

RAILROAD COMMISSION OF TEXAS

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Agency at a Glance

The Railroad Commission of Texas serves as the State's primary regulator of the oil and gas industry. The Commission's mission is to ensure efficient production, safe transportation, and fair access to the state's energy resources, with minimal effects to the environment. To fulfill its mission, the Commission:

- oversees all aspects of oil and natural gas production, including permitting, monitoring, and inspecting oil and natural gas operations;
- permits, monitors, and inspects surface coal and uranium exploration, mining, and reclamation;
- inspects intrastate pipelines to ensure the safety of the public and the environment;
- oversees gas utility rates and ensures compliance with rates and tax regulations; and
- promotes the use of propane and licenses all propane distributors.

Summary

Despite its misleading name, the Railroad Commission regulates the state's oil and gas industry and has nothing to do with railroads. The clarity of its name matters as the Commission's job takes center stage in overseeing an unprecedented expansion of oil and natural gas drilling in the state. While clearly beneficial to Texas' economy, questions have been raised about the impact of this rapid growth on public safety, groundwater, and local roads and infrastructure. With these challenges in mind, the Sunset Commission concluded having a transparent and objective regulator is more important now than ever.

Having three statewide-elected Commissioners also raises questions regarding the Commissioner's regulatory role versus their need to solicit campaign funds. With campaigns requiring millions of dollars and an increasing majority of these funds coming from the regulated community, the public needs assurance that the Commission's regulatory decisions are made in the public's interest. The Sunset Commission adopted several recommendations to address these concerns.

Ensuring the effective functioning of the Commission's recently expanded authority to self-fund its operations is also important to having a regulatory

With the recent boom in production, having a transparent and objective regulator is more important now than ever.

agency that can keep pace with a growing industry. Based on Sunset's recommendation, the Legislature enabled the Commission to self-fund its Oil and Gas program in 2011. However, exponential growth in oil and gas production may soon put the Commission at risk of exceeding the \$20 million cap on this funding.

For pipeline safety, the Commission relies on a back-end fee paid by gas utility customers, with no front-end fee on pipeline operators to obtain a permit. This approach limits the Commission's ability to cover its costs to ensure appropriate public safety and oversight of a growing network of oil and gas pipelines.

Inadequate enforcement efforts, a concern raised in 2011 by the Sunset Commission, led to Railroad Commission initiatives to beef up its enforcement processes, with higher penalties for repeat and serious violations. While no clear-cut impact of these changes could be measured as yet, clear statutory direction would help to ensure these efforts continue. The following material summarizes each of the Sunset Commission's recommendations regarding the Railroad Commission, including several recommendations brought forward from the previous Sunset review in 2011.

Issue 1

Changing the Railroad Commission's Name and Addressing the Appearance of Conflicts of Interest Remain Critical to Ensuring Transparent and Effective Regulation.

The Railroad Commission's name does not reflect its duties, is unclear to the increasing number of people coming into contact with oil and gas production, and confuses voters about the duties of the three Commissioners the public elects on a statewide basis. The Sunset Commission also expressed concern about the potential for conflicts of interest when these elected individuals rely significantly on the industry they regulate for campaign contributions. Accepting contributions from parties with contested cases before the Commission poses a particularly egregious conflict. Another concern stems from Commissioners running for other offices while still serving on the Railroad Commission, diverting time and attention from their full-time jobs at the agency.

Recommendations

Change in Statute

1.1 Change the name of the Railroad Commission of Texas to the Texas Energy Resources Commission and continue the agency for 10 years.

This recommendation would continue the agency in the same capacity, renamed to ensure increased transparency for its primary role in overseeing energy resource exploration and production in Texas — eliminating confusion regarding any ongoing role with railroads, as it has none. Continuing the Commission for 10 years, rather than the standard 12-year period, would keep the agency's Sunset review aligned with other related agency reviews. As part of this recommendation, the Commission must develop a policy that encourages alternative dispute resolution and negotiated rulemaking, a standard Sunset Across-the-Board Recommendation.

1.2 Limit the solicitation and receipt of campaign contributions by a Commissioner or any candidates seeking the office to a year and a half timeframe around the election, rather than throughout the full six-year term.

