Executive Summary

Railroad Commission of Texas

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Few agencies are as steeped in the Texas mystique as the Railroad Commission. Created 125 years ago at a time when regulating rates and operations of railroads made it arguably one of the most important and powerful government agencies in the country, the commission's profile grew still higher when it assumed responsibility for regulating oil and gas production and associated pipelines. In its heyday, the actions of the Railroad Commission largely determined the global price of oil. This heightened profile was not limited to the commission, but also extended to individual commissioners. State office buildings have been named for railroad commissioners.

Transparency demands that the agency's name reflect its actual mission.

But the world has changed. While the commission still regulates oil and gas drilling and production, it has not overseen railroads in many years. Capitol insiders know this, but the average citizen, busy with the demands of everyday life, most assuredly does not. Additionally, while the commission continues to establish production allowables and seeks to prevent waste of natural resources, its actions no longer control oil markets or oil prices as they once did. Today, the commission is also concerned with other aspects of the energy industry, including preventing pollution, well plugging and site remediation, and other activities like pipeline safety and damage prevention, surface mining of coal and uranium, rate regulation of gas utilities, and regulation of alternative fuels.

During the Sunset review, the Railroad Commission commemorated its 125 years with a celebration attended by past commissioners, and retrospectives of its history. The agency and its place in history should be a source of pride for the commission and its hardworking staff and for the regulated oil and gas industry. But instead of looking back to its storied past, the agency now needs to look forward to the challenges of regulating energy resources in an environment of continued urbanization, water concerns, and possible seismic activity.

For the Railroad Commission to even be under Sunset review is a direct challenge to the commission's status quo. Intense and pointed debate in the waning days of the 2015 legislative session rejected a proposal to delay the agency's review until 2021 and instead culminated in this third Sunset review of the agency since 2010. Such frequent review is hard on agency staff who have their own important jobs to do in addition to attending to the needs of the Sunset review. It also heightens interest in having a positive review and a "clean" Sunset bill that will finally pass the Legislature. However, the Legislature did not suggest such limitations and directed a full review of the agency with detailed requirements to examine alternative organizational structures and assess whether other state agencies would be able to perform the commission's functions.

Sunset staff followed the Legislature's direction in conducting its review. The recommendations in this report aim to better prepare and position the agency to achieve its important mission. Enactment of a bill in the next legislative session to reauthorize the commission for 12 years would be a start. However, probably the most important change to provide transparency is to let the people of Texas in on what this agency does by having its name accurately reflect its mission. Recommendations in Issue 1 would continue the agency and change its name to the Texas Energy Resources Commission, while fully addressing the constitutional, federal delegation and cost concerns that have ensnared past efforts to achieve this simple transparency improvement.

The other recommendations would help the agency better focus on its core regulatory activities without having to replicate hearings and utility rate functions that are so capably administered by the State Office of Administrative Hearings and the Public Utility Commission of Texas. These recommendations would also provide needed tools for an improved, more strategic enforcement program that makes the best use of limited staff resources; provide a fairer, updated approach to making operators responsible for plugging abandoned wells; provide needed resources for pipeline safety; address damage prevention related to pipelines; and ensure agency contracting improvements stay on track.

Some of these changes have been suggested in previous Sunset reviews of the Railroad Commission. This approach reflects the continuing need for better and more efficient ways for Texas to regulate the oil and gas industry, and is not a reflection of Sunset staff simply maintaining a semblance of consistency with past recommendations. The following material highlights Sunset staff's key recommendations on the Railroad Commission of Texas.

Issues and Recommendations

Issue 1

Continue the Railroad Commission of Texas for 12 Years With a Name That Reflects the Agency's Important Functions.

Sunset staff determined that the functions of the Railroad Commission of Texas continue to be needed, and that a standalone agency is warranted to carry out these functions. However, two of these functions would be more efficiently placed at other agencies. Issue 2 reflects these transfers. Further, if the commission is continued, its name remains problematic. The agency's outdated name misleads the public and continues to impede the agency's efforts to be more transparent. Changing the commission's name to the Texas Energy Resources Commission would help resolve these issues.

Key Recommendation

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

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.

