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Construction Legal Edge

Summer 2018

Articles in this Issue:

Contractors Must be Prepared for Zoning and Development Permit Application Hearings

A natural gas company recently lost its permit to drill and operate multiple natural gas fracking wells because the company failed to present sufficient evidence to the local zoning board to establish that fracking was a permissible use in an area zoned Residential-Agricultural. While the zoning board found the company's evidence sufficient and granted a permit to conduct drilling, local residents appealed the decision. The Supreme Court of Pennsylvania ultimately invalidated the permits based on the zoning board record of evidence. The Court did not rule that fracking is never permitted in residential or agriculturally zoned districts, but instead held that the company failed to put sufficient evidence into the record to meet zoning standards.

The company could have avoided losing its permit by knowing the zoning ordinances and developing an appropriate record of evidence. In preparing for public zoning board hearings, permit applicants must be aware of all zoning ordinances and must develop a record for purposes of withstanding scrutiny from the courts.

In a June 1, 2018 Opinion, the Supreme Court of Pennsylvania held that the Fairfield Township Zoning Ordinance (the "Zoning Ordinance") did not allow natural gas fracking in a district zoned Residential-Agricultural. *Gorsline v. Bd. of Supervisors of Fairfield Twp.,* No. 67 MAP 2016 (Pa. June 1, 2018). The Court held that the contractor, Inflection Energy, LLC ("Inflection"), failed to present sufficient evidence during public hearings to establish that its use of land was similar to other permissible uses.

The issue first came before the Fairfield Township Board of Supervisors (the "Board") when Inflection submitted a permit application to drill, complete, produce and operate multiple fracking gas wells on land zoned Residential-Agricultural. The Zoning Ordinance defined a Residential-Agricultural district as one intended to "foster a quiet, medium-density residential environment while encouraging the continuation of agricultural activities and the preservation of farmland", and defined permitted uses to include agriculture, single-family detached dwellings, and "essential services" such as electric, water, and gas distribution systems. Conditional uses included agricultural business, and public service facilities.

The Zoning Ordinance did not provide that natural gas fracking was allowed, but there is a provision of the Zoning Ordinance that allows the use of land for purposes that are similar to expressly permissible uses, i.e., a "savings clause".

Two public hearings were held before the Board. At these hearings, Inflection presented Thomas Erwin as an expert witness to support its application. Regarding similarity of uses, Mr. Erwin testified inconsistently, that (1) fracking was not a "public service facility" use, and that (2) fracking fits the definition of a "public service facility". Inflection elected not to ask Mr. Erwin to explain his inconsistent testimony, and failed to offer other testimony relevant to the issue of similarity through Mr. Erwin or other witnesses.

The Board ultimately allowed the construction and operation of the natural gas well under the savings clause. The Board found that fracking was a use that was similar to allowable uses, but failed to identify which permissible use was similar to fracking. There followed a series of appeals. The Commonwealth Court upheld the permit award, finding that fracking was similar to a "public service facility" or an "essential service".

The case ultimately came before the Supreme Court of Pennsylvania. The Court reversed the decision to allow fracking based on two primary conclusions: (1) a lack of sufficient evidence at the public hearings, and (2) a conclusion that fracking is not similar to any permissible use. In the first instance, Inflection's expert witness gave inconsistent testimony and failed to provide any specific reason why fracking was similar to a public service

facility. Inflection failed to meet its evidentiary burden and present evidence regarding similarity of use.

Second, the Court concluded that natural gas fracking "is not, in any material respect, of the 'same general character' as any allowed used in the R-A [Residential-Agricultural] zoning district, including the 'public service facility' and 'essential services' uses…." The Court found that a public service facility or essential service is designed to provide services for the local residents of Fairfield Township. Because Inflection failed to offer any evidence that natural gas extraction provides any benefit to the residents of Fairfield Township, or indeed, Lycoming County, the record was insufficient to accept Inflection's application to conduct fracking. Moreover, Inflection's use was intended solely for its own commercial benefit, and not for the benefit of local residents.

In making these conclusions, the Court repeatedly noted the lack of evidence presented to the Board during the public hearings. The Court specifically held that its "decision should not be misconstrued as an indication that oil and gas development is never permitted in residential/agricultural districts, or that it is fundamentally incompatible with residential or agricultural uses." Instead, the Court found that a permit will not be awarded "based upon a clearly inadequate evidentiary record and no meaningful interpretive analysis of the language of its existing zoning laws."

A more substantial record of evidence at the public hearing may have saved Inflection's accepted permit application. Zoning ordinances must be fully considered before any permit application hearing, and such ordinances differ between municipalities. The *Gorsline* case is a strong reminder that contractors must be fully prepared to set forth specific evidence at public hearings in order to meet all zoning standards or risk losing permits after substantial litigation.

