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COLORADO PASSES SWEEPING NEW LAW TO ALTER THE STATE'S OIL AND GAS REGULATORY FRAMEWORK

To Our Clients and Friends:

On April 16, 2019, the Governor of Colorado signed Senate Bill 19-181 (“**SB-181**”) into law, making sweeping changes to Colorado’s framework for oil and gas regulation.[1] SB-181 marks the latest attempt to manage growing tensions between Colorado’s oil and gas operators, who have seen crude oil production quadruple since 2010,[2] and fast-growing population centers along the Front Range, which includes suburbs of Denver along the I-25 corridor.[3]

SB-181 was enacted after last year’s unsuccessful ballot campaign for Proposition 112, which if approved by voters would have significantly curtailed oil and gas development in Colorado. Proposition 112 was a ballot initiative that would have required new oil and gas development to be subject to a 2,500-foot setback from occupied buildings and “vulnerable” areas, broadly defined to include water bodies and public spaces.[4] According to an impact assessment of Proposition 112 conducted by the Colorado Oil and Gas Conservation Commission (the “**COGCC**”), the state’s oil and gas regulatory arm, approximately 85% of the non-federal land in Colorado would have been unavailable for oil and gas production had Proposition 112 passed.[5] The oil and gas industry raised a record-setting \$38 million to help defeat the initiative, nearly doubling the previous fundraising record for a single group in a ballot initiative.[6] Ultimately, Colorado voters rejected Proposition 112 by a 56.1% vote.[7] At the same time, however, the 2018 election saw a so-called “blue wave” crash into Colorado, with Democrats taking control of the state Senate, expanding control of the state House, and sweeping every statewide election, including the races for governor, secretary of state, and attorney general.[8]

In the shadow of Proposition 112’s defeat by Colorado voters, the state’s newly elected lawmakers and legislative leaders pushed for an overhaul of oil and gas regulation in Colorado, culminating in Governor Jared Polis’s signing of SB-181 last week.[9] While SB-181 mandates a host of changes to oil and gas regulation in Colorado, three changes in particular may have a significant impact on future oil and gas development, each of which is discussed below. First, SB-181 grants local governments new power to regulate oil and gas development, including enhanced authority over surface activities. Second, SB-181 requires the COGCC to prioritize and emphasize the protection of public health, safety, and the environment in its regulations, which could lead to an adjustment of the balanced approach to regulation that the COGCC had been implementing over the past decade. Third, SB-181 alters Colorado’s mandatory pooling rules to make it more difficult to pool nonconsenting mineral interest owners into a drilling unit.

Increased Local Control of Oil and Gas Sites

Prior to the passage of SB-181, Colorado law explicitly limited the ability of local governments to regulate oil and gas development, and the Colorado Supreme Court had recognized the primacy of state regulation over oil and gas operations.[10]

SB-181 grants local governments significant new power to regulate the surface impacts of oil and gas development. Local governments that elect to regulate oil and gas operations can now control where oil and gas wells are located to minimize adverse impacts to public health, safety, and the environment.[11] The bill requires all operators to first file applications to approve well sites with local governments which opt into the local regulatory scheme and to include such applications with their drilling permit applications to the COGCC (or, if a local government opts out of the local regulatory scheme, to include proof that the local government does not regulate the siting of oil and gas wells).[12] Both local governments and oil and gas operators may ask the COGCC to appoint a technical review board to assess a local government's preliminary or final determination (or lack thereof) regarding an operator's well locations, but, notably, local governments are not required to consider the findings of a technical review board in making their final determinations.[13] Local governments can also inspect oil and gas facilities; impose fines for leaks, spills, and emissions; impose fees on operators to cover the costs of permitting, regulation, and inspection; and enforce operators' compliance with local noise ordinances.[14]

The authority granted to local governments by SB-181 could therefore significantly affect the balance in Colorado between statewide and local regulatory control of oil and gas operations. At the other end of the spectrum is Texas, where a local government's power to regulate oil and gas operations is expressly preempted by statute, except in limited circumstances.[15] Colorado's shift toward additional local control of oil and gas development may significantly increase local government oversight of oil and gas operators and may prompt some localities to explore ways to use their new authority to substantially limit, and perhaps effectively ban, drilling operations.

