



Todd Staples

Staples Testimony
Texas Sunset Commission Hearing
Railroad Commission
August 22, 2016

Good afternoon, I'm Todd Staples, President of the Texas Oil and Gas Association ("TXOGA"). TXOGA is a non-profit corporation representing the interests of the oil and natural gas industry in the State of Texas. The membership of TXOGA produces in excess of 90 percent of Texas' crude oil and natural gas, operates nearly 100 percent of the state's refining capacity and is responsible for the vast majority of the state's pipelines. The oil and natural gas industry not only produces the products we use every day; it also anchors our state's economy. In 2015 Texas' oil and natural gas industry paid \$13.8 billion in state and local taxes and state royalties that directly fund our schools, roads and emergency services.

I appreciate the opportunity to be before you today. We applaud the work of the Sunset Commission staff and that of the Railroad Commission to undertake this arduous and meaningful sunset process. TXOGA supports the continuation of the Railroad Commission. A strong, robust state agency to oversee the oil and natural gas industry is essential to ensure the safety and wellbeing of all Texans as well as the economic strength of our state. Good regulation promotes safety, protects the environment and grows jobs.

When you, as Sunset Commission members, are determining what recommendations to make to the legislature, TXOGA strongly urges you to consider how controversial and detrimental to the sunset process the inclusion of the Railroad Commission name change recommendation has been in the past. I say detrimental because rather than focusing on the issues that affect the day-to-day operations, the name issue – which has no merit on the operations of the agency – hijacks the process. The Railroad Commission name change should be moved out of the sunset process and should be looked at and debated in a separate piece of legislation. For the record, TXOGA is neutral on the name change.

When discussing the contested case process, it is important to keep at the forefront that the Railroad Commission is constitutionally and statutorily charged with:

[Type here]

promoting conservation of mineral resources; protecting surface and groundwater resources and the environment; ensuring public safety in pipeline transportation; protecting correlative rights of mineral interest owners; preventing waste of natural resources; and assuring fair and equitable services and rates by Texas intrastate utilities and pipelines. The contested case process is one of the most essential functions for the Railroad Commission to be able to carry out these duties. The Railroad Commission is the only agency that is bound to carry out all of these important duties and TXOGA disagrees with the Sunset Staff recommendation to move the hearings.

Moving contested case hearings to SOAH and away from the commission provides no enhanced consumer protections of any kind, what so ever. Furthermore, moving the hearings totally dismantles the current regulatory structure that is protecting our environment and has made Texas the best state to do business.

The contested case proceedings allow the Commission to interpret and enforce Statewide Rules, which are promulgated by the Commission. It is important to note that cases involving exceptions may be termed "contested cases," but do not involve a protestant challenging a certain application. In those proceedings, an applicant may provide scientific evidence to support a requested exception to those rules. A technical examiner reviews scientific evidence presented by an applicant to determine if an exception is appropriate. Roughly 40% of contested case hearings do not involve a protestant.

Scientific expertise is required to evaluate the evidence. The Railroad Commission's hearing panels consist not only of a lawyer, but also an engineer or geologist capable of understanding petroleum engineering, geologic, geophysical and land issues, which are unique to the Railroad Commission's hearing determinations. Therefore, we believe the effectiveness, efficiency, and case law established should continue at the Railroad Commission and not be removed. Doing so would weaken the strong, science-based approach that is working and working well. Further, we support transparency, and implementing a docket management system would go a long way to bringing visibility to this process.

TXOGA also disagrees that changes need to be made to the current bonding requirements to plug abandoned wells. The Oil Field Cleanup Fund is funded by the Texas oil and natural gas industry in the form of production fees, filing fees,

[Type here]

enforcement actions and penalties. Absolutely no burden is placed on individual Texas taxpayers and no taxpayer dollars are used to finance the Oil Field Cleanup Fund.