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Waiver of Consequential Damages Clauses in Construction and Other Contracts

One purpose of most contracts is to allocate risk as between or among the parties to the contract in the event a contract is breached and a building doesn't get built on time, or at all, or a product turns out to be defective or not available or [fill in the blank]. Many standard form contracts contain provisions to deal with such eventualities, including American Institute of Architects (AIA) Standard Forms of Agreement.

One such clause, having to do with recoverable damages in the event of a breach, is a Waiver of Consequential Damages clause as contained in an AIA Standard Form of Agreement Between Owner and Contractor. If there is a breach and litigation ensues, then the question may arise as to exactly what damages are included within such a clause.

As a general matter, "consequential" damages are to be distinguished from "direct" damages, which are said to "naturally flow from a breach." Some waiver clauses may specify what potential damages are to be categorized as direct and what as consequential, but others do not. Even when there is a specification, there may be an issue as to what specific damages are included in a particular category. For instance, in *Jay Jala, LLC v. DDG*

Construction, Inc., 2016 WL 6442074 (E.D. Pa. October 1, 2016), Jay Jala had entered into an AIA Standard Abbreviated Form of Agreement Between Owner and Contractor with DDG Construction, Inc., to build a motel in Allentown, PA, with completion by a specified date. DDG did not finish the project on time and eventually left it with the work still incomplete. Jay Jala then terminated the contract for cause and finished the motel on its own. Among the damages sought by Jay Jala in subsequent litigation were "project completion fee by owner; loss of income; insurance; advertising expenses; furniture; fixtures; and equipment and interest paid; and bank interest paid from January 23, 2015 [the date the contract was terminated] until May 15, 2015 [the date the motel was opened]."

The Agreement included a mutual waiver of consequential damages provision under which the parties agreed generally to waive claims against each other for "consequential damages arising out of or related to this contract," including: "damages incurred by the owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons." The section on termination in the Agreement called for payment of "other damages incurred by Owner and not expressly waived." Other provisions focused on timing and delay.

In ruling on defendant's motion for partial summary judgment seeking to block recovery of certain categories of damages, the district court in *Jay Jala* held that, as a general matter, "direct damages" are damages which represent " 'a loss in value of the other party's performance'" or the " 'benefit of the bargain,' " whereas "consequential damages" refer to " 'collateral losses following the breach' " or to " 'economic harm beyond the immediate scope of the contract.' " In other words, "direct damages are the costs of a plaintiff getting what the defendant was supposed to give – the costs of replacing the defendant's performance. Other costs that the plaintiff may not have incurred if the defendant had not breached, but that are not part of what the plaintiff was supposed to get from the defendant, are consequential."

Ultimately, as to the specific categories of damages that were the subject of the defendant's motion, the Court ruled that: (1) a project completion fee may be recoverable as a direct damage because as a general contractor the defendant charged a fee for his overhead, and when plaintiff took over as a general contractor, his company would have similar expense, i.e., it would represent the cost of a "substitute performance;" (2) costs of insurance coverage may be recoverable as direct damages if defendant was supposed to pay them during its work on the project, i.e., they were part of defendant's expected performance, but otherwise they would be consequential; (3) "advertising expenses," even though they may have increased or been rendered wasteful, were consequential under the terms of the contract; (4) costs of leasing "furniture, fixtures, and equipment" for an extra period of time due to delay were consequential in that they were an indirect consequence of the delay caused by the defendant and not a cost the defendant was supposed to pay; (5) "bank interest," which included an additional seven months of interest on a construction loan, which plaintiff had to pay to keep the loan in place until construction was completed, was similar to other "necessary construction input," including time, and therefore recoverable as direct damages; (6) the costs of "monthly utility bills," which the contractor was supposed to pay until the building was complete were "expressly part of defendant's performance" and therefore recoverable as direct damages.

In an earlier case, *Atlantic City Associates, LLC v. Carter & Burgess Consultants*, 453 Fed. Appx. 174 (3d Cir. May 4, 2011), cited in the *DDG Construction* case, which involved a contract between the owners of a mixed use retail and commercial project and a company hired to oversee construction of the project, a contract which included a mutual waiver or non-liability clause with respect to "indirect, special or consequential damages," in general, including but not limited to "loss of use, loss of profit or claims for delay, impact or disruption damages," the Third Circuit Court held that most of the specific damages sought by ACA, including lost rental income, additional payments to contractors due to delay and additional administrative costs, "were consequential, in the sense they went beyond the loss in value of C&B's performance," and therefore were not recoverable given the language of the contract. According to the Court, the "only damages representing a loss in value of ACA's performance were the additional construction costs necessary to repair the errors [in the work] as these were the damages that

allowed it to recover the value of what it had bargained for under the contract."

