SUBJECT: Expressly preempting certain local oil and gas regulations

COMMITTEE: Energy Resources — committee substitute recommended

VOTE: *After recommitted:*
7 ayes — Darby, Paddie, Craddick, Keffer, P. King, Landgraf, Meyer

6 absent — Anchia, Canales, Dale, Herrero, Riddle, Wu

WITNESSES: *March 23 public hearing:*
For — Frank Macchiarola, America's Natural Gas Alliance; Don Tymrak, City of Karnes City; Ed Smith, City of Marshall; Jeanette Winn, Karnes City ISD; J. Ross Lacy, Midland City Council; Candice Brewer, National Association of Royalty Owners; Ben Shepperd, Permian Basin Petroleum Association; Josiah Neeley, R Street Institute; Bill Stevens, Texas Alliance of Energy Producers; Carlton Schwab, Texas Economic Development Council; Ed Longanecker and Raymond Welder, Texas Independent Producers and Royalty Owners; Todd Staples, Texas Oil and Gas Association; Jess Fields and Leigh Thompson, Texas Public Policy Foundation; Tricia Davis and Kent Sullivan, Texas Royalty Council; and 10 individuals; (*Registered, but did not testify*: John Fainter, Association of Electric Companies of Texas; Nelson Nease, America's Natural Gas Alliance; Peggy Venable, Americans for Prosperity-Texas; Adrian Acevedo, Anadarko Petroleum Corp; Matthew Thompson, Apache Corporation; Dan Hinkle, Association of Energy Service Companies, BP, EOG Resources, EP Energy, EnerVest; Charles Yarbrough, Atmos Energy; Robert Flores, Breitling Energy; Jeff Bonham, CenterPoint Energy, Inc.; Christie Goodman, Richard Lawson, Ben Sebree, Julie Williams, and Steve Perry, Chevron; Stan Casey, Concho Resources Inc.; JD Adkins, ConocoPhillips; Martin Allday, Consumer Energy Alliance-Texas, Enbridge Energy; Shayne Woodard, DCP Midstream; Teddy Carter, Devon Energy; Grant Ruckel, Energy Transfer; Marida Favia del Core Borromeo, Exotic Wildlife Association; Samantha Omey, ExxonMobil; Kelly McBeth, Gas Processors Association; Royce Poinsett, Halliburton; Bill Oswald, Koch Companies; Chris Hosek, BASA Resources, Exco Resources, Linn Energy, Newfield Exploration, QEP

Resources, R360, Range Resources, Select Energy, SM Energy; Hugo Gutierrez and Amy Maxwell, Marathon Oil Corporation; Lindsay Sander, Markwest Energy; Julie Moore, Occidental Petroleum Corporation; Anne Billingsley, ONEOK; David Holt, Permian Basin Petroleum Association; Mark Gipson, Pioneer Natural Resources; Kinnan Golemon, Shell Oil Company; Patty Errico and Cade Campbell, SM Energy; Jim Tramuto, Southwestern Energy Company; Stephanie Simpson, Texas Association of Manufacturers; Steven Garza and Daniel Gonzalez, Texas Association of Realtors; Stephen Minick, Texas Association of Business; Hector Rivero, Texas Chemical Council; Lisa Kaufman, Texas Civil Justice League; Laura Buchanan, Texas Land and Mineral Owners Association; Thure Cannon, Texas Pipeline Association; Julie Klumpyan, Valero; Jim Rudd, West Texas Gas; Greg Macksood)

Against — Don Crowson and James Parajon, City of Arlington; Nelda Martinez, City of Corpus Christi and Texas Municipal League; Philip Kingston, City of Dallas; Chris Watts, City of Denton; Sarah Fullenwider, Jungus Jordan, and Danny Scarth, City of Fort Worth; Don Postell, City of Grand Prairie; Clayton Chandler, Bill Lane, and Peter Phillis, City of Mansfield; Bryn Meredith, City of Mansfield, City of Southlake, City of Flower Mound; Ken Baker, City of Southlake; Adam Briggle and Cathy McMullen, Denton Drilling Awareness Group; Sharon Wilson, Earthworks; Luke Metzger, Environment Texas; Scott Anderson, Environmental Defense Fund; Calvin Tillman, League of Independent Voters of Texas; Susybelle Gosslee, League of Women Voters of Texas; Lon Burnam, Public Citizen; Elizabeth Riebschlaeger, Sisters of Charity of the Incarnate Word of San Antonio; Robin Schneider and Zac Trahan, Texas Campaign for the Environment; Bennett Sandlin, Texas Municipal League; David M. Smith, Texas Neighborhoods Together; Snapper Carr, Texas Coalition of Cities for Utility Issues; and 18 individuals; (*Registered, but did not testify*: David Crow, Arlington Professional Fire Fighters; Jesus Garcia, City of Alice; Jennifer Rodriguez, City of College Station; Tom Tagliabue, City of Corpus Christi; Brie Franco, City of El Paso; Lindsay Lanagan, City of Houston; Jon Weist, City of Irving; Sam Fugate, City of Kingsville; Frank Sturzl, City of North Richland Hills; David Foster, Clean Water Action; Ellen Friedman, CommonSpark; Doug

