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Expert Analysis

Potential Disclosure Regimes In the Hydraulic Fracturing Industry

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The expansion of hydraulic fracturing for natural gas drilling has raised concerns about the chemicals used in the process and whether they should be publicly disclosed. At issue are whether chemical disclosure should be voluntary or mandatory, whether the disclosure should be made to governmental regulators or the public and whether companies should be allowed to withhold certain information to protect their business interests. This article discusses the proposals being advanced and the major policy considerations involved.

The process of fracturing deep natural gas reserves held in tightly packed shale formations involves three fundamental elements:

- Vertically and then horizontally drilling into the rock using fluids injected at very high pressures to fracture the formation.
- Injecting proppant (usually sand or a ceramic product) into the fractures to keep them open and provide a conductive pathway for the natural gas to flow into the well bore.
- Recovering some of the fracturing products and flowback water from the well bore in order to gather the natural gas.

Different geologic formations respond differently to combinations of pressures, fluids and proppant. Thus, an increasingly sophisticated industry of providers has developed to serve natural gas exploration and production companies. Some of these service companies created the chemical and proppant products on which the process relies and have helped to spur exponential growth in hydraulic fracturing. Their interests need to be balanced with the public outcry for disclosure, regardless of what disclosure regime is used.

MANDATORY VERSUS VOLUNTARY DISCLOSURE

The mandatory-versus-voluntary debate is rooted in part in the question whether public pressure alone can make the oil and gas companies adopt voluntary public disclosure protocols of the products they use, such as chemical constituents, the well

location and the product volume. There is at least some evidence that the various market and public relations pressures brought to bear can ensure voluntary public disclosure. Specifically, some companies have already agreed to disclosure regimes and, perhaps more significantly, a number of companies have jointly sponsored a website (http://Fracfocus.org) where information on these topics can be located by any member of the public.

Of course, these developments are relatively recent and leave some critics unsatisfied. Among their concerns are that voluntary regimes leave too much discretion to the individual companies and are unlikely to provide all the information that the public deserves or that policymakers require. Voluntary programs can also be abandoned or modified without government approval and are not subject to independent vetting or review. Thus, at both the federal and state level, legislative and regulatory proposals continue to be offered that would require disclosures, whether to the general public, state regulators or both.

But those proposals for mandatory disclosure face their own criticisms. For example, they threaten to impose greater administrative costs on participating companies than do voluntary regimes and threaten to give short shrift to legitimate concerns about protecting sensitive business information that can assist a competitor. Businesses are understandably hesitant to put decisions on the scope of disclosure in the hands of government officials rather than those working day to day in the industry,

Voluntary regimes leave too much discretion to individual companies, critics say.

DISCLOSURE TO GOVERNMENT REGULATORS VERSUS THE PUBLIC AT LARGE

Assuming some disclosure will be made, whether voluntarily or due to government mandate, there is still the debate of who should receive that disclosure. One option, often justified by the need to protect confidential business information, is to disclose only to government regulators at expert agencies (such as a state environmental or natural resources agencies), which can review the information to detect any patterns or product uses that suggest risk to the public.

Such an approach is, of course, not a failsafe for either side of the debate as government agencies make mistakes and can release information inadvertently. Thus, even a focused "regulator only" disclosure regime generates anxiety in some business quarters. Moreover, both the federal government and most states have freedom-of-information or sunshine laws that require their regulatory agencies to provide information in their possession when requested. The adequacy of the protection for confidential information can look highly uncertain and unpredictable to those who stand to be subjected to that disclosure regime.

On the flip side, critics are concerned that as a matter of fundamental democratic principle, limited disclosure deprives citizens of their "right to know." Public knowledge is seen as both an end in itself and a means to an end. Giving the broader citizenry access to the information would enlarge the pool of those monitoring industry practices and point out the risks and flaws that government regulators might otherwise miss.

WHOLESALE DISCLOSURE VERSUS PROTECTION FOR CONFIDENTIAL BUSINESS INFORMATION

Another way of addressing the concerns about protecting sensitive business information focuses less on the "who" at the receiving end of the information than on the "what" they receive. Regimes that would require disclosure only to government regulators essentially address the business sensitivities by saying to the industry, "Don't worry, the folks who will see the data are not even in the business, so they won't be able to take competitive advantage of the sensitive information they see."

A competing option, of course, is to allow wider access but to less information, allowing businesses to carve out or redact disclosure for the most sensitive information upon a showing that their business interests would be hurt by release of the confidential business information. The claims to protect this status would presumptively be honored unless later challenged and rejected.

Proposals that allow less than full disclosure face many of the same critiques mentioned above in terms of whether disclosure should be to regulators only or to a broader public audience. For the regulated, regimes that offer presumptive protection but allow the claim to CBI status to be challenged and rejected can look highly uncertain. Much depends on who is adjudicating that claim and the standards used to make a decision. For example, a regulatory regime that provides a bright-line rule that CBI must not be further disclosed may lead to very different results from a regime that says CBI can be disclosed if the public interest warrants it.

Even a focused "regulator only" disclosure regime generates anxiety for some businesses.

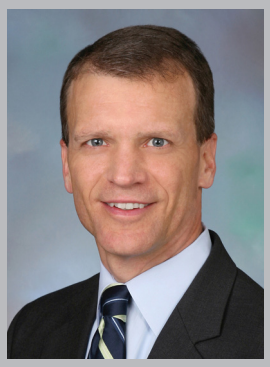
Rules vary on what information can be considered CBI. Again, there is the backdrop of existing sunshine and freedom-of-information laws and the issue of how to ensure that protections are consistent with the existing statutes. In addition, industry critics worry that CBI claims will be used other than to truly protect legitimate business interests, imposing unnecessary hurdles on the public to secure information that really poses no business significance.

Many of these points about the policy options and tradeoffs they present will be familiar to those engaged in issues of environmental regulation in other contexts and industries. But at least one aspect is especially important to note: the potential to undermine the very environmental goals that disclosure advocates seek to serve. If the proper balance cannot be struck between the public interest and the intellectual property interests of business, innovation may be stifled. In the current climate with heightened focus on fracturing and the products used in that process, innovation with a "green focus" is actually one way that a fracturing service provider can compete, gain market share and satisfy public concerns.

Whether fracturing genuinely presents risks to drinking water supplies or not, it is more economically rational for exploration and production companies to limit their risk by using products that present a less-daunting chemical profile. Such an approach allows them to reduce risk should existing products actually carry any danger and, if they do not, to still achieve a benefit for their individual public image and the industry at large. Such innovation is thus likely to increase public acceptance of their exploration and development activities, and there is clearly some competitive

advantage to those service companies able to be innovative in their development of fracturing fluids.

Of course, innovation and bringing innovation to market costs money, in terms of research, development and the education of customers on the virtues that new products bring. If companies are not able to capture the benefits of their innovation because others can instantly gain access to and copy their advancements, then that innovation will stop. Getting the balance right and recognizing that disclosure can have costs as well as benefits is important, not simply to protect sensitive information for exploration and production companies, but also to encourage and reward those who seek to compete through "green innovation."



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