



ATTACHMENT 3

MEMORANDUM

TO: City Council
FROM: Bill Tuthill
DATE: May 31, 2013
RE: Legal Framework for Analyzing Local Government Regulatory Authority Concerning Oil & Gas Development

PROPERTY INTERESTS INVOLVED

In Colorado, the ownership of the surface of land is often severed from the subsurface or mineral estate which may then be owned by someone else. Severed mineral estates can be sold or leased just like the surface estate. The surface owner cannot prevent the subsurface owner from making reasonable use of the surface property to access and develop the underlying minerals. Conversely, the owner of the subsurface mineral estate cannot prevent development of the surface. The owners of each type of property are entitled to use and develop their property.

STATE AUTHORITY V. LOCAL AUTHORITY

In 1951, the Colorado legislature adopted the original version of the Oil and Gas Conservation Act which contains the following legislative declaration:

It is declared to be in the public interest to: 1) foster the responsible, balanced development, production, and utilization of the natural resources of oil and gas in the state of Colorado in a manner consistent with protection of public health, safety, and welfare, including protection of the environment and wildlife resources; 2) protect the private and public interests against waste in the production and utilization of oil and gas; and 3) safeguard, protect, and enforce the co-equal and correlative rights of owners and producers in a common source or pool of oil and gas to the end that each such owner and producer of the common pool or source of supply of oil and gas may obtain a just and equitable share of production therefrom.

To carry out this legislatively declared State interest, the legislature created the Colorado Oil and Gas Conservation Commission (COGCC) and gave it the power to adopt rules and regulations to help effectuate these State interests.

For the past several decades, local governments have repeatedly adopted regulations that are more restrictive of oil and gas drilling operations than those that have been adopted by the COGCC. In numerous court cases, oil and gas operators and/or the COGCC have vigorously resisted local efforts to impose rules and regulations more restrictive than those adopted by the COGCC. To the extent that local regulations have attempted to dictate the technical aspects of drilling and pumping, local regulations have generally been invalidated by the courts.

For example, when the Colorado Supreme Court invalidated a voter-approved ordinance in Greeley that banned all oil and gas drilling activity within the city, the Court stated:

We hold that the State's interest in efficient development and production of oil and gas in a manner preventative of waste and protective of the correlative rights of common-source owners and producers to a fair share of production profits, preempts a home-rule city from totally excluding all drilling operations within the city limits.

It is important to note that when considering the state's interest in preventing "waste," the concept of waste does not merely include spilling product on the ground or allowing it to escape into the air – it also involves the desire not to waste the resource by leaving it underground. To the extent that oil and gas from an underground pool is not extracted and brought to the surface, it is considered "wasted."

Although the courts have held, in the abstract, that local governments are free to adopt regulations that "harmonize" oil and gas developmental and operational activities with the State's interest in those developmental and operational activities, the Colorado Supreme Court has determined that there may be instances where the county's regulatory scheme conflicts in operation with the State statutory or regulatory scheme. For example, the Court has determined that the "operational effect of the county regulations might be to impose technical conditions on the drilling or pumping of wells under circumstances where no such conditions are imposed under the State's statutory or regulatory scheme, or to impose safety regulations, or land restoration requirements contrary to those required by State law or regulation. To the extent that such operational conflicts might exist, the county regulations must yield to the State interest." The Court has also established an approach for determining whether an "operational conflict" exists between the local government regulations and the State's interests as managed through the state regulatory scheme, indicating that that determination must be made on an ad-hoc basis under a fully developed evidentiary record. Providing guidance as to what types of local regulations would create an "operational conflict," the Court has stated unequivocally that "there is no question that the efficient and equitable development and production of oil and gas resources within the state requires uniform regulation of the technical aspects of drilling, pumping, plugging, waste prevention, safety precautions, and environmental restoration." The Court has also held that the State interest in oil and gas production is closely tied to well location, with the result that the need for uniform regulation extends also to the location and spacing of wells.