Statute charges the Sunset Commission with reviewing overlapping programs and their potential for consolidation, and statute further requires Sunset's current review of the Railroad Commission to assess state agencies that would be able to perform the commission's functions. Both the State Office of Administrative Hearings (SOAH) and the Public Utility Commission of Texas (PUC) not only have clear expertise to perform the same or similar functions the Railroad Commission currently conducts, they specialize in these functions. SOAH provides a neutral and independent forum to conduct contested hearings for nearly 60 agencies. Although the Railroad Commission has taken steps to restructure its in-house hearings function, the fairness of its contested proceedings is clouded by ongoing ex parte concerns and the commission's in-house judges' lack of independence, and the commission fails to adequately track its hearings performance.

In addition, PUC provides state-level regulation of all utilities other than gas utilities, which are currently regulated by the Railroad Commission. PUC focuses on utility ratemaking and has developed an organizational structure and systems to ensure fair and transparent ratemaking. PUC's expertise has grown even more in recent years since the Legislature transferred regulation of water and wastewater utilities to PUC beginning in 2014. Transferring gas utility regulation from the Railroad Commission to PUC offers significant benefits from aligning all state utility regulation within a single agency.

Key Recommendations

- Require use of the State Office of Administrative Hearings for contested gas utility cases.
- Require the Railroad Commission to use the State Office of Administrative Hearings for all other contested case hearings.
- Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.

Issue 3

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

Despite the attention given to the Railroad Commission's oil and gas enforcement program in recent years, the agency continues to struggle to provide reliable data to show the effectiveness of its efforts. Basic questions such as how many severe violations occurred, what percentage of violations were repeat violations, and how many operators with severe violations did not face legal enforcement last year remain unanswered. The commission's emphasis on getting operators to take corrective action to come into compliance with its requirements certainly has merit, but falls short of providing incentive for operators to comply without first having to be told by the commission's limited field staff. What information is available suggests that the commission's actions have little deterrent effect and that its main enforcement tool — severing a lease to stop production — may well be weakened because of inadequate cross checks to ensure compliance with the severance. Requiring the Railroad Commission to demonstrate the effectiveness of oil and gas enforcement through performance measures and to use existing resources strategically addresses concerns raised through this review and through the 2011 and 2013 Sunset reviews.

Key Recommendations

- 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.
- Require the Railroad Commission to develop in rule a process for issuing expedited penalties for minor violations.
- Direct the Railroad Commission to accurately track and report the number of oil and gas violations annually.
- Direct the Railroad Commission to develop a definition of repeat violations in rule and report the number of repeat violations on its website.
- Direct the Railroad Commission to audit a sample of oil and natural gas production reports and transportation reports.
- Direct the Railroad Commission to develop a policy to require production reports to be filed electronically.

Issue 4

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

Since 2004, the Legislature has required all oil and gas well operators to provide financial assurance, referred to as bonding, to cover a portion of the cost to plug the well and remediate the site, should the operator go out of business. The revenue from these required bonds covered just 15.9 percent of the cost to plug wells in fiscal year 2015. These insufficient statutory bond requirements have left the Railroad Commission with less funding to plug wells and increased liability, as the cost to plug wells has more than doubled since the bond amounts were set in 1991, diverting commission funding that could have been used for other needed program improvements. In addition, the backlog of abandoned wells has increased since 2011 to 9,715 wells. While the question of funding levels for well plugging is an appropriative decision, the review identified a problem with the bonding structure. The current statutory blanket bond structure does not account for risk of well abandonment and places a disproportionate share of bond coverage per well on oil and gas producers who operate fewer than 19 wells. Increasing the number of blanket bond tiers and decreasing the bond requirements for operators with fewer wells would increase equitability and better reflect risk.

Key Recommendation

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

Issue 5

Improved Oversight of Texas' Pipeline Infrastructure Would Help Further Ensure Public Safety.

Sunset staff found that the Railroad Commission requires additional statutory authority to more effectively protect public safety. Neither the federal government nor the Railroad Commission enforces damage prevention rules for interstate pipelines. This regulatory gap limits Texas' ability to fully enforce damage prevention rules. Additionally, while the Railroad Commission has required pipeline operators to receive a permit from the agency to operate a pipeline for almost 100 years, it has never had the authority to have operators pay a permit fee to support this function.