These cases illustrate the importance of knowing what might or would be categorized as consequential damages under the law of the applicable jurisdiction in drafting and/or reviewing proposed language in a contract and in determining whether the relevant provisions accomplish the desired allocation of risks. Certainly, it would be a mistake to agree to a waiver of such damages without having an idea of what one was giving up and there well may be situations where one party does not want to waive the right to claim as damages losses which otherwise might not be recoverable because they are considered "consequential" and not "direct" in that jurisdiction. These cases also illustrate the importance, if a dispute arises and litigation ensues, of doing a careful analysis up front as to which category the damages sought would or arguably should be placed and constructing a position accordingly.

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Supreme Court Rules Employers May Block Employee Class Action Lawsuits Through Arbitration Agreements in Monumental Ruling

On May 21, 2018, the Supreme Court of the United States ruled that employers can require employees to agree to resolve any claims against them outside of the courtroom through individual arbitration rather than class action lawsuits. Approximately 25 million Americans have already signed arbitration agreements that bar them from pursuing claims in court against their employers. The Supreme Court's decision in *Epic Systems Corp. v. Lewis (Epic),* No. 16-285, provides employers assurance that these agreements will be upheld if employees file claims in court and will likely influence many more companies to make similar arbitration agreements standard for their employees.

The Court's ruling was decided in the context of wage-and-hour claims, but will likely be applied by lower courts to bind employees to their agreement not to pursue class action claims under other federal employment laws, including Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act, and the Americans with Disabilities Act.

Following this ruling, employers are faced with an important decision: whether they should require employees to submit employment disputes to arbitration under existing or new arbitration agreements. Benefits of arbitration for employers include a more informal and efficient forum and lower costs and fees compared to litigation in the courts. However, there are potential disadvantages to compelled arbitration for employers, including the inability to obtain a decision ending the case before a hearing, the unavailability of formal rules of evidence, limited or no appeal options, and an increased risk of inconsistent results in similar cases because arbitration is often confidential.

Therefore, employers should consult an attorney to determine whether their best interests are protected under an existing arbitration agreement or if and how they should implement.

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Third Circuit Confirms the Importance of Receipt of Goods in

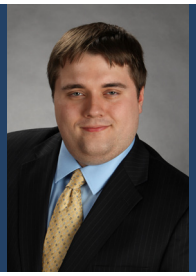
A recent Third Circuit case confirmed the importance of the receipt of goods for suppliers who provide goods to parties who subsequently go bankrupt. Pursuant to 11 U.S.C. § 503(b)(9), a creditor may recover as a priority administrative expense the value of goods "received by the debtor within 20 days before" the bankruptcy petition is filed. An administrative expense is highly coveted in bankruptcy as it is one of the first levels of creditors to receive payment and is typically entitled to 100% payment of its claim. As such, creditors seek to fit their claims into the administrative priority whenever possible.

The case *In re World Imports, Ltd.,* 862 F.3d 338 (3d Cir. 2017) involved a dispute over the meaning of "received" within §503(b)(9). In *World Imports* two manufacturers sold a number of goods to the debtor, World Imports, prior to bankruptcy. The manufacturers fulfilled each order and placed them on a common carrier to be delivered from China to World Imports in the United States. Each shipment was placed with the common carrier "free on board" ("FOB") meaning that the risk of loss or damage to the cargo passed from the manufacturers to World Imports at the time the goods were placed with the carrier. The shipments left China on May 17, May 26, May 31, and June 7, 2013. World Imports took physical possession of the goods on or about June 21, 2013, only 12 days before it declared bankruptcy on July 3, 2013.

Both of the manufacturers filed claims for administrative payment pursuant to § 503(b)(9) on the basis that World Imports received the goods within 20 days of the bankruptcy. World Import objected to both claims arguing that it had actually "received" the goods on the dates that they were loaded onto the common carrier in China for delivery in May and early June. World Import argued that at this point it "constructively received" the goods because the manufacturers no longer possessed the goods and because it bore all risk of loss under the FOB shipping terms. Under World Import's proposed interpretation, it "received" each of the shipments outside to the critical 20-day window and the manufacturers were therefore not entitled to administrative priority claims.

The Third Circuit was required to define the exact definition of "received" within § 503(b)(9). After review of relevant case law and secondary sources, the court held that "receipt as used in 11 U.S.C. § 503(b)(9) requires physical possession by the buyer or his agent." Accordingly, World Import only truly "received" the goods from the manufacturers when it took physical possession of the goods within the 20 days before bankruptcy, and not when they were placed for shipment. Therefore, both of the manufacturers were properly permitted an administrative priority claim in the bankruptcy.

