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STATE AND LOCAL REGULATION OF OIL & GAS OPERATIONS IN COLORADO

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THE NATIONAL EMPHASIS ON development of domestic oil and gas resources, combined with dramatic advances in production technology and a favorable market, have pushed oil and gas production in Colorado to record levels. This has resulted in more Colorado municipalities being confronted by the challenge of local oil and gas development. This paper is intended to provide a general introduction to state and local regulation of oil and gas operations in Colorado for municipal officials and staff. It is not intended as an exhaustive legal analysis, and it should not serve as a substitute for advice from the municipal attorney.

Introduction

In Colorado, the ownership of the surface of land is often "severed" from the subsurface, or "mineral estate," which is owned by someone else. The severed mineral estate can be sold or leased, just like the surface estate. Furthermore, the mineral estate is "dominant" over the surface estate, meaning that a surface owner cannot prevent the subsurface owner from making reasonable use of the surface property to access and develop the underlying minerals. The terms of a mineral owner's access to the surface estate usually are secured through a "surface use agreement," addressing matters such as revegetation, access roads, wellhead security, tank battery access, and so forth.

Like a surface owner, Colorado municipalities have had to deal with the necessity that oil and gas activity occur where the resource is located. Until recently, the well had to be located on the surface directly above the area that must be drilled to fully develop the resource. This prerogative of the oil and gas industry has resulted in industrial land use occurring in residential, school, and other areas where it is unexpected, and has been the source of conflict between municipal residents and this industry.

State regulation

Drilling and production of oil and gas are subject to regulations promulgated by the Colorado Oil and Gas Conservation Commission (COGCC). The traditional focus of COGCC rules has been the technical and operational aspects of how a well is drilled and operated. In recent years, the commission's authority has been broadened, with the result that rules now also address protection of the environment and wildlife, and compatibility with other surface uses.

Until recently, COGCC regulations and enforcement had little credibility with local government. The commission was viewed widely as dominated by the industry that it regulated; indeed, the industry enjoyed a voting majority of seats on the commission itself. In 2008, following enactment of legislation to reconstitute the commission and reduce industry influence, the COGCC conducted a top-to-bottom rewrite of the state's oil and gas regulations. As a result, regulations that once were not taken seriously are now viewed as among the most stringent in the nation. While the substantive credibility of the state's rules has improved, the limitations of the COGCC's field enforcement capability continues to be of concern for many local governments.

Local regulation

Oil and gas development is first and foremost an industrial land use. As with any other land use, citizens look to their local governments to assure protection of health and safety, protection of property values, and compatibility of surface uses. As noted above, the right of this industry to locate where the resource is found has given rise to friction between drillers and municipal residents. Beyond bare application of local special or conditional use permit requirements, many jurisdictions have developed their own local oil and gas regulations, often citing a lack of confidence in either the substance of COGCC rules or in the field enforcement presence of state inspectors. Municipalities have developed requirements addressing local concerns such as noise, odors, fencing, lighting, and good housekeeping at the well site. As one might expect, concerns about protection of surface and groundwater, and avoidance of surface contamination, are paramount. It is not uncommon for municipalities suddenly confronted with drilling applications to adopt a moratorium on processing the applications until the requisite permitting and regulatory structure is put in place.

Conflict over state and local regulation

As the COGCC's regulatory program began to address more and more matters within the traditional land-use jurisdiction of local government, the industry began to argue, in a series of court cases, that the General Assembly, in conferring regulatory authority on the commission, had eliminated or "preempted" all local authority over oil and gas, leaving no room for local regulation.

The Colorado Supreme Court rejected this argument. The court held in *Board of County Commissioners of La Plata County v. Bowen-Edwards*, 830 P.2d

1045 (1992) that the General Assembly did not intend to preempt local authority, either expressly or by implication, in its enactments granting power to the commission. In particular, the Supreme Court rejected (as have other courts since) so-called "same subject" preemption — the notion that locals are preempted from regulating anything that is the subject of a COGCC regulation. Both state and local regulatory schemes should be given effect, the Supreme Court said, and only when the local regulation "operationally conflicts" with fulfillment of the state's interest in full development of the resource will the local requirement be preempted. To show "operational conflict," the court directed that a "fully developed evidentiary record" must demonstrate that the local rule, in operation, "materially impairs" or" destroys" the state's interest. The Supreme Court emphasized in its ruling that the interests of the state in full development of the resource are not so "patently dominant" over local interests as to foreclose the possibility of a harmonious application of both state and local rules.