Commissioners and any candidates seeking office as a Commissioner would be limited to soliciting and receiving campaign contributions in an 18 month period, starting 17 months before the election and ending one month after the election. This structure would provide adequate time for fund raising before the primary and general elections, while not allowing fundraising throughout the person's full six-year term. This timeframe also complies with existing prohibitions against accepting contributions during the time around a regular legislative session.

1.3 Prohibit a Commissioner from knowingly accepting contributions from a party with a contested case before the Commission.

This prohibition would apply to political committees affiliated with parties with a contested case before the Commission. This timeframe would extend from the date the hearing is set until the 30th day after the hearing ends. Commission staff would keep a running list of active contested cases, along with the parties to the case, to facilitate compliance with this requirement. Any contribution accepted by mistake must be returned.

1.4 Require the automatic resignation of a Commissioner that announces or becomes a candidate for another elected office.

This recommendation would include announcing or becoming a candidate for an elected office in any general, special, or primary election, other than a run for reelection to the Commission. Commissioners opting to run for other office have to resign from their full-time jobs at the agency. Commission members would be allowed to run for other offices in the last 18 months of their terms.

1.5 Require the Commission to develop a policy in rule to prohibit and ensure against any inadvertent ex-parte communications between hearing examiners and the Commissioners, and hearing examiners and technical staff who are parties to a contested case.

With in-house hearing examiners, the potential for inadvertent ex-parte communications is clear. Having a policy in rule to specifically prohibit such communications would help ensure against such biases impacting the fair and impartial role of the hearing examiner in overseeing and making recommendations in a contested case before the Commission.

Management Action

1.6 Direct the Commission to review its recusal policy, and revise as necessary to ensure Commissioners' awareness of, and compliance with, its requirements.

This recommendation would ensure the Commission revisits its standards, requirements, and procedures for recusal of a Commissioner. Clarifying when Commissioners must recuse themselves would help avoid any appearance of bias based on a personal or financial interest in an item up for decision.

Issue 2

Self-Funding of the Oil and Gas Program Is Working Well, But Would Benefit From Removal of the \$20 Million Cap on the Oil and Gas Regulation and Cleanup Fund.

Based on a Sunset recommendation, the 82nd Legislature authorized the Commission to levy surcharges to make its Oil and Gas program self-supporting, and decreased the amount of General Revenue the Commission receives to correspond with these increases in surcharges. While these changes to the Commission's funding sources are working well, the Oil and Gas Regulation and Cleanup Fund has outgrown the purpose of its \$20 million statutory cap. The Fund's cap also restricts the Commission from increasing statutorily authorized surcharges to adequately fund its oil and gas regulatory and cleanup operations. In addition, the Sunset Commission found that the Oil Field Cleanup Fund Advisory Committee has served its purpose and is no longer needed.

Recommendations

Change in Statute

2.1 Eliminate the cap on the Oil and Gas Regulation and Cleanup Fund.

Without a funding cap, the Commission would still only be allowed to spend funds at the level appropriated by the Legislature. To ensure transparency, the Commission would continue to produce its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature and the Legislative Budget Board and to place this report on its website.

2.2 Abolish the Oil Field Cleanup Fund Advisory Committee.

This recommendation would repeal statute that establishes the Advisory Committee and the requirement for the Committee to provide information on the administration of the Oil Field Cleanup Fund. Instead, the Commission would provide this information through its report on the Oil and Gas Regulation and Cleanup Fund.

Issue 3

The Commission's Current Pipeline Safety Fee Does Not Cover the Program's Costs, Limiting the Agency's Ability to Ensure Public Safety Within a Growing Oil and Gas Industry.

Unlike the Railroad Commission's Oil and Gas program, the Commission's Pipeline Safety program is not entirely self-funded. Instead, the program is funded with a combination of pipeline safety fees, paid by natural gas utility customers, and General Revenue. Pipeline operators applying for a permit must provide information on the pipeline's location, mileage, and type of fluid transported, which the Commission uses to help ensure public safety. However, the Commission does not have authority to assess a fee for operating a pipeline, limiting the Commission's ability to ensure public safety and oversight of a growing industry.