Dickerson, Dallas Fire Fighters Association; Shelby Dupnik, Karnes County; Linda Curtis, League of Independent Voters of Texas; Cyrus Reed, Lone Star Chapter Sierra Club; Jill Hinckley, National Nurses United; Jon Andreyo, Andrew Dobbs, and Anne Robertson, Texas Campaign for the Environment; Chance Sparks, American Planning Association-Texas Chapter; David Weinberg, Texas League of Conservation Voters; Shanna Igo, Texas Municipal League; Julian Muñoz Villarreal, Texas Neighborhoods Together; Paula Littles, Texas National Nurses Organizing Committee; Trish O'Day, Texas Physicians for Social Responsibility; Ric Holmes, Texas Municipal League Region 9; William Sciscoe, Town of DISH; Conrad John, Travis County Commissioners Court; Gwendolyn Agbatekwe, Texas National Nurses Organizing Committee, National Nurses United; and 42 individuals)

On — Alan Day, Brazos Valley Groundwater Conservation District; Steve Lindsey, City of Mansfield; Jim Allison, County Judges and Commissioners Association of Texas; Jon Olson, Department of Petroleum and Geosystems Engineering at the University of Texas at Austin; C.E. Williams, Panhandle Groundwater Conservation District; John Love, Texas Municipal League, City of Midland; (*Registered, but did not testify*: Diane Goss and Keith Sheedy, Texas Commission on Environmental Quality)

BACKGROUND: Land ownership in Texas is divided into two estates: the surface estate and the mineral estate. It is common for the mineral estate and the surface estate to be owned by different people or entities. Current interpretation of Texas law provides that the owner of a mineral estate has certain rights to surface use, including, but not limited to, constructing roads, pipelines, wells, storage tanks, and canals.

DIGEST: **Definitions.** CSHB 40 would define "commercially reasonable" as "a condition that would allow a reasonably prudent operator to fully, effectively, and economically exploit, develop, produce, process, and transport oil and gas." The bill would specify that this would be determined based on the objective standard of a reasonably prudent operator and not an individualized assessment of an actual operator's

capacity to act.

The bill would define "oil and gas operation" as "an activity associated with the exploration, development, production, processing, and transportation of oil and gas." The bill would specifically include "hydraulic fracture stimulation, completion, maintenance, reworking, recompletion, disposal, plugging and abandonment, secondary and tertiary recovery, and remediation activities" in this definition.

Preemption. This bill expressly would preempt ordinances and regulations enacted by a political subdivision of the state that ban, limit, or otherwise regulate an oil and gas operation, unless the regulation:

- regulated only aboveground activity;
- was "commercially reasonable";
- did not effectively prohibit an oil and gas operation conducted by a reasonably prudent operator; and
- was not otherwise preempted by state or federal law.

An ordinance would be considered commercially reasonable if it had been in effect for at least five years and had allowed the oil and gas operations at issue to continue during that period.

The preamble to the bill includes a statement noting that the regulation of oil and gas operations by municipalities and other political subdivisions is "impliedly preempted" by statutes already in effect.

CSHB 40 would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2015.

SUPPORTERS SAY:

CSHB 40 would affirm the preemptive nature of state regulations on oil and gas production over local ordinances and would ensure consistent, fair application of rules across the state. It would create a clear four-prong test for preemption that would both reduce litigation and ensure that owners of mineral estates were not effectively stripped of their property rights.

State vs. local regulation. The state historically has been responsible for the majority of oil and gas regulations. State agencies, therefore, are the most experienced regulatory bodies and have highly specialized subdivisions equipped to handle highly specialized issues. Local governments have less expertise and less of an ability to draft regulations that reflect engineering reality.

Additionally, this bill would incentivize cooperation and agreements between municipalities and operators because municipalities no longer would be able to regulate without considering the property rights of mineral owners. This would create a better balance between property rights and reasonable restrictions on oil and gas operations than is achieved by the current patchwork of municipal regulations.

Some opponents suggest that the distance between affected individuals and state agencies will cause state regulators to be less responsive to concerns than municipal regulators. However, this is not unique to state agencies. Municipalities can be heavily influenced by operators, even more so if the municipality is small and the operator is influential. The state agency is in a better position to understand the effects of any given oil and gas operation than is a municipality.

