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Kirkland Alert

## Passage of Senate Bill 19-181: New Era of Change and Uncertainty for Oil and Gas Operations in Colorado

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On April 3, 2019, the Colorado State Senate approved Senate Bill 19-181 (“SB 181” or the “bill”), marking the end of the bill’s whirlwind progress through the Colorado legislature. It now heads to Governor Polis for his anticipated signature in the near term. The final bill differs from the original in several significant respects; however, it still ushers in the most drastic changes to the regulatory landscape for oil and gas operations in state history.

Colorado’s top democrats in the General Assembly, House Speaker KC Becker and State Senate Majority Leader Stephen Fenberg, first introduced SB 181 on March 1, 2019. The democrats’ introduction of legislation aimed at oil and gas operations was not a surprise – Colorado’s newly elected democrats have supported stronger regulation of the oil and gas industry since before election day in 2018, and several recent developments in the courts and at the ballot box have only spurred calls to leadership for legislative reform. The bigger surprises were that such sweeping legislation was introduced without a broad stakeholder process and the speed at which the bill moved through the legislature.

Nevertheless, despite pressure from industry opponents who argued that any amendments would weaken the bill, the oil and gas industry secured some favorable amendments prior to the bill’s final passage. While these changes softened some aspects of the bill, the mandate to prioritize health, safety and the environment over resource production remains. A number of rulemakings will be required to implement the bill’s broad mandates, and state officials have promised to work with industry in pursuing these rulemakings; therefore, the final effect of Senate Bill 181 on industry remains to be seen.

Below is a summary of the background surrounding SB 181, the three fundamental aspects of SB 181 that change the regulatory framework in Colorado and key takeaways for consideration, along with a summary of concessions made to industry in the final bill.

## Background

SB 181 follows Colorado's move toward greater restrictions on oil and gas development in recent years and was an unsurprising direct response to recent political and judicial developments, including the democrats' recent sweep of all levels of government in the state. The principal regulator of oil and natural gas within the state, the Colorado Oil and Gas Conservation Commission ("COGCC" or "Commission"), traditionally worked with industry to strike a balance between competing interests of all stakeholders. This was largely because of the Oil and Gas Conservation Act's ("Act") mandate to "foster the responsible, balanced production, and utilization of the natural resources" of the state in a manner "consistent" with protecting public health, safety, welfare and the environment.

Over the last year, however, several changes have pushed state leaders to take swift legislative action to prioritize health and environmental issues over production in the regulation of oil and gas.

- In 2017, a fatal explosion in Firestone, Colorado resulting from an abandoned flow line began to galvanize support for further regulation of the industry.
- This led to a statewide ballot initiative, Proposition 112, which proposed a statewide 2,500-foot mandatory setback on the drilling and completions from homes, schools and other buildings.
- Proposition 112 was defeated in the 2018 election; however, a number of Colorado counties voted in favor of the measure. Representatives from these areas have been supportive of increased restrictions on the industry, and environmentalists continued to push for stricter setback requirements.
- Democrats, many of whom are vocally supportive of further restrictions on the oil and gas industry, also took control of the General Assembly and the governor's mansion in the election.
- A few months later, in January 2019, the state Supreme Court issued a decision in *Colorado Oil & Gas Conservation Commission v. Martinez* that reinvigorated tensions. Specifically, the Colorado Supreme Court reversed a lower court ruling that had concluded that the Commission should more heavily weigh public health, safety and

the environment when considering new drilling. Democrats in the state reacted negatively to this decision.

- As a result of these developments, it was widely expected that legislation increasing protection of public health and the environment and addressing climate change would emerge early this year, and it did – in the form of SB 181.

## What the Bill Does

SB 181 changes the regulatory framework for industry in three key ways:

1. Increases local control;
2. Elevates public health, safety and environmental concerns; and
3. Changes forced pooling and drilling and operating requirements.