Recommendations

Change in Statute

3.1 Authorize the Commission to create a pipeline permit fee to help support its Pipeline Safety program.

This new permit fee would provide a mechanism for the Commission, based on legislative appropriations, to generate additional revenue to better ensure public safety by hiring sufficient field inspectors, and to make information technology improvements to meet the needs of a growing oil and gas industry. The Commission would establish a methodology for developing the fee that reflects the time needed to perform the regulatory work associated with permitting pipelines; the impact of the permit fee on operators of all sizes; and other factors it considers important. The Commission would assess the fee based on the mileage of pipeline, the number of new and renewed permits, the number of amended permits, the number of pipeline systems, or any other factor that enables the Commission to equitably and efficiently recover its costs.

Change in Appropriations

3.2 Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the costs of administering its Pipeline Safety program, including administration costs and benefits.

This recommendation would add new rider language in the Commission's appropriation pattern to require that the pipeline safety and pipeline permit fees, and any other miscellaneous revenue associated with the Pipeline Safety program cover, at a minimum, all program costs including direct and indirect administrative costs as well as benefits.

Issue 4

While Changes Have Begun, the Commission Continues to Need Statutory Direction to Improve Its Enforcement Processes.

One of the key findings of the Sunset Commission in 2011 was that the Railroad Commission's enforcement efforts were sorely lacking. Although recommendations to strengthen its enforcement failed to pass during the 2011 session, the Railroad Commission took action on its own to adopt penalty guidelines in rule, field test a more aggressive enforcement policy, and track and publish enforcement data on its website. However, the Sunset Commission concluded that statutory direction is still needed to ensure an ongoing focus on and full implementation of the Commission's new enforcement efforts, particularly in regards to going beyond simple compliance for serious violations and better deterrence of repeat violators.

Recommendations

Change in Statute

4.1 Require the Commission to develop an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.

While the Commission is developing a new policy, this recommendation would ensure the agency includes specific processes for classifying violations based on the risk to public safety or the risk of pollution. The Commission would adopt standards to guide field staff on which type of violations to

appropriately dismiss and which to forward for enforcement. The Commission's standards must take into account an operator's previous violations and compliance history when determining whether to forward a violation.

4.2 Require the Commission to formally adopt penalty guidelines.

Even though the Commission has adopted penalty guidelines, placing this requirement in statute would help ensure the Commission maintains such guidelines in the future. The Commission would obtain public input when considering penalty amounts based on their risk and severity, making full use of higher penalties for more serious and repeat violations. In addition, the Commission must consider the number of times a violator has had a lease severed when determining a penalty amount.

Issue 5

The Commission's Promotion of Propane Is No Longer Necessary.

The Commission licenses businesses and individuals that supply, transport, or distribute propane to ensure its safe delivery to both commercial and residential users. In addition, the Commission promotes the use of propane as an alternative fuel, primarily through a rebate program that provides financial incentives to purchasers of propane appliances. The Commission funds the rebates by charging a delivery fee on the sale of propane gas.

The Sunset Commission found that the Railroad Commission's promotion of propane poses a conflict with its role as a regulator of propane. In addition, other state and national organizations promote propane, making the Railroad Commission's efforts duplicative and unnecessary, especially as, in the end, these extra marketing costs simply increase the cost of propane to the consumer.

Recommendation

Change in Statute

5.1 Eliminate the Commission's statutory authority to promote the use of propane and to charge a delivery fee for this purpose.

This recommendation would also dissolve the Alternative Fuels Research and Education Division dedicated account, which houses these propane funds. The Commission would continue to administer, until completed, its current propane-related grants and could continue to apply for such grants; provided that each grant covers the agency's associated administrative costs.

These changes would not impact the Commission's ongoing propane licensing activities and the Propane Alternative Fuels Advisory Committee would continue to develop ideas for training and testing of propane licensees. However, the Advisory Committee's statutory authority to advise the Commission on the promotion of propane would be eliminated.

Issue 6

Texas' Interstate Pipelines Lack Damage Prevention Oversight Needed to Ensure Public Protection.

Texas has more than 214,000 miles of pipeline, including both *intrastate* pipelines that run within the state and *interstate* pipelines that connect to other states. To help ensure public safety, Texas established

a damage prevention program to educate excavators and operators and take enforcement action when violations occur. However, the Commission only has statutory authority over intrastate pipelines. Thus, the Commission's damage prevention program does not extend to interstate lines, leaving a large and potentially dangerous regulatory gap.