Key Recommendations

- Authorize the Railroad Commission to enforce damage prevention requirements for interstate pipelines.
- Authorize the Railroad Commission to create a pipeline permit fee.

Issue 6

The Railroad Commission's Contracting Procedures Are Improving, but Continued Attention Is Needed.

The Railroad Commission depends on contracting to carry out essential functions, including state-funded well plugging, site remediation, and information technology improvements. While most individual contract amounts are relatively small, almost 40 percent of the agency's fiscal year 2015 expenditures were on contracted activities. Sunset staff found that the Railroad Commission is actively implementing policies to improve contracting procedures, but ongoing effort to institutionalize these improvements will ensure this momentum continues.

Key Recommendations

- Direct the Railroad Commission to centralize all contract administration functions by September 1, 2016.
- Direct the Railroad Commission to implement and keep updated contracting best practices as outlined by recent legislation and the comptroller.
- Direct the Railroad Commission's executive director to report quarterly to the commissioners at their open meetings regarding the status of contracting improvements.

Issue 7

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

Among the standard elements considered in a Sunset review are provisions that the Sunset Commission applies across the board to all state agencies under review designed to ensure open, responsive, and effective government. The Railroad Commission's governing statute does not include a standard provision relating to alternative dispute resolution that would help improve rulemaking and resolution of other disputes. In addition, the Texas Sunset Act states that advisory committees are abolished on the date set for abolition of an agency unless the committee is expressly continued by law. Sunset staff found that the Oil and Gas Regulation and Cleanup Fund Advisory Committee has not met in more than four years and should be allowed to expire. The Sunset Act also directs the Sunset Commission to recommend the continuation or abolishment of each reporting requirement imposed on an agency under review. Sunset staff found that the Oil and Gas Regulation and Cleanup Fund report continues to be needed.

Key Recommendations

- Apply the Sunset across-the-board recommendation regarding alternative dispute resolution to the Railroad Commission.
- Allow the Oil and Gas Regulation and Cleanup Fund Advisory Committee to expire.
- Continue requiring the Railroad Commission to submit its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature.

Fiscal Implication Summary

Overall, recommendations in two issues would result in an increase of almost $4.1 million in revenue to the state over the next five years. Two additional recommendations could potentially result in an overall five-year positive impact on the General Revenue Fund of more than $18 million. The fiscal implication of each recommendation is summarized below.

Issue 3 — The recommendation to begin requiring production reports to be submitted to the Railroad Commission electronically by September 1, 2018, would save the Oil and Gas Regulation and Cleanup Fund $46,835 annually because a contractor would no longer be needed to scan reports submitted on paper. The recommendation to develop a process for issuing expedited penalties could add about $2.7 million annually to the General Revenue Fund beginning in fiscal year 2019. This figure is based on the number of sign violations issued in fiscal year 2015 and a penalty of $250 to $500 per violation, including the agency's standard 50 percent discount, but the actual revenue gain would depend on the violations the agency chooses to include in the new expedited penalty process.

Issue 4 — Changing the tier structure of required blanket bonds would increase the amount of money the Railroad Commission collects from those bonds and deposits in the Oil and Gas Regulation and Cleanup Fund by almost $900,000 in 2019 and then $1.3 million annually thereafter. The recommendation would not take full effect until January 1, 2019, resulting in the smaller amount in 2019.

Issue 5 — Authorizing the Railroad Commission to establish a pipeline permit fee could result in a $1.8 million annual savings to general revenue beginning in fiscal year 2019, but the actual amount of savings would depend on the fee amount set by the agency.

Railroad Commission of Texas

Fiscal Year	Revenue Gain to the Oil and Gas Regulation and Cleanup Fund	Savings to the Oil and Gas Regulation and Cleanup Fund
2018	$0	$0
2019	$886,373	$46,835
2020	$1,329,559	$46,835
2021	$1,329,559	$46,835
2022	$1,329,559	$46,835