### 1. Increases Local Control

Local governments' ability to regulate oil and gas development in Colorado has been an increasing source of controversy in the state. For years, Colorado courts recognized that the Act does not preempt a local government's authority to enact local land use regulations applicable to oil and gas development and operations, as long as such regulations do not conflict with state law or materially impede or destroy the state's interests in efficient production and development of those resources. SB 181 vastly increases the power of local governments, clarifying that local governments share regulatory power with the state and are free to regulate oil and gas more restrictively than the state does.

Industry proponents expressed fears that these changes would allow municipalities to use their power over siting approval to institute de facto bans or moratoriums on drilling and operations, and that municipalities could also use their regulatory powers over siting to influence operations in neighboring communities – a not unfounded fear in light of the temporary moratorium on new permits issued by Adams County in late March 2019. The final bill responds to these concerns in three ways: (1) it tempers local authority with a requirement that local regulations be “necessary and reasonable”; (2) it clarifies that local governments only have authority over surface impacts of oil and gas operations; and (3) it reiterates that local governments only have authority within their own jurisdiction.

## Takeaways: Local Government Control

- Expands local governments' jurisdiction over oil and gas operations
- Removes limitations on local governments to charge taxes or fees for inspections and monitoring
- Repeals an existing exemption that prevented local governments from regulating noise from facilities
- Clarifies that local governments have land-use authority to regulate the siting of oil and gas locations and to regulate land use and surface impacts, including the ability to inspect facilities and impose fines and fees
- Alters the permitting process by requiring operators to show that either the relevant local government has authorized their operations or the local government does not regulate siting before obtaining a permit from the COGCC
- Changes preemption law by specifying that local governments' regulations may be "more protective or stricter than state requirements"

## Concessions to Industry From Original Bill to Final Bill:

- Tempers local authority with a requirement that local regulations be "necessary and reasonable"
- Clarifies that local governments only have authority over surface impacts of oil and gas operations
- Reiterates that local governments only have authority within their own jurisdiction

## 2. Elevates Public Health, Safety and Environmental Concerns

The failure of Proposition 112 and the subsequent *Martinez* decision sparked pressure for legislative action to address health, safety and environmental concerns. The original bill sought to accomplish these legislative objectives by: overhauling the makeup of the COGCC; shifting the focus of the Act; requiring affirmative action on health, safety and environmental issues; and, reiterating the power of other government bodies to regulate the industry to protect health, safety and the environment. While most of these changes to the Colorado regulatory framework survived the amendment process, the final bill contains key concessions to industry.

## Takeaways: Public Health, Safety and the Environment

- Elevates health and environmental issues by stating that the intent and purpose of the Act is to permit oil and gas production “subject to the protection of public health, safety, and welfare, the environment, and wildlife resources and the prevention of waste”
- Changes the priorities of the Act and the Commission from one of fostering responsible development of resources to “regulating” oil and gas development to “protect” public health, safety, welfare, the environment and wildlife resources
- Gives the Commission authority to prevent a broader range of health and environmental impacts, not just those that are “significant”
- Clarifies that the COGCC has authority over oil and gas issues, but other government bodies have jurisdiction to regulate air and water pollution; hazardous, radioactive, and exploration and production waste disposal; and siting
- Removes considerations of cost effectiveness and technical feasibility when taking action to mitigate impacts to wildlife
- Changes the definition of “waste” to permit non-production of oil and gas to protect health and safety
- Directs the Air Quality Control Commission to adopt rules to minimize emissions of methane and other hydrocarbons and nitrogen oxides from the entire oil and gas fuel cycle, and establish a list of hazardous air pollutants
- Requires the COGCC to adopt rules to:
  - require alternate location analyses for oil and gas facilities proposed to be located near populated areas, and to evaluate and address the cumulative impacts of development in consultation with the Department of Public Health and Environment;
  - address abandoned/inactive wells and to ensure proper well head integrity of wells;
  - require worker safety certification for certain workers who deal with compliance or whose work involves materials that could pose a risk to public safety