Recommendation

Change in Statute

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

This recommendation authorizes the Commission to extend its damage prevention rules to interstate as well as intrastate pipelines, and to enforce violations affecting both types of pipelines. This approach extends administrative penalty authority to excavators and operators that violate damage prevention rules on interstate lines. The Commission would deposit these penalties in the General Revenue Fund, as it does with penalties from its intrastate pipeline damage prevention program.

Issue 7

The Commission's Mineral Pooling and Field Spacing Hearings Lack Certain Procedural Safeguards for Mineral Owners.

The Mineral Interest Pooling Act allows the Commission to pool mineral interests for a particular oil or natural gas well under certain circumstances. The Commission's process for informing mineral owners affected by an application for pooling uses outdated and highly technical language, resulting in potential confusion and a general lack of understanding of how to engage in contesting a permit. In addition, mineral owners seeking to protest a pooling permit do not have the option of requesting a local hearing on the matter.

Another concern is that applicants for field spacing exceptions may withdraw their permit at any time, without penalty, adding further burden to the mineral owner who may be forced to travel multiple times to Austin for hearings that never actually occur. Travelling to Austin is time consuming and costly, posing a potential disincentive for mineral owners or land owners wanting to participate in Commission hearings

Recommendations

Change in Statute

7.1 Authorize a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled.

This recommendation authorizes a mineral owner or other party affected by forced pooling to request a local hearing, instead of having to attend a hearing at the Commission's central office in Austin. Further, the Commission could hold such hearings by telephone if both parties agree.

Management Action

7.2 Direct the Commission to develop a fee schedule for increased charges associated with re-filing previously withdrawn applications for forced pooling or field spacing exceptions.

The Commission should develop an increased fee for those applicants who re-file applications for forced pooling or field spacing exceptions, when they have previously submitted and withdrawn an application set for hearing without giving proper notice. As part of this recommendation, the Commission would develop the timeframe as well as the fee associated with re-filing an application under these circumstances.

7.3 Direct the Commission to study the use and development of telecommunication technology designed to increase the transparency of, and the public's participation in, agency hearing processes to ensure the rights of mineral owners and land owners in the state of Texas.

This recommendation directs the Commission to research and develop a plan to increase the use of technology for affected parties in the agency's hearing process.

Issue 8

The Railroad Commission's Key Reporting Requirement Continues to Serve a Useful Purpose.

The Texas Sunset Act directs the Sunset Commission to recommend the continuation or abolishment of each reporting requirement established in law for an agency under review. The Sunset Commission determined that the Railroad Commission addresses three of its four reporting requirements in one report, the *Report on the Oil and Gas Regulation and Cleanup Fund*, and this report should be continued. The fourth one, the *Report on the Oil Field Cleanup Fund Advisory Committee*, is no longer needed and should be eliminated, as is provided for in Recommendation 2.1.

Recommendation

Change in Statute

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

This recommendation would continue this one comprehensive report to address three reporting requirements.

Fiscal Implication Summary

These recommendations would have a net positive fiscal impact to the State of about \$2.55 million in fiscal year 2014 and about \$1.5 million each year after, as summarized below.

Issue 1 — Changing the agency's name would have no significant fiscal impact as the Commission would phase in these changes over time using existing resources.

Issue 3 — Authorizing a new pipeline permit fee would have a savings of about \$1.5 million to the General Revenue Fund. Revenue from the newly created pipeline permit fee would be used to offset the general revenue the Legislature currently appropriates to the Commission for its Pipeline Safety program.

Issue 4 — Requiring the Commission to develop an enforcement policy and penalty guidelines would likely generate additional revenue from penalties, which are deposited in the General Revenue Fund. However, the fiscal impact of these changes could not be estimated because penalty amounts generated would depend on the number and seriousness of future violations.

Issue 5 — Eliminating the propane promotion program and associated fee would result in no net fiscal impact, but would result in the elimination of four FTEs. In addition, eliminating the program's associated dedicated account would result in a one-time gain to General Revenue of about \$1.05 million because all remaining funds in the account would roll into General Revenue Fund 1.

Railroad Commission of Texas

| Fiscal Year | Savings to the General Revenue Fund 1 | Change in Number of FTEs From FY 2013 |
|--------------------|--|--|
| 2014 | \$2.55 million | -4 |
| 2015 | \$1.5 million | -4 |
| 2016 | \$1.5 million | -4 |
| 2017 | \$1.5 million | -4 |
| 2018 | \$1.5 million | -4 |