There is also a misconception about what constitutes an abandoned well. The Railroad Commission refers to Delinquent Inactive Wells and of those only 1,265 are considered orphaned and are on the plugging list. Within this group, a priority list is established to immediately address wells with environmental concerns.

Additionally, I would like to comment on oil and natural gas enforcement and monitoring at the Commission. You will see in our written comments to the Sunset Commission, we agree with some of the recommendations on Recommendation 3. However, we do not agree with Recommendation 3.2 that the Commission should develop a process for issuing expedited penalties for minor violations because the Commission currently has the authority to shut down an operator for any violation. The Commission can issue an order to sever pipeline access for operators, which prohibits the operator from producing, selling hydrocarbons, or otherwise using any of the wells under the order until the violation has been corrected.

The last issue I would like to highlight before closing is TXOGA's support for Sunset Staff recommendations on improved oversight of Texas's pipeline infrastructure helping further ensure public safety.

Again, thank you for the opportunity to be before you today. The oil and natural gas industry is an important economic driver for this state and spends literally billions of dollars yearly to protect and improve the environment. A strong regulatory agency overseeing the industry is vital. The legislature should continue to give the agency the tools it needs to continue to ensure the public safety. I'm happy to answer any questions.



Jonny Jones
Chairman

D. Todd Staples
President

May 13, 2016

The Honorable Larry Gonzales
Chairman, Sunset Advisory Commission
P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Van Taylor
Vice Chairman, Sunset Advisory Commission
P.O. Box 12068 – Capitol Station
Austin, Texas 78711

RE: Sunset Staff Report on the Railroad Commission of Texas

Dear Chairmen:

The Texas Oil and Gas Association (“TXOGA”) appreciates the opportunity to comment on the Sunset Commission staff recommendations on the Railroad Commission of Texas (“RRC”). Texas’ oil and natural gas industry is the lifeblood of our economy in terms of jobs, economic activity and state and local tax revenue. As the primary regulatory body overseeing the oil and natural gas industry in Texas, the RRC embraces a stable, science-based regulatory approach that is protecting the environment, promoting responsible production and growing the economy.

TXOGA supports the continuation of the RRC. The RRC has met the challenges of an evolving oil, natural gas, mineral, and energy industry with extraordinary sophistication and skill. The oil and natural gas industry is one of the most regulated industries in the state. The RRC oversees all aspects of drilling activity such as well spacing, well design including depth of casing and cement, groundwater protection during drilling and completion, water protection, wastewater handling and disposal, as well as operation and public safety.

We applaud the work of the Sunset Commission staff and that of the RRC to undertake this worthwhile process. While we agree with many of the items recommended, we do have concerns with several of the recommendations, some of which have been included in previous Sunset reviews of the RRC. Our full comments are attached. When formulating RRC Sunset Legislation, it is TXOGA’s position that controversial issues such as the Railroad Commission name change and moving contested cases to the State Office of Administrative Hearings be debated in legislation that is separate from the continuation of the agency.

Thank you for your consideration of these items.

Sincerely,

A handwritten signature in black ink that reads "Todd Staples".

Todd Staples
Attachment

Issue 1 – Continue the Railroad Commission of Texas for 12 Years With a Name That Reflects the Agency’s Important Functions.

1.1 Change the name of the Railroad Commission of Texas to the Texas Energy Resources Commission and continue the agency for 12 years.

TXOGA agrees with the recommendation to continue the Railroad Commission (“RRC”) for 12 years. The RRC has met the challenges of an evolving oil, gas, mineral, and energy industry with extraordinary sophistication and skill. The agency’s unique understanding of technical and regulatory issues facing the industry have allowed Texas to remain a leader in the energy world.

TXOGA believes the RRC should continue its unique mission to conserve and develop Texas mineral resources and protect the valuable property rights of Texas citizens. Specifically the agency is charged with: promoting conservation of oil, gas, geothermal, and mineral resources; protecting surface and groundwater resources and the environment; ensuring public safety in pipeline transportation and underground storage; protecting correlative rights of mineral interest owners; preventing waste of natural resources; and assuring fair and equitable services and rates by Texas intrastate utilities and pipelines.