Concerns that state agency subsurface regulations are insufficient and lack enforcement do not justify turning to a patchwork set of municipal ordinances. Instead, the Legislature should fully fund the Railroad Commission and focus on improving state policies and regulations instead of offloading that task to municipalities.

This bill would not impede performance of statutory obligations because there are few (if any) statutory obligations that would implicitly require municipal regulation of oil and gas operations. The bill is also unlikely to affect many local ordinances that are not related to oil and gas operations like fire codes and traffic ordinances because these regulations likely would pass the four-prong test.

The ordinances that would be preempted by this bill are predominantly duplicative with state agency regulations, so this bill would not harm public health or public safety.

Property rights. Mineral rights are just as important to protect as surface rights, but municipal regulations that effectively ban attempts to exploit resources deprive mineral rights owners of their property. This bill is needed to protect property rights and the dominance of the mineral estate as it has been recognized by Texas law for centuries.

Current protections against uncompensated regulatory takings are not sufficient, and litigation currently in progress could result in the erosion of property rights due to this deficiency. This bill unambiguously would secure the right of mineral rights owners to access and exploit their property.

Any impact that oil and gas operations have on property values is both temporary (drilling rigs are only operational for less than 30 days) and mitigated by aboveground regulations such as setbacks, fencing, and landscaping requirements (which would pass the four-prong test). In fact, the data is ambiguous as to whether there is any negative, long-term impact on property values for land near oil and gas wells.

Regulatory certainty. By creating a simple and straightforward test for preemption, this bill would reduce the need for litigation to determine whether or not an ordinance was preempted. Operators choose not to commence operations in certain circumstances where regulatory uncertainty risks eventually shutting down a prospective drilling operation entirely, so this bill would increase the number of oil and gas operations and thus increase economic activity in the state, boosting tax revenues.

Additionally, if municipalities and political subdivisions continued to be allowed to regulate subsurface activity, an operator that horizontally drilled across multiple jurisdictions could be subject to multiple sets of potentially contradictory regulations. This bill would resolve this otherwise intractable quagmire of regulation.

The Railroad Commission already has 15 separate districts to accommodate local concerns with region-specific approaches, and a patchwork approach to regulation in different parts of the state would be inappropriate.

Preamble. This is a statement of intent by the Legislature, and it is the Legislature's belief that current law does impliedly preempt the regulation of oil and gas operations by municipalities and other political subdivisions.

Scope. The term "reasonably prudent operator" is well established and clearly understood by litigators and the industry. The fact that it originated from another area of law is inconsequential. "Political subdivision" is also a frequently used term throughout statute and by litigators, and it is not unclear or ambiguous.

Likewise, the possibility that the phrase "an oil and gas operation" could lead to an overly broad effect on ordinances would be limited by the reasonably prudent operator standard. For instance, an operator could not argue that it should be allowed to drill in the middle of Main Street for any number of reasons, but primarily because a reasonably prudent operator would not locate a well site in the middle of a major road. This bill would not effectively eliminate all aboveground ordinances.

CSHB 40 effectively would balance the property rights of mineral owners with public safety by clarifying that the most effective entity would have purview to regulate.

OPPONENTS SAY:

CSHB 40 is overly optimistic about the efficacy of state regulation and is overbroad, effectively prohibiting even basic ordinances intended to ensure public safety and public health. The bill would upend the balance between protecting property rights and environmental protection in favor of the oil and gas industry, disregarding legitimate public health concerns brought by affected individuals.

State vs. local regulation. Effects of oil and gas operations are necessarily felt most acutely at the local level. Although state agencies may have more expertise surrounding oil and gas operations, municipalities are better equipped to understand the effects of the operations on their communities and would be under more pressure to respond to local resident concerns. This bill would remove much of the power the average individual has to influence regulatory changes on oil and gas operations and place more power into the hands of organized interest groups such as the oil and gas industry.

State agencies may not have political will to enforce the regulations necessary to protect public health and the environment. Municipalities are more accessible and responsive to individual complaints than a state agency, which can be beholden to industry interests and disconnected from the citizenry. It would be a mistake to rely only on state agencies. Municipal regulations are necessary only because state regulation is perceived to be inadequate.

Even if state agencies adequately enforced existing regulations, gaps in state subsurface rules and regulations currently are filled by local ordinances. None would remain in effect because each would fail one of the four prongs of the test in this bill. A few examples of local ordinances that could be preempted include those requiring operators to bury saltwater pipelines at sufficient depth to protect city infrastructure, that thumper trucks rather than explosives be used to conduct seismic surveys, and that pipelines crossing roads be bored or tunneled to prevent damage.