Accordingly, while the Supreme Court provides lip-service to the concept that local regulations can be adopted provided that they "harmonize" with State regulation, the conclusion to be reached from reviewing the numerous court cases is that state regulation preempts local regulation when it comes to the "technical aspects of drilling, pumping, plugging, waste prevention, safety precautions, and environmental regulation," as well as location and spacing of wells. However, because the courts have also emphasized that the determination of whether an "operational conflict" exists must be resolved on an ad hoc basis under a fully developed evidentiary record, recent local legislative efforts have sought to adopt regulatory schemes that are less likely to be challenged on their face by an operator and instead must be challenged in a tedious evidentiary litigation process to determine whether the specific local regulations conflict directly with the state regulatory requirements or create an operational conflict with the state's interests as articulated in the Oil and Gas Conservation Act. As an alternative to challenging local regulations through the litigation process, some local governments have turned to offering oil and gas operators an alternative to an expensive, uncertain litigation outcome by offering the opportunity to obtain expedited or administrative approval of well permits or land use applications if the applicant agrees to contractually undertake through a memorandum of understanding, or an administrative plan or permit, the responsibility to engage in best practices for oil and gas development operations.

These negotiated MOUs typically address technical aspects of drilling and well site operations, such as air quality emissions reduction and monitoring, groundwater monitoring, spill containment, and inspections. Because they are entered into voluntarily by the operators, they are not subject to legal challenge by those operators. The COGCC has been generally supportive of voluntary MOUs between operators and local governments and in some instances has included reference to them in the permits issued by the COGCC.

Where operators have challenged the specific regulatory authority of local jurisdictions, they have generally obtained favorable results. Most recently, in a case involving the town of Milliken, the Court of Appeals invalidated a \$400 per year fee imposed by the town in order for the town police to make routine, often daily, drive-by inspections of well site operations within the town. The town attempted to justify the fee and the inspections as reasonable so that police could determine if illegal or dangerous activities or conditions existed at the well site, such as graffiti, vandalism, openly visible damage to or leaking equipment, or drug activity was taking place at the well site. The town argued that the COGCC had not adopted any regulations that specifically addressed this type of routine safety inspection, and that therefore the town could impose a fee for its inspections in this regard. The Court of Appeals rejected this argument, holding that “oil and gas well site safety and security are matters subject to rule, regulation, order, or permit condition administered by the commission.” The Court determined that “it is irrelevant whether the Commission actually conducts inspections like those performed by the town’s police department. The relevant inquiry is whether the town’s inspection concerned ‘matters that are subject to rule, regulation, order, or permit condition administered by the Commission.’” Accordingly, the Court held that the relevant state statute regarding imposition of fees on oil and gas operators prohibited the town from imposing its own fee on a matter that was subject to regulation by the Colorado Oil and Gas Conservation Commission.

WHAT IS CLEARLY PERMITTED AND WHAT IS CLEARLY PROHIBITED

Local governments can require:

- oil and gas operators to apply for and obtain a permit prior to commencing operations
- building permits for above-ground structures and access roads
- emergency access plans
- fire plans
- traffic impact fees that are reasonably related to the impacts and are non-discriminatory
- fees to monitor for compliance with local fire codes

Local governments cannot:

- ban oil and gas operations
- charge a fee or tax to conduct inspections or monitoring of oil and gas operations with regard to matters that are subject to rule, regulation, order, or permit condition administered by the COGCC.

REGULATIONS SUBJECT TO “OPERATIONAL CONFLICT” ANALYSIS

Ban on hydraulic fracturing (almost certain to be an operational conflict because it is, in effect, a ban on drilling).

Setbacks greater than those established by COGCC –found to be invalid by Court of Appeals in Town of Frederick v. North American Resources.

Noise abatement requirements stricter than COGCC – found to be invalid in Town of Frederick case.

Visual impact regulations greater than those imposed by COGCC – also invalidated in Town of Frederick case.

Any technical regulation of drilling, pumping, plugging, waste prevention, safety precautions, and environmental restoration.

MORATORIUMS

The law surrounding moratoriums on land use does not, for the most part, stem from any specific grant of power to local governments to place moratoriums on certain land uses or types of land use applications. Most of the law in this area has been created when landowners sue local governments alleging that the result of a moratorium on processing or granting land use applications amounts to a “regulatory taking” for which the landowner seeks monetary compensation. In general, a regulatory taking has not occurred when moratoriums have been enacted for a specified period of time, during which the local government is working on developing a regulatory land use planning framework within its power to adopt. A moratorium cannot be an end upon itself – it is a timeout that allows the local government to plan effectively for development. The United States Supreme Court has held that there is no set time period that is inherently reasonable or unreasonable for a moratorium. Instead, it has held that a compensatory taking occurs only where the delay amounts to an “extraordinary” circumstance.