Moreover, the RRC plays a vital role in preserving private property rights in Texas. Mineral rights are private property rights owned in place subject to the “Rule of Capture.” The RRC has been given the duty to administratively ensure that owners do not waste the resource by drilling as many wells as they can to drain a formation. At the same time, the regulations of the RRC protect the correlative rights of other owners in a formation from any owner that would otherwise “capture” all the minerals through wasteful production practices. No agency other than the RRC plays such an important role in the protection of private property rights.

TXOGA strongly believes in moving the debate of the RRC name change out of the sunset process. If pursued, TXOGA would recommend addressing the name change of the commission in legislation separate from the Sunset legislation.

Issue 2 – Contested Hearings and Gas Utility Oversight Are Not Core Commission Functions and Should Be Transferred to Other Agencies to Promote Efficiency, Effectiveness, Transparency, and Fairness.

2.1 Require use of the State Office of Administrative Hearings for contested gas utility cases.

TXOGA disagrees with this staff recommendation. The Gas Services Division personnel have committed to enhancing efficiency in gas utility rate regulation since its creation. Yet they are not the first step in what is already a long and costly process; to change rates for customers within a city's limits, a gas utility must first apply to the city government. When a city and a utility can't agree on a proposed gas rate change, either may appeal to the Commission, which will then set the rates. In 2001, the Legislature authorized the transfer of contested gas utility cases to the SOAH, yet the following legislative session the Legislature reversed itself and moved hearings back the RRC. By using the State Office of Administrative Hearings (SOAH), an additional layer of bureaucracy is created, therefore increasing time and costs, borne ultimately by the consumer, associated with rate regulation. We

agree with the Legislature's recent action to maintain this function within the agency. Moving it to SOAH is not good policy.

2.2 Require the Railroad Commission to use the State Office of Administrative Hearings for all other contested case hearings.

TXOGA disagrees with this staff recommendation. To add to our comments in 2.1, we believe the RRC to be a significant agency, given the economic impact the oil and gas industry has in the State. The agency is tasked with overseeing contested cases that are very important to the development of oil and natural gas. The agency possesses the in-house resources and expertise to effectively and efficiently administer hearings as it has done for more than a 100 years.

It is important to note the agency's charge is to regulate the exercise of private property rights in oil and natural gas. In doing so, its responsibility is to prevent waste and protect the public and environment and it is empowered to conduct investigations, hold hearings, and issue orders. In carrying out this responsibility, staff, including administrative law judges, technical examiners, and support staff, have become specialized and well-educated in the hearing and resolution of contested cases involving the unique regulation of private property rights of oil and natural gas.

Time is of the essence when regulating the exploration and production of oil and natural gas because of timetables set forth in private agreements between mineral owners and operators. In the event of contested matters, the agency is poised to quickly resolve the issues because of its focus and experience on these cases. The agency's technical and legal staff are an integral part of the regulatory process of the agency and provide expert analysis and evaluation in the resolution of contested cases.

We see no benefit to moving such a critical function to another agency, in fact, the RRC would lose important cost sharing functions and economies of scale should this recommendation be enacted, which would lead to a degradation of other remaining important functions. Texans cannot afford to dissect such an important and functioning agency.

2.3 Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.

TXOGA disagrees with this staff recommendation. The RRC has regulated the oil and natural gas industry for more than a century from well head and beyond, and its extensive knowledge of all aspects of the industry is invaluable in gas utility regulation. While the Public Utility Commission (PUC) may have ratemaking experience, the RRC has expertise in the oil and gas industry as well as in the setting of gas utility rates. It makes sense to maintain continuity in all state-related facets of its regulation.

We believe it is also important to note the distinct differences between the basis for pipeline rates and distribution rates. Distribution system rates are service-based, whereas most rates for pipelines are negotiated or market-based, and to our knowledge the PUC has no experience in this type of ratemaking.