While defining "received" is seemingly a simple exercise, the resolution has substantial real-world consequences. A creditor who has an allowed administrative claim within the 20-day window is entitled to full repayment of that amount. However, a claim arising outside that 20-day window will only be unsecured and likely receive pennies on the dollar. Accordingly, the determination of when a good was "received" can determine whether a creditor can receive any real recovery. While suppliers to a construction project may be able to secure repayment through processes such as mechanic's liens, it is critical to be aware of other ways to improve chances of repayment. Recognizing the importance of the date when a debtor receives goods is one possible way to improve the chances of repayment.



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Industry Standard of Care for Scheduling

Since 2011, individual construction disputes have globally averaged $40 million and 17 months to resolve. (Global Construction Disputes Report, 2017, ARCADIS) The resolution of construction disputes is most often constrained by the lack of accurate and detailed project performance data. The schedule is arguably the single most important record of project performance data. Presented with a construction claim, one of the most common first tasks of a claims analyst is to determine the quality of the project schedules. There is a linear relationship between the quality of the schedules and the accuracy of information determined from their analysis. Determining the quality will indicate the type of analysis that should be performed and how accurately the results will represent project events. When evaluating the quality of anything, one must have a standard by which to perform the evaluation. Typically, the first place to look is the contract. Many contracts including standard forms like AIA A102 "Standard Form of Agreement Between Owner and Contractor," and C191 "Multi-Party Agreement," include a clause requiring the contractor to exercise a standard of care in the performance of its work. Scheduling is typically included as part of the contractor's responsibilities under the general conditions section of the contract but specific quality standards and metrics may not be provided. Absent quality requirements and metrics in the contract, to what might a claims analyst turn in evaluating the quality of a construction schedule?

One answer might be a scheduling standard of care. A standard of care establishes a baseline performance that a professional must meet. Standard of care is generally defined by common law as the ordinary and reasonable care usually exercised by one in that profession, on the same type of project, at the same time, and in the same place, under similar circumstances and conditions.

Some may argue that schedulers are not professionals but technicians and therefore not held to a design standard of care. This may be true historically but professional level certifications such PSP (Planning & Scheduling Professional) have been introduced by groups like AACEi (American Association of Cost Engineers, International), and scheduling is becoming more professionalized at an accelerating pace. Modern scheduling software has enabled schedules to become orders of magnitude more complex than a generation ago. Today's schedulers must be fluent in complex software suites like Primavera, and may have to maintain schedules of tens of thousands of activities and relationships. The question of scheduling professionalism is beyond the scope of this article; but, if current trends such as 5D BIM continue to revolutionize construction management, scheduling will continue to become more complex and to be pulled ever further towards professionalism.

The idea of a standard of care exercised by scheduling professionals presents many benefits. It can serve as an objective standard against which to measure performance, shielding the competent scheduler. Additionally, a standard of care in scheduling would serve to publicly communicate scheduling expectations to all parties, thereby reducing some of the risk associated with uncertainty.

Note that the general definition of standard of care does not preclude mistakes in performance, much less delivery of a perfect product. The standard of care for design professionals is not the creation of a perfect plan or even the delivery of a reasonable result, but a comparison of the skill and care applied by the professional to the skill and care ordinarily applied by a similarly situated professional.

Importantly, regardless of their not being codified into a formal standard of care, scheduling best practices do

already exist. Identifying and compiling these best practices can be a good place to start when considering a standard of care for scheduling. One place to find these best practices is among the published guidelines of the "major" industry groups. The Project Management Institute's Best Practices Guidelines presents detailed step-by-step recommendations for schedule creation, and describes itself as being a "reflection of the concept thatsome sort of order was needed to come to the construction industry in terms of scheduling best practices and guidelines, based on an awareness of a need for improvement and standardization of the scheduling process." The Defense Contract Management Agency's 14-point assessment states that it, "provide(s) the analyst with a framework for asking educated questions and performing follow-up research" related to the project schedule. The Government Accountability Office presents, "10 best practices associated with developing and maintaining a reliable, high-quality schedule." There is significant overlap between the recommendations of these three standards, as well as among many other industry standards; however, while these standards have significant overlap, they are not identical and the decision on which to use remains largely personal preference. This raises the possibility for the claims analyst to "cherry pick" standards that suit the needs of the client, thus undermining the objectivity of the analysis. A standard of care is an objective, industry-wide measure of performance.

