inc-v-ace-american-insurance-company-et-al>.

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- <sup>iv</sup> Burke Coleman, *Natural Gas Driller and Insurer Dispute Coverage for Fracking Claim*, CLAIMS JOURNAL, Sept. 5, 2012. <http://www.claimsjournal.com/columns/burkes-law/2012/09/05/213109.htm>.
- <sup>v</sup> HB Litigation Conferences, *The New Generation of Environmental Claims* (Mar. 2, 2012) <http://litigationconferences.com/wp-content/uploads/2012/09/1115-Coverage-Implications-PPT.pdf>.
- <sup>vi</sup> *Id.*
- <sup>vii</sup> *Employers Ins. Of Wassau v. Duplan Corp.*, 30 Env'tl. L. Rep. 20, 001, 8 (S.D.N.Y. 1999).
- <sup>viii</sup> *Id.*
- <sup>ix</sup> *Id.*
- <sup>x</sup> *Employers Ins. Of Wassau v. Duplan Corp.*, 899 F.Supp. 1112, 1123 (S.D.N.Y. 1995).
- <sup>xi</sup> J. M. Nonna et al., 1 Insurance Law *Practice* 128 (2d ed. 2010).
- <sup>xii</sup> *Id.*
- <sup>xiii</sup> 18 Cal. 4<sup>th</sup> 857, 878 (Cal. 1998).
- <sup>xiv</sup> *Wassau*, 899 F.Supp. at 1119.
- <sup>xv</sup> *Aukema v. Chesapeake Appalachia, LLC*. 904 F.Supp.2d 199, 202 (N.D.N.Y. 2012).
- <sup>xvi</sup> [http://en.wikipedia.org/wiki/Marcellus\\_Formation](http://en.wikipedia.org/wiki/Marcellus_Formation)
- <sup>xvii</sup> F. Klopott & J. Efstathious Jr., *Cuomo Said to Want to Limit Fracking to 5 New York Counties*, BLOOMBERG, Jun. 13, 2012, <http://www.bloomberg.com/news/2012-06-13/cuomo-said-to-want-to-limit-fracking-to-five-new-york-counties.html>.
- <sup>xviii</sup> *Id.*
- <sup>xix</sup> *Aukema*, 904 F.Supp.2d at 202.
- <sup>xx</sup> Francis Gradijan, *State Reuglations, Litigation, and Hydraulic Fracturing*, 7 Env'tl.& Energy Law & Policy Journal 47, 73 (2012).
- <sup>xxi</sup> *Id.*
- <sup>xxii</sup> *Norse Energy Corp. USA v. Town of Dryden*, 964 N.Y.S.2d 714, 718 (3d. Dep't. 2013).
- <sup>xxiii</sup> *Id.*
- <sup>xxiv</sup> Ed Roggenkamp, *Appellate Division Upholds Municipal Zoning Law Banning Fracking*, Env'tl. L. Blog, <http://blog.sprlaw.com/2013/05/appellate-division-upholds-municipal-zoning-law-banning-fracking/>.
- <sup>xxv</sup> *Id.*
- <sup>xxvi</sup> *Norse*, 965 N.Y.S.2D at 719.
- <sup>xxvii</sup> *Id.* at 724.
- <sup>xxviii</sup> C. Dolmetsch & D. McLaughlin, *Anti-Fracking Laws in New York Towns Upheld on Appeal*, BLOOMBERG, May 2, 2013.
- <sup>xxix</sup> *Id.*
- <sup>xxx</sup> *Id.*
- <sup>xxxi</sup> Joe Mahoney, *Lawyer: Ruling could start N.Y. fracking*, THE DAILY STAR, May 7, 2013, <http://thedailystar.com/localnews/x326076526/Lawyer-Ruling-could-start-N-Y-fracking>.
- <sup>xxxii</sup> *Id.*
- <sup>xxxiii</sup> S. L. Brantley & A. Meyendorff, *The Facts on Fracking*, N.Y. TIMES, Mar. 13, 2013.
- <sup>xxxiv</sup> *Id.*
- <sup>xxxv</sup> *Id.*
- <sup>xxxvi</sup> Global Possibilities. *Pennsylvania Fracking Study Shows Chemicals Did Not Contaminate Water*. July 19, 2013.
- <sup>xxxvii</sup> *The Facts on Fracking*, N.Y. TIMES, Mar. 13, 2013.
- <sup>xxxviii</sup> *Id.*
- <sup>xxxix</sup> *Id.*
- <sup>xl</sup> *Id.*
- <sup>xli</sup> Danny Hakim, *New York Governor Puts Off Decision on Drilling*, N.Y. TIMES, Feb. 12, 2013, [www.nytimes.com/2013/02/13/nyregion/cuomo-delays-decision-on-gas-drilling-as-health-study-continues.html?\\_r=0](http://www.nytimes.com/2013/02/13/nyregion/cuomo-delays-decision-on-gas-drilling-as-health-study-continues.html?_r=0).