Issue 3 – Oil and Gas Monitoring and Enforcement Need Improvements to Effectively Ensure Public Safety and Environmental Protection.

3.1 Require the Railroad Commission to develop a strategic plan for the Oil and Gas Division that tracks and measures the effectiveness of monitoring and enforcement.

TXOGA is supportive of improved evaluation and analysis with clear and specific parameters. The recommendation, however, appears to overlap existing strategic planning requirements and has vague references which need better definition. We agree consistent evaluation of program effectiveness is important; however, the requirement of a strategic plan appears to create an undue burden on the agency as all state agencies are required to submit an agency strategic plan every two years. We would encourage utilizing the state's existing strategic planning process as the venue to identify how the agency will monitor and measure its enforcement effectiveness. Additionally, consideration should be given to adhering to the Commission's "minor, significant, and major" classification when tracking and reporting violations.

3.2 Require the Railroad Commission to develop in rule a process for issuing expedited penalties for minor violations.

TXOGA disagrees with requiring the Railroad Commission to develop in rule a process for issuing expedited penalties for minor violations. While we support bolstering the Railroad Commission's credibility on regulation as well as ongoing efficiencies, the recommendation appears to encourage establishment of new penalties. We are not supportive of new penalties as the current process is comprehensive and is designed to fully ensure safety, accountability and compliance. We believe that, unless these rules are developed through an appropriate legislative process this provision would lead to significant numbers of appeals of penalties when they are issued, leading to more time spent on potentially expensive appeals processes and distracting from the mission of the RRC without any improvement to the system. The Railroad Commission has extensive processes to levy fines and penalties, and the need to expand these processes is not justified.

Additionally, we would appreciate clarification on the compliance-based nature of the process and a clear understanding of whether the fines in this recommendation would be from initial notices or on unresolved rechecks.

3.3 Direct the Railroad Commission to accurately track and report the number of oil and gas violations annually.

TXOGA agrees with this recommendation. However, we would like to emphasize the need for timely reporting of the information to operators and the ability to retrieve this information via self-directed queries. We also would like to call to attention the need for education of the public and media, in order to reflect an accurate perception of the reporting in this recommendation. It is important to be clear to the public that there are significant differences between a "non-compliant minor violation" and a "significant safety or pollution violation."

3.4 Direct the Railroad Commission to systematically track major violations.

TXOGA believes the agency currently accomplishes this recommendation.

3.5 Direct the Railroad Commission to develop a definition of repeat violations in rule and report the number of repeat violations on its website.

TXOGA disagrees with the recommendation to develop new measures of repeat violations and the reporting requirements regarding these new measures as information such is already available online at <http://www.rrc.state.tx.us/oil-gas/compliance-enforcement/enforcement-activities>.

We are also unsure if this provision is necessary as it seems to divert from, rather than support, the compliance-based nature of the program. We are concerned about the definition of “repeat violations” as potentially disjointed with the compliance-based nature of the program. Feedback on leading indicators helps to prevent more serious violations.

3.6 Direct the Railroad Commission to audit a sample of oil and natural gas production reports and transportation reports.

TXOGA supports this recommendation.

3.7 Direct the Railroad Commission to develop a policy to require production reports to be filed electronically.

TXOGA supports the recommendation to require production reports to be filed electronically. The transition to full electronic filing would likely not be difficult, and the benefits to the state likely outweigh the costs of moving to electronic filing. However, we would encourage the agency to allow adequate time for operators who are not currently filing electronically to have a phase-in schedule to adequately update their systems in order to meet this requirement.

3.8 Direct the Railroad Commission to expand its risk matrix for oil and gas inspections.

TXOGA supports this recommendation as long as agency staff has the flexibility to adapt to changing industry activities and high risk behaviors to optimize the Commission’s effectiveness.