#### Concessions to Industry From Original Bill to Final Bill:

- Professionalizes the COGCC by making Commission positions governor-appointed, senate-confirmed, full-time, and paid and downgrading the members who must have environmental or wildlife experience from two to one
- Clarifies that the Commission may only “delay” permit applications until a limited number of rules become effective (specifically those relating to the (i) protection of health and the environment, (ii) alternative location analyses, and (iii) flow-line disclosure and inactive well management), and requiring that the Commission’s

decision to reject a permit be based on “objective criteria” published after a public comment period

- Requires the consent of surface owners on permit-specific conditions for wildlife habitat protection that directly impact their property
- Defines “minimize adverse impacts” as “the extent necessary and reasonable, to protect public health, safety, and welfare and the environment, and wildlife resources”
- Provides a technical review process to assist with siting disputes between local governments and operators
- Requires only that the Air Quality Control Commission review its existing rules and consider “more stringent provisions”
- Requires that the COGCC enact rules amending the Commission’s flowline and inactive, abandoned and shut-in well rules only “to the extent necessary” to ensure that the rules “protect and minimize adverse impacts to public health, safety, welfare, and the environment”

### 3. Changes Forced Pooling and Drilling and Operating Requirements

SB 181 also alters forced pooling and several drilling and operating requirements, which will likely increase costs for operators. Except for moderate modifications to forced pooling requirements, none of these provisions changed during the amendment process.

As introduced, SB 181 attempted to strike a balance by continuing to allow the practice of forced pooling but making it more difficult to force non-consenting individuals into forced pooling agreements, and providing non-consenting owners with more rights and a greater royalty. To achieve this balance, the original bill required the consent of 50% of the mineral interest owners. This figure was lowered to 45% in the amendment process, however, in response to industry concerns that many companies’ ability to drill in the Front Range would have been compromised by a 50% standard. The amendments also modified the original bill’s proposed royalty increases.

#### Takeaways: Pooling and Drilling and Operating Requirements

- Raises the threshold for the number of mineral rights holders that need to give their approval before drillers can tap a shared pool of oil and gas from just one to 45% of the mineral-rights owners

- Requires mineral-rights owners to obtain local government authorization or show that the local government does not regulate siting before obtaining a pooling order
- Specifies that operators cannot use the surface owned by a non-consenting owner without the non-consenting owner's permission
- Raises a non-consenting owner's royalty rate during the payback period from 12.5% to 13% for gas wells and from 12.5% to 16% for oil wells
- Alters the permitting process by requiring operators to show that either the relevant local government has authorized their operations or the local government does not regulate siting before a permit can be obtained from the COGCC
- Requires financial assurance sufficient to provide adequate coverage to plug all abandoned wells and comply with all current and future rules passed pursuant to the Act
- Removes caps on fees that operators must pay before obtaining a permit

Concessions to Industry From Original Bill to Final Bill:

- Modified the pooling percentages and royalty rates to be more conservative

## Senate Bill 181 Takeaways

On paper, SB 181 appears to dramatically change the regulatory landscape for oil and gas operations within Colorado. However, here are some key overall takeaways:

- The full effects of SB 181 remain to be seen because the final regulatory regime is dependent on a number of post-enactment rulemakings under the leadership of a new, professional Commission
- As a result of industry pressure, state officials have promised to work with industry during these rulemakings
- Although SB 181 empowers communities to regulate oil and gas in a way they never could before, communities where the majority of development occurs are heavily dependent on oil and gas operations and are unlikely to wield their newfound power in a manner that would harm industry
- Stakeholders should therefore closely track and monitor future rulemakings at the local and state level, and consult with counsel and consultants in order to evaluate and participate as warranted in such rulemaking processes

For additional questions regarding the implications of Colorado's Senate Bill 181, please contact one of the authors listed below.

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## Practices

- [Energy & Infrastructure](#)

# Suggested Reading

- [27 March 2019 Press Release Kirkland Counsels HG Energy on \\$400 Million Pending Sale of Gas Assets to Diversified Gas & Oil](#)
- [26 March 2019 Kirkland Alert FERC Considering Major Update to Energy Infrastructure Investment Policies](#)
- [26 March 2019 Award The Deal Awards Middle Market 2019](#)

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