Every project is different, and the schedule should reflect that. Typical practices like eliminating open ends and minimizing constraints are applicable in most situations, but not all. Certain best practices (for example, bifurcated schedule updates, in which multiple versions of monthly schedule updates are submitted in order to track the effect of schedule changes separately from the effect of progress updates) can drastically increase workload (more schedules created means more schedules to be reviewed) without a necessary direct improvement in project performance. Construction projects have numerous variables that affect the sophistication required for a schedule to track progress accurately. Sophisticated schedules required by large and complex projects would likely be a waste of resources in smaller or simpler projects. Additionally, large and complex projects typically have greater resources to accommodate greater schedule sophistication. The definition of standard of care provided above accounts for this project individuality based by comparing the care that a similarly situated professional exercised on a project of similar type, time, place, circumstances, and conditions.

When evaluating a schedule retrospectively, are published best practices for construction scheduling useful in determining a standard representing the skill and care ordinarily applied by a similarly situated professional? Despite the differences inherent in each project, some documents produced by industry institutions could be useful in determining the skill and care expected to have been applied by a similarly situated professional. Certain commonalities among these documents could be viewed as widely accepted practices, and provide the basis for a standard of care. However, even this basis leaves substantial ambiguities. For example, what constitutes a "major" industry group? What are we to make of practices that are included in most but not all guidelines? How can we address the inherent problem of applying a standard set of metrics to the unique circumstances and conditions of each project and location?

In conclusion, the advent of powerful scheduling tools have already enabled the creation of complex schedules tracking massive amounts of project data. New technologies will continue to disrupt the construction management world in powerful ways, and schedules and scheduling are likely to continue to increase in complexity. The inconsistent quality of project schedules represents a failure of the industry to leverage the potential power of this new technology, allowing low hanging fruit in the form of reduced claims costs, increased certainty, etc. to wither on the vine.

One specific way to harness this technology might be to identify a standard of care for scheduling, a single, industry-wide standard by which a scheduler might create, and by which an analyst might objectively measure, a construction schedule. The creation of an industry-wide standard of care for scheduling would appear to benefit all parties by clarifying expectations and reducing uncertainty for owners and contractors.

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Pennsylvania Supreme Court Issues Rulings Related to Hydraulic Fracture Gas Industry Impoundments

Impoundments are large pits constructed at or near shale gas well sites to hold fluids used in the hydraulic fracturing process. These fluids contain mostly fresh water, but can also contain other chemicals used in the process, and can be re-used at other fracking sites. The impoundments are constructed by excavating a pit in the ground, which is then lined with synthetic material to prevent leaking of the fluid. These impoundments can be several football fields in size. The Supreme Court of Pennsylvania has issued two opinions on regulations and regulatory penalties pertaining to impoundments since the most recent issue of the Construction Legal Edge.

Supreme Court rules on Marcellus Shale Coalition Challenge to Environmental Regulations

In the case of *Marcellus Shale Coalition v. Dept. of Environmental Protection,* No. 115 MAP 2016 (Pa. June 1, 2018), the Department of Environmental Protection (DEP) and the Environmental Quality Board filed a direct appeal of a single-judge Commonwealth Court pre-enforcement judicial review preliminarily enjoining regulations governing the construction and operation of unconventional gas wells in Pennsylvania. Pennsylvania defines an unconventional gas well as "a bore hole drilled or being drilled for the purpose of or to be used for the production of natural gas from an unconventional formation." An unconventional formation is defined as "a geologic shale formation below the base of the Elk Sandstone or its geologic equivalent where natural gas generally cannot be produced except by horizontal or vertical well bores stimulated by hydraulic fracturing." Although the Court ruled on various other regulations in its opinion, it affirmed the Commonwealth Court's enjoining the new impoundment regulations to the extent they would authorize the DEP to change impoundment construction standards for impoundments built years ago in reliance on the DEP's prior authorization.

Section 78a.59c of the regulation required centralized impoundments to be closed or re-permitted by October 8, 2019 and Section 78a.59b(b) mandated that any well-development impoundments be upgraded to use a synthetic, impervious liner and be surrounded by a fence to prevent unauthorized acts by third parties and damage from wildlife. The agencies argued that the statutory authority did not change, but that they retain the authority to change impoundment requirements via the rulemaking process and to apply the new requirements retroactively to existing impoundments without violating due process.

The Pennsylvania Supreme Court agreed with the agencies' position on well-development impoundments only, explaining that the sheer size of well-development impoundments, ranging up to 30 million gallons, are essentially in the nature of a dam, and as such are regulated under the Dam Safety and Encroachments Act (DSEA), 32 P.S. §§693.1-693.27. The Court further explained that although these impoundments generally store freshwater, the water may at times include other fluids used in well development which are not indigenous to the local watershed, the escape of which can pose a threat of pollution to the waters of the Commonwealth. The Court noted that the state's police power, including regulations maintaining the state's water resources, may be applied to business operations even where doing so causes the imposition of new costs. Thus the DEP may enforce these regulations until the challenge is decided on the merits.