In Texas, state regulations on oil and gas operations are notoriously weak. Fines for certain violations, for instance, are 30 years old, have not kept up with inflation, and are no longer adequate disincentives. Leak detection and repair programs, the standard in other states, are not required of the oil and gas industry. The state should not categorically preempt municipal regulations without first ensuring state regulations are actually complete.

Municipalities might have certain statutory obligations that could not be performed without limiting subsurface activity. As the bill is currently

written, it is not clear what would happen if a regulation necessary to fulfill a statutory obligation violated one of the four prongs of the test.

Ordinances preempted by this bill would not be specific to oil and gas operations — they could be part of the fire code or traffic or explosives ordinances, for example. Reasonable ordinances could be preempted if they somehow were construed to limit commercially reasonable oil and gas operations.

Property rights. Property rights should be protected, but current law is sufficient. Regulatory takings are not inherently bad when the regulation protects a public interest and property owners are compensated. Regulations that serve as effective bans on resource extraction would likely be ruled inverse condemnations under current law and mineral owners given compensation for the regulatory taking.

An erosion in property rights is worthwhile if municipal regulations are needed to protect neighborhoods from environmental degradation and harmful public health consequences. Municipalities should be able to enact regulations to save lives even if it effectively prohibits an oil and gas operation by making it uneconomical.

Oil and gas operations infringe upon the property rights of surface owners near the mineral rights by reducing their property values. The traffic, noise, light and air pollution, and general unsightliness drives down property values, particularly if the operation is in a residential area. Homeowners should be free from such nuisances, and this bill would eliminate tools municipalities have to reduce the negative impact of oil and gas operations.

Regulatory certainty. A certain level of variation is necessary in regulations due to operational environments differing throughout the state. This bill would create a flat set of regulations that ignore the need for some local subsurface regulations. For instance, coastal areas subject to hurricane activity require subsurface shut-off valves that can be activated to prevent catastrophic oil spills. In other cases where the municipality

holds some subsurface rights, the municipality requires the operator to hold insurance to pay for any potential damage to the municipality's subsurface rights. This bill could preempt these regulations and expose the regions to safety or fiscal risks.

Preamble. The preamble in this bill is not merely a statement of intent but could significantly change the outcome of litigation. Courts have routinely held that local regulations on oil and gas operations are not currently "impliedly preempted."

Scope. The bill includes ambiguous terms that could create litigation and potentially expand an already broad provision such that courts would have to decide what the terms meant in their new context. The term "reasonably prudent operator," similar to the reasonable person standard, is common in tort law but not municipal law or preemption law. Stripped of its context in tort law, the reasonably prudent operator standard becomes ambiguous even though it is commonly used. The bill should clarify that the standard involves a certain level of due regard to surface rights.

With the term "political subdivision," it is not immediately clear if the bill would preempt important groundwater conservation district regulations for spacing, water withdrawal, and reporting by oil and gas operators.

A third term that could increase the scope of the bill is "an oil and gas operation." As currently worded, the bill could invalidate even ordinances regulating only aboveground activity. For instance, setbacks prohibit an oil and gas operation within a certain distance around a building. A setback ordinance could fail the third prong since it effectively (or, in this case, actually) "prohibits an oil and gas operation" within that distance from the building. Under this reading, virtually all ordinances could be preempted, even those meeting the other prongs of the test.

This phrase makes the bill less about ensuring property rights and more about oil and gas operations being able to drill anywhere. The bill should use verbiage not about oil and gas operations but about whether or not an operator can actually access leased minerals.

If municipalities exceed their authority under current law, the situation should be resolved by the courts on a case-by-case basis. This bill would be an overreach, endangering environmental quality and public health.

NOTES:

The Legislative Budget Board's fiscal note indicates that there could be an indeterminate fiscal impact to the state, depending on the number of political subdivisions affected by the bill.

The committee substitute differs from the introduced version in that CSHB 40 would include in the basis of determining a "commercially reasonable" measure the objective standard of a reasonably prudent operator and not an individualized assessment of a specific operator's capacity to act.

CSHB 40 specifies that political subdivisions could impose regulations on aboveground activities under certain circumstances.

CSHB 40 also differs from the original bill in providing that an ordinance would be considered commercially reasonable if the ordinance had been in effect for at least five years and had allowed the oil and gas operation at issue to continue during that period.

The Senate companion bill, SB 1165 by Fraser, et al., was reported favorably by the Senate Natural Resources and Economic Development Committee on March 25.

CSHB 40 was placed on the General State Calendar on April 14 and was recommitted to the Energy Resources committee. The bill was again reported favorably on April 14.