Issue 4 – Insufficient and Inequitable Statutory Bonding Requirements Contribute to the Large Backlog of Abandoned Wells.

4.1 Amend blanket bond requirements in statute to better reflect risk and increase equitability.

TXOGA disagrees with this recommendation. TXOGA strongly believes that the RRC has the necessary financial assurances in place designed to fund oil field clean up needs. The blanket bonding requirements were *never* meant to pay 100% of the costs to plug abandoned oil and gas wells. TXOGA believes the expectation has always been that the bonds would cover only a portion of the plugging costs. Bonding coupled with inactive well management requirements, well plugging requirements, and plugging funds from the Oil Field Cleanup Fund are all necessary components to ensuring wells are plugged. The Oil Field Cleanup Program is funded almost exclusively by Fees on production, filing fees, enforcement actions and penalties imposed on the oil and gas industry operating in Texas (a slight

amount of funding comes from interest earned on the principal as well as a small amount from federal funds). Importantly, absolutely no burden is placed on individual Texas taxpayers and no taxpayer dollars are used to finance the fund.

Ironically, if the current bond amounts were to be raised, it would pose a substantial risk of inducing the opposite result from that which is intended. This is because a significant amount of small and medium size operators would be forced out of business due to their inability to comply with the new bond requirements. Thus, their newly orphaned wells would become the responsibility of the Oil Field Cleanup Fund putting an unfair and disproportionate burden on the remaining operators.

Through the bonding, regulatory requirements and the Oil Field Cleanup Fund, the mechanisms are in place to ensure wells are plugged in accordance with their risk. The broader question lies not in the financial assurances currently in place for this program, but the overall agency funding mechanism particularly in a downturn to ensure agency funding and attention is not diverted from its intended purpose.

For background:

Explanation of bonding requirements:

A person required to file a P-5 Organization Report (P-5), under the Texas Natural Resource Code §91.142 and Commission rules, must also execute and file a bond, letter of credit or cash deposit. The P-5 bond is a license/permit surety bond. P-5 bonds are required to ensure different aspects of operating and abandoning oil or gas wells are managed and/or completed in accordance to Texas laws and regulations. There are two options available under which a person would be considered a “Bonded Operator” under Commission rules: Option 1 – an individual performance bond, letter of credit or cash deposit covering only wells (amount calculated by multiply the depth of all wells by \$2/ft); or Option 2 – a blanket performance bond, letter of credit or cash deposit covering wells and/or other oil and gas operations (amount ranging from \$25K-250K based on total number of wells operated). An operator of bay and/or offshore wells must provide additional entry level bonding of \$60,000/well for inactive bay wells or \$100,000/well for inactive offshore wells. The amount is determined by base amount + entry level amount + non-producing amount.

In addition to P-5 bond, there are financial security requirements for inactive wells. An operator must submit a Form W-3X- Application for an Extension of Deadline for Plugging an Inactive well. There are 3 blanket extension options: Option A – operator has plugged or restored to active status 10% of the number of inactive wells operated at the time of the last annual renewal of the operator’s P-5 Organization report; Option B – operator is a publicly traded entity and has filed with the Commission documentation naming the operator as “debtor” and the RRC as the “secured creditor” and specified the funds covered by the documents in the amount of the cost calculation for plugging all inactive wells; or Option C – operator has submitted additional financial security covering the amount of the cost calculation for plugging all inactive wells or \$2 million, whichever is less.

Keep in mind, there is no revenue to the RRC at the time bonds are secured. It is not until the bond is collected due to default by the operator, that money is accessible to the RRC.

Fees on Industry for Oil-Field Cleanup Fund

Sec. 81.070. ESTABLISHMENT OF SURCHARGES ON FEES. (a) Except as provided by Subsection (b), the commission by rule shall provide for the imposition of reasonable surcharges as necessary on fees imposed by the commission that are required to be deposited to the credit of the oil and gas regulation and cleanup fund as provided by Section 81.067 in amounts sufficient to enable the commission to recover the costs of performing the functions specified by Section 81.068 from those fees and surcharges.