As to the regulation governing centralized impoundments, the Supreme Court noted that the agencies estimated that well operators would incur costs between $39,000,000 and $65,000,000 to retrofit existing centralized impoundments. Thus, the Commonwealth Court had a reasonable basis to conclude that injury to the Marcellus Shale Coalition (MSC) members from the denial of the injunction was greater than the harm to the agencies from granting it, pending a final resolution on the merits. The Supreme Court also found fault with the agencies' argument that they had not previously regulated centralized impoundments under the Solid Waste Management Act (SWMA) because they fell under the SWMA's exemption for drill cuttings from well sites. The Supreme Court noted that the agencies' prior interpretation that drill cuttings only encompass waste processed solely at

the well site was in error. The Supreme Court could not fathom how leaks from centralized impoundments are not part of the associated wells from SWMA purposes, thus supporting the MSC's position that a there was a substantial legal question as to whether the SWMA authorized the promulgation of Section 78a.59c. As a result, the consideration of the merits of the MSC's challenge to this provision will proceed in the Commonwealth Court.

The Clean Streams Law Does Not Authorize Ongoing Civil Penalties for the Presence of Contaminants Following the Initial Entry into the Waters of the Commonwealth

On March 28, 2018, the Supreme Court considered the scope of a civil penalty applicable to violations of environmental statutes regulating the entry of contaminants into any of the waters of Pennsylvania, specifically the Clean Streams Law, 35 P.S. §§691.1 – 691.1001). In the case of *EQT Production Co. v. Dept. of Environmental Protection,* 181 A.3d 1128 (Pa. March 28, 2018) EQT filed a declaratory judgment action challenging the DEP's "soil-to-water" theory as creating "significant uncertainty and unending civil liability" under the Clean Streams Law. Under the DEP's theory, the DEP could impose a penalty of up to $10,000 per day that contaminants from gas well impoundments remain in subsurface soil and passively enter groundwater and/or surface water. EQT asserted that subsections 301, 307 and 401 granted the DEP the authority to assess a civil penalty only for the days that the pollutants were *actually discharged* from the impoundment. The DEP countered that the statute does not employ the phrase "actual discharge".

The DEP had charged that industrial waste from EQT's impoundment had entered and remained in bedrock and soil beneath the impoundment liner "continually polluting new groundwater" and asserted that the contamination could continue to last for months or years as groundwater passed through it. EQT asserted that a "water-to-water" migration theory was more appropriate, meaning only actual movement of the contaminants into waters of the Commonwealth could establish a violation. The Commonwealth Court had ruled that the Clean Streams Law required culpability stemming from an initial active discharge or entry of industrial waste into the waters of the Commonwealth and rejected the DEP's "water-to-water" approach. On remand to the Environmental Hearing Board (EHB), the board imposed a civil penalty on EQT of $1,137,296 and appeared to depart from the Commonwealth Court's ruling by citing *potential* passive continuing migration.

On appeal to the Supreme Court EQT argued that the Commonwealth Court correctly confined penalties to the duration of an initial active discharge. The DEP argued that under the Commonwealth Court's interpretation, there could be no violation for entry of contaminants to waters remote from an initial entry point. The DEP also stated that EQT's concerns for unlimited liability were tempered by the EHB's role as a quasi-judicial body determining penalties and the imposition of the burden of proof on the DEP.

The Supreme Court held that the Clean Streams Law was ambiguous as it relates to the ongoing migration of previously-released contaminants and found that the Legislature intended to protect the waters of the Commonwealth with reference to the places of initial entry and rejected the "water-to-water" theory. The Court's mandate stated the "the *mere* presence of a contaminant in a water of the Commonwealth or a part thereof does not establish a violation of Section 301, 307, or 401 of the Clean Streams Law, since *movement* of a contaminant into water is a predicate to violations." The Commonwealth Court must now apply the ruling of the Supreme Court to its review of the EHB's penalty determination.

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Pennsylvania's Superior Court Does Not Extend the Rule of Capture to Companies Engaged in Subsurface Hydraulic Fracturing

In the case of first impression called *Briggs v. Southwestern Energy Production Company*, No. 1351 MDA 2017 (Pa. Super. Ct. April 2, 2018), the Superior Court of Pennsylvania held that the rule of capture does not preclude liability for trespass due to hydraulic fracturing.

