Earthquake: Claim Homeowners Awarded

District Court North Netherlands, 2 September 2015

ECLI:NL:RBNNE:2015:4185 *Stichting Waardevermindering door Aardbevingen Groningen (and 3 others) v. Nederlandse Aardoliemaatschappij B.V.*

Introduction:

On 2 September 2015 the District Court North Netherlands (Assen) ruled that a Natural Gas company (Nederlandse Aardoliemaatschappij B.V. or "NAM") owned by Royal Dutch Shell and Exxon Mobile must compensate homeowners for declines in the value of their properties caused by repeated earthquakes linked to production of gas at the Groningen field. Interestingly, the court ruling specified that homeowners need not show that their property had suffered any physical damage, only that its value had been affected by its location in the quake area. Homeowners can claim their losses on a case-by-case basis and homeowners need not wait with claiming their losses until they sell their houses. The Court held NAM is responsible for earthquakes in the northern province of Groningen and that these have led to a decline in home values of "several percent". Preceding the court's ruling in February 2015 the Dutch Safety Board published a report about the role of the safety of citizens during the decision-making process on gas extraction in the years 1959-2014. The report is critical about the way the interests at stake were addressed during the relevant period. Until the beginning of 2013, the safety of citizens in the northern province Groningen in relation to induced earthquakes had no influence on decision-making on the exploitation of the Groningen gas field. The parties concerned deemed the safety risk to the population to be negligible and thus disregarded the uncertainties surrounding this risk assessment. The Dutch Safety Board concluded that the parties concerned failed to act with due care for citizens' safety in Groningen with regard to the earthquakes caused by gas extraction.

Besides fault and the causal connection, (the extend of) the damage must also be proven by the homeowners. According to Article 6:97 of the Dutch Civil Code the court shall assess the damage in a manner most appropriate to its nature. If necessary and appropriate, the damage which a party has suffered may be estimated. According to Dutch law, an estimate of the damage is allowed if it is not possible to provide an exact amount. This rule of law allows a lot of room to a court to use whatever evidence is available regarding the amount of damages. However, if the amount of damages can be determined, although it is costly to do so, a Dutch court will feel more restraint in coming to an estimate. Generally speaking the court will take all circumstances of the case into account in attempting to restore the harmed party to the situation before the unlawful act (or breach of contract) occurred. The way to achieve this result is to compare the situation "as is" after the incident with the situation as it presumably would have been if the incident had not taken place. The court has discretionary power to assess damages without taking into account special circumstances prevailing on the side of the party that has suffered damages. Only in a few cases the law contains statutory provisions which must be followed in this regard.

NAM has said that it is studying the court ruling and planning how to react to the public. It has accepted its role in the earthquakes but until now it was only ready to pay compensation to homeowners if their property value had been reduced and this transpired at the occasion of a sale of their property. With the court ruling of 2 September 2015 in their hands, homeowners can already now cash their losses. The court ruling is open to an appeal until 3 December 2015.

Hedonic Pricing Method

It seems obvious that the Groningen earthquake damages are not an unique event. Courts in many jurisdictions have faced similar cases dealing with the effects of a natural disaster.

Unlike damages that have resulted from a one-time event (e.g. fire) the effects of a repeated natural disaster (flooding or earthquakes) may have a serious impact on house prices located in the endangered area. It cannot be denied that the likely occurrence of repetitive natural disasters will trigger a certain perception of risk under the relevant public, i.e. buyers and sellers of homes in high (or higher)-risk area's. The price of houses in high-risk area's will decrease, sometimes substantially, depending on the risk perception on potential buyers' side. Although the immediate effects of the Groningen earthquakes have been assessed by damage surveyors the long-term effects of repeated earthquakes on house prices should not be under-estimated. A model identifying price factors according to the premise that price is determined both by internal characteristics of the good being sold and external factors affecting it is commonly known as the Hedonic Pricing Method (HPM). The HPM has been used in the housing market for many decades already. The price of a property is determined by the specifics of the house (rooms, appearance, features and condition) as well as the characteristics of the surrounding neighbourhood (accessibility to shops, schools, value of other homes, near to a road or in a residential area, etc.). The HPM is used to estimate the extent to which each factor affects the price of a house. Several studies have used Hedonic property models to estimate the marginal willingness to pay for reduced risk of natural disasters. [1] The results of Bin and Polasky's study indicate that after a natural disaster, increased risk perception causes a decrease in the value of houses in high-risk area's. In another Hedonic study Beron and others (1997)[2] found that the Hedonic price of reduced earthquake risk decreased after a major earthquake in northern California. Beron and others attributed the surprising decrease in the Hedonic price of risk to inaccurate perception of earthquake risk. They contended that homebuyers over-estimated the risk of damage due to earthquakes, and after experiencing an earthquake re-evaluated their risk profiles. So, even though the hedonic price of earthquake risk was reduced after an earthquake, Beron and others' study indicates market failure due to imperfect information.

[1] Bin and Polasky (2004) used a Hedonic model to estimate the effect of flooding on residential property values. They found at houses located within a floodplain have lower prices than houses located outside a floodplain.
[2] Kurt J. Beron – An Analysis of the housing market before and after the 1989 Loma Prieta Earthquake.

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