Sec. 81.116. OIL-FIELD CLEANUP REGULATORY FEE ON OIL. (a) An oil-field cleanup regulatory fee is imposed on crude petroleum produced in this state in the amount of five-eighths of one cent on each barrel of 42 standard gallons.

Sec. 81.117. OIL-FIELD CLEANUP REGULATORY FEE ON GAS. (a) An oil-field cleanup regulatory fee is imposed on gas initially produced and saved in this state in the amount of one-fifteenth of one cent for each thousand cubic feet.

Issue 5 – Improved Oversight of Texas’ Pipeline Infrastructure Would Help Further Ensure Public Safety.

5.1 Authorize the Railroad Commission to enforce damage prevention requirements for interstate pipelines.

TXOGA agrees with this recommendation. The Railroad Commission has long had the ability, expertise and knowledge to perform this responsibility. This is displayed currently in their oversight of intrastate pipelines. However, while we agree with the recommendation, we would suggest there are details to conveyance of authority that are not as simple. All stakeholders should be included in the process, and a deadline should take into account the time required to address any statutory or rule changes. Ultimately, TXOGA wants to ensure and reinforce the safety of pipelines operating in the state.

5.2 Authorize the Railroad Commission to create a pipeline permit fee.

TXOGA agrees with this recommendation. The creation of a pipeline permit fee would support the Railroad Commission’s pipeline safety program, as long as the fee is solely used for the administration of the pipeline safety and gas pipeline regulatory programs.

5.3 Modify language in the General Appropriations Act to further ensure that the Railroad Commission collects, and is appropriated back, fee amounts to offset the costs of administering its Pipeline Safety program, including administration costs.

TXOGA agrees with this Sunset staff recommendation. This recommendation is vital, otherwise ensuring the safety of Texans could be compromised by denying the Railroad Commission the resources needed to perform the responsibility.

Issue 6 – The Railroad Commission’s Contracting Procedures Are Improving, but Continued Attention Is Needed.

Recommendations

6.1 Direct the Railroad Commission to centralize all contract administration functions by September 1, 2016.

TXOGA agrees with this recommendation.

6.2 Direct the Railroad Commission to implement and keep updated contracting best practices as outlined by recent legislation and the comptroller.

TXOGA agrees with this recommendation.

6.3 Direct the Railroad Commission's executive director to report quarterly to the commissioners at their open meetings regarding the status of contracting improvements.

TXOGA agrees with this recommendation.

Issue – The Railroad Commission's Statute Does Not Reflect Standard Elements of Sunset Reviews.

7.1 Apply the Sunset across-the-board recommendation regarding alternative dispute resolution to the Railroad Commission.

TXOGA disagrees with this recommendation. The alternative dispute resolution should not apply to the rule-making process, but rather should only apply to circumstances that do not have a clear and established process in place. Texas law has significant rulemaking requirements in place today which provide for public comment and input. RRC rules already permit the use of alternative dispute resolution techniques for certain activities, such as mediation, as codified in Texas Administrative Code Title 16 Part 1 Chapter 20 Subchapter A Division 2, Title 16 Part 1 Chapter 12 Subchapter G Division 11, and Title 16 Part 1 Chapter 2.

7.2 Allow the Oil and Gas Regulation and Cleanup Fund Advisory Committee to expire.

TXOGA agrees with this recommendation. Specifically, TXOGA agrees with the Sunset staff's assessment that the Railroad Commission staff routinely tracks and reports on the Oil and Gas Regulation and Cleanup Fund to the railroad commissioners and the Legislature.

7.3 Continue requiring the Railroad Commission to submit its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature.

TXOGA agrees with this recommendation. The information provided in the Railroad Commission report on the Oil and Gas Regulation and Cleanup Fund is a very informative and demonstrates the success of the program.