The Briggs Plaintiffs owned an 11 acre parcel of land. Defendant Southwestern Energy Production Company (Southwestern) is the lessee of oil and gas rights on a tract of land adjoining Plaintiffs' property. Southwestern engaged in hydraulic fracturing to extract natural gas from a Marcellus Shale Formation. The Marcellus Shale Formation was on both Plaintiffs' property and on the property that Southwestern was engaged in fracking. Southwestern did not have an oil and gas lease with the Plaintiffs.

Hydraulic fracturing is done by pumping fluid down a well at high pressure and it is forced out into a Marcellus Shale Formation. The pressure creates cracks in the rock that propagate along the natural fault lines. Behind the fluid comes a slurry containing sand, ceramic beads, or bauxite that lodge themselves in the cracks. The fluid is then drained leaving the cracks open for gas or oil to flow to the wellbore.

The Plaintiffs in this case made claims of trespass and conversion alleging that Southwestern had been extracting natural gas from beneath the Plaintiffs' property.

The Trial Court applied the rule of capture and granted Summary Judgment in favor of Southwestern. According to Black's Law Dictionary, the Rule of Capture is a fundamental principle of oil and gas law holding that there is no liability for drainage of oil and gas from under the lands of another so long as there has been no trespass and all relevant statutes and regulations have been observed (10th ed. 2014). In Pennsylvania, the rule of capture had long been applied in conventional oil and gas drilling.

Plaintiffs appealed the Trial Court's decision and the Superior Court of Pennsylvania reversed the Trial Court and sent the case back to the lower court for a determination as to whether or not there was a trespass. Additionally, because the Superior Court found that the rule of capture was not applicable to hydraulic fracturing, the Superior Court said that Plaintiffs must be afforded the opportunity to develop their conversion claim.

The Pennsylvania Superior Court held that hydraulic fracturing is distinguishable from conventional methods of oil and gas extraction. As the Court explained:

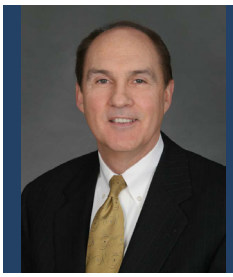
> Traditionally, the rule of capture assumes that oil and gas originates in subsurface reservoirs or pools, and can migrate freely within the reservoir and across property lines, according to changes in pressure … Unlike oil and gas originating in a common reservoir, natural gas when trapped in a shale formation, is non migratory in nature … Instead, the shale must be fractured through the process of hydraulic fracturing; only then may the natural gas contained in the shale move freely through the artificially created channels.

The Superior Court went onto say that:

> … precluding trespass liability based on the rule of capture would effectively allow a mineral lessee to expand its lease by locating a well near the lease's boundary line and withdrawing natural gas from beneath the adjoining property, for which it does not have a lease. Such an allowance would nearly eradicate a mineral lessee's incentive to negotiate mineral leases

with small property owners, as the lessee could use hydraulic fracturing to create an artificial channel beneath an adjoining property, and withdraw natural gas from beneath the neighbor's land without paying a royalty.

Constructors and operators of horizontal Marcellus Shale wells should consider the risk of trespass and/or conversion claims when planning wellbores that are located near property where the minerals are not leased.