Since the Supreme Court's pronouncements in 1992, the basic law concerning limits on local authority in the oil and gas area has not fundamentally changed. Several court of appeals decisions have found provisions of various local ordinances preempted by reason of "operational conflict." These decisions, while flawed by a lack of analysis or citation to a "fully developed evidentiary record," nonetheless raise questions about municipal authority to regulate particular matters. These somewhat confusing decisions, together with the Supreme Court's declared "ad hoc" approach to determining "operational conflict" preemption questions, has led to what many practitioners describe as a legal "grey area," as to the limits of local regulatory authority. There does seem to be a general consensus that the highly technical, mechanical aspects of well drilling and operation, subject to what often is referred to as "down-hole" regulation, is probably outside local authority. This could include, for example, regulation of how the process of hydraulic fracturing, or "fracking," is conducted, as this occurs thousands of feet "down hole." Also clearly prohibited are outright bans on drilling within a municipality. Residents of Greeley initiated such an ordinance by petition, but the Colorado Supreme Court overturned it, finding that the Greeley ordinance was preempted because it materially impaired the state's interest in full development of oil and gas resources.

The legal grey area concerning the reach of local regulation means that concern over whether proposed local rules "go too far" will continue to be a common topic of discussion as these rules are developed. Fortunately, the successful example of other jurisdictions provides guidance for municipalities new to the oil patch and can help such municipalities avoid reinventing the wheel.

What is in the toolbox?

Municipalities confronted with oil and gas development in their jurisdictions now have the benefit of decades of experience of other municipalities. These municipalities have utilized a variety of means to balance the competing interests involved, some of which are discussed below.

Land use/police power regulation
This is the most conventional approach to addressing oil and gas development, and by far the most widely used. Most jurisdictions utilize some sort of land use permitting process for this industrial use, usually issuing a "special use" or "conditional use" permit. These permits contain various requirements relating to oil and gas development. Many municipalities also have developed local regulations addressing various impacts of this type of land use. Such regulations often stir controversy, to the extent they are perceived to intrude into the legal grey area described above. Consequently, close consultation with the municipal attorney is always involved in the development of local oil and gas regulations.

Intergovernmental agreements
During the 2012 legislative session, Gov. John Hickenlooper appointed a task force of industry and public sector representatives (including CML) to identify cooperative approaches for state and local regulation of oil and gas development. One of the featured strategies was intergovernmental agreements (IGAs) between the COGCC and local governments relating to inspections.

Inspection IGAs are a way of addressing local concerns about the COGCC's field inspection capability. With recent staff additions, the commission will deploy 16 inspectors to oversee 50,756 active wells in Colorado — one inspector for every 3,172 active wells. The COGCC's goal is to inspect each active well once every three years. Many local governments, including those that consider the commission's rules to be substantively adequate, believe that a greater level of local oversight of these operations is required.

Under an IGA with the COGCC, a local inspector would have the same authority as a state inspector to enter a well site and inspect all aspects of the operation for compliance with COGCC regulations to the extent defined in the IGA. The governor's task force contemplated IGAs under which local inspectors could oversee compliance with all COGCC regulations or some subset of them — such as the rules concerning traditional areas of local interest (noise, odors, dust, etc.). The local inspector could notify the operator of apparent violations and, if necessary, refer apparent violations to the COGCC for enforcement. While ultimate enforcement authority remains with the commission, most alleged violations have been cured promptly upon notification of the operator, obviating the need for further enforcement.

Now that the COGCC rules enjoy far broader substantive credibility, the IGA route gives local governments one way to boost local oversight of this industry without necessarily adopting a local regulatory scheme (much as municipalities do with model building, electrical, plumbing, and other standard codes). Additionally, since the IGA involves inspection of local oil and gas operations for compliance with state requirements, the IGA arrangement is free of the jurisdictional questions and legal risks that can arise in connection with a local regulatory approach.

Inspection IGAs could conceivably have a multijurisdictional application, with several jurisdictions sharing the cost of a qualified well inspector.

Memoranda of understanding

A memorandum of understanding (MOU) is a contract between a local government and (in this context) an oil and gas operator. As a contract rather than an exercise of legislative power, an MOU reflects an agreement between the parties. Experience shows that operators may be willing to agree to all sorts of things that they might at the same time argue are beyond the government's authority to require by ordinance. Yet the terms of an MOU nonetheless create a legally enforceable obligation to the community (through their municipal government) on the part of the operator. As contracts, MOUs avoid the questions about jurisdiction and the legal grey area that are a feature of a local regulatory approach.

Many jurisdictions have a relatively small number of wells and an even smaller number of operators, often one or two. An MOU with the local operator may be a practical way to at once serve the public interest and work out expectations with the local operator.

CML is here to help

CML has a wide array of resources available regarding oil and gas operations, regulation, and agreements. We have put some oil and gas regulation resources on the CML website at www.cml.org/oil.aspx, including links to other useful sites. For questions that aren't answered online, contact CML General Counsel Geoff Wilson (gwilson@cml.org) or CML Law Clerk Abby Kirkbride (lawclerk@cml.org).