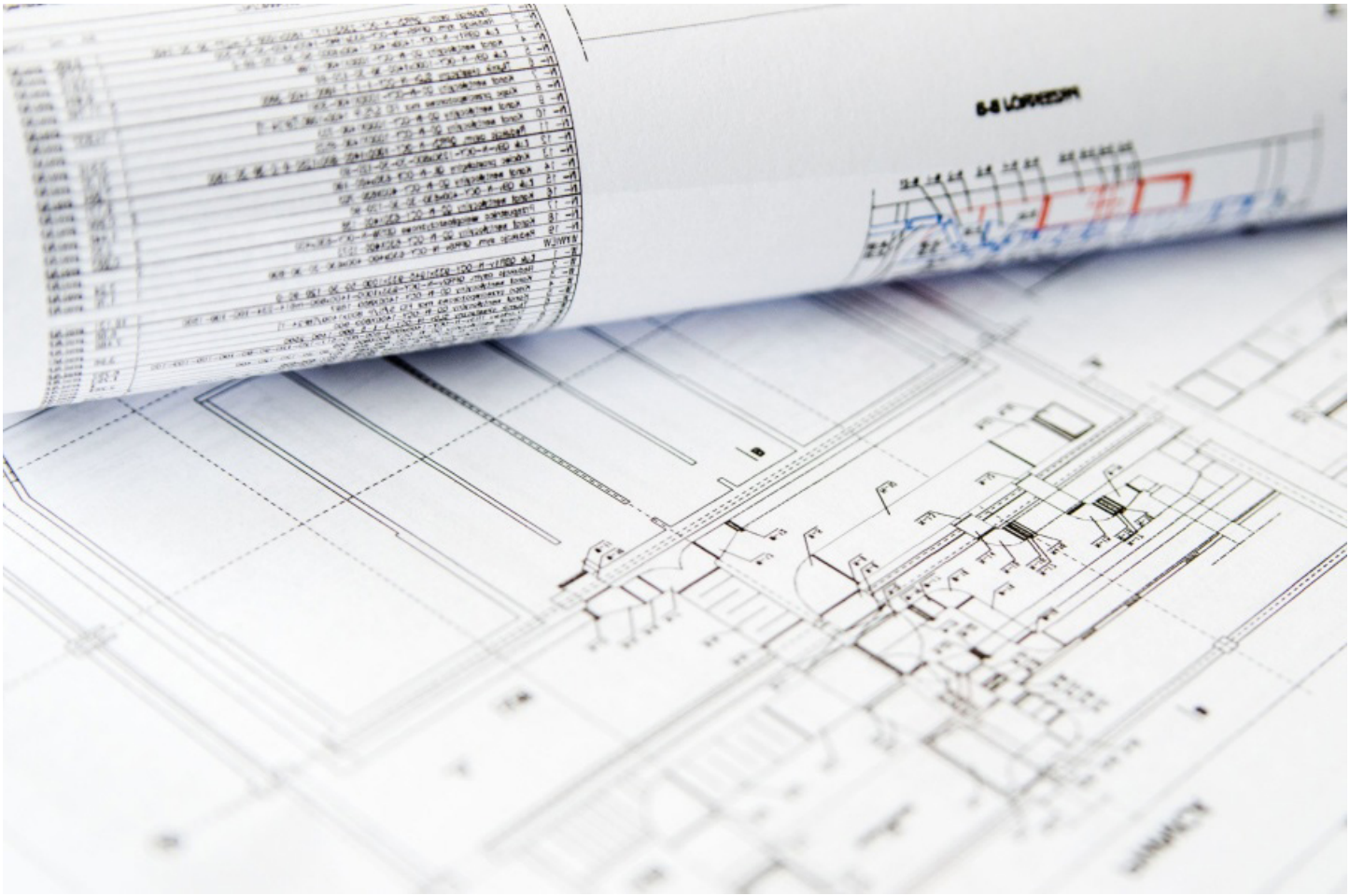


For more information, contact:

Joseph J. Bosick at JJB@Pietragallo.com

About the Construction Group

Time is money. This is never truer than in construction. Pietragallo appreciates the time constraints of construction projects and the owners who pay for them. We understand the complexities of the construction process from conceptual planning, site acquisition and development, design, contract drafting and negotiation, to dispute resolution, risk management, community participation and city processes, insurance coverage, and labor relations. We use our experience to guide your project to its successful completion.



Where In The World?

Construction Mystery: Two creative titans of the 19th century had adjoining homes along the Caloosahatchee River. Both of these homes, now part of a 20-acre estate, are on the National Register of Historic Places, as well as having National Historic Chemical Landmark status. The oldest structure on the estate, the cracker-style Caretaker's House, built on a cattle trail, predates the 1885 purchase of the property by a noted inventor. The term "cracker" is derived from the sound of swinging cattle whips. By 1886, two Queen Anne-style homes were built as mirror images of each other, costing approximately $12,000 each---including the furnishings. The inventor and his good friend and business partner used pre-fabricated building materials. An estrangement resulted in the inventor acquiring the second house in 1906. Of the seven structures on site in 1886, five still stand contributing to an understanding of rural architecture and the life-style of the period. The historic buildings have been restored to look as they did in 1929. The estate has a sumptuous botanical garden, including an award-winning Moonlight Garden. The largest banyan tree in the continental US is always a hit with visitors from Northern climates. Adding to this interesting venue is a research laboratory, with original test tubes and equipment. It was established to find a domestic source of rubber. Over ten million Model Ts, produced by 1925, required rubber. The rubber was for tires and hoses, but also for the assembly lines on which they were made. A museum on the grounds is full of fascinating inventions, many still work as museum staff demonstrate. The estate is open 363 days a year, closing only for Thanksgiving and Christmas. There is even an opportunity to take a cruise with certified naturalists and historians on the Caloosahatchee River.

Question: What is the name of this estate?

Last Issue Answer: Bolt Castle, 1000 Islands, New York

CONTRIBUTED BY JANE OCKERHAUSEN, TRAVEL EDITOR

The Construction Legal Edge is a quarterly publication of the Construction Practice Group.

If you would like to be added to or deleted from the Distribution List of the CLE, please contactJoe Bosick (the Chair of the CPC) at JJB@Pietragallo.com.

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