Shifts in Regulatory Priority

Prior to the passage of SB-181, the COGCC was tasked with ensuring that the efficient development of oil and gas resources in the state was balanced with other regulatory objectives. Colorado's Oil and Gas Conservation Act (the "**Act**") required the COGCC to "foster the responsible, balanced development, production, and utilization" of oil and gas resources to achieve the "maximum efficient rate of production" and to prevent "waste" of oil and gas.[16] The Act required that such development occur "in a manner *consistent* with protection of public health, safety, and welfare, including the protection of the environment and wildlife resources," but the Act also prioritized the controlled development of oil and gas in Colorado so as to maximize production.[17] Health and environmental impacts were an important consideration under existing legislation, but they were to be weighed against effective resource management.

SB-181 alters the COGCC's objectives, deemphasizing its role in promoting oil and gas development. The bill amends the Act to state that the COGCC's mission is to "regulate," not "foster," the efficient development of oil and gas "in a manner *that protects* public health, safety, and welfare,

including the protection of the environment and wildlife resources.”[18] While the COGCC may still pursue maximally efficient production, that goal is now “subject to” the protection of public health, safety, and the environment.[19] Further, SB-181 alters the definition of “waste” to specifically exclude the nonproduction of oil and gas if such nonproduction is necessary to protect public health, safety, and the environment.[20]

These shifts in regulatory priority could have a dramatic effect on the mission of the COGCC. By making the development of oil and gas resources subject to the protection of public health, safety, and the environment, SB-181 potentially requires the COGCC to adjust its balanced approach to regulation, through which it currently considers the efficient extraction of oil and gas weighed against other objectives. After SB-181, the COGCC may perceive its top priority to be the protection of public health, safety, and the environment.[21] Under SB-181, the COGCC must exercise its regulatory authority “in a reasonable manner to protect and minimize adverse impacts” to public health, safety, and the environment.[22] Furthermore, the changes to the definition of “waste” suggest that the COGCC may consider requiring nonproduction in some circumstances to fulfill its new regulatory focus.[23]

Changes in Mandatory Pooling Orders

Prior to the adoption of SB-181, Colorado law allowed “any interested person” to file an application with the COGCC to pool oil and gas resources within a particular drilling unit.[24] Colorado did not require a specific percentage of mineral interest owners to join in a pooling application; rather, any person with a mineral interest could seek a mandatory pooling order, including operators with lease or royalty interests. If the COGCC approved the interested person’s pooling application, mineral interest owners who did not consent to pooling were entitled to a 1/8th royalty from oil or gas production until cost recovery was achieved.[25] In addition, prior law did not restrict the operator from using the surface land of such nonconsenting owners for oil and gas operations.[26]

SB-181 makes it significantly more difficult for operators to obtain a mandatory pooling order and increases the burden on operators if a mandatory pooling order is granted. Colorado now joins several other oil and gas producing states in requiring a minimum percentage of the mineral interest owners to join a pooling application, requiring the consent of owners of 45% of the relevant mineral interests.[27] If a mandatory pooling order is granted, nonconsenting owners are entitled to a 13% royalty from gas wells and a 16% royalty from oil wells until cost recovery is achieved.[28] Finally, operators are specifically prohibited from using the surface land of a nonconsenting owner for oil and gas operations.[29] Given the often bitter debates among mineral interest owners in or near large metropolitan areas in Colorado, under these changes operators could find mandatory pooling orders more difficult to obtain.

Implementation Issues and Other Changes

Implementation provisions in the initial drafts of SB-181 caused significant alarm in the oil and gas industry. Early drafts of the bill allowed the COGCC to refrain from issuing any new oil and gas permits until the COGCC promulgated and implemented every new or revised rule required by SB-181.[30] Many in the oil and gas industry argued that this allowed the COGCC to establish a moratorium

on drilling lasting for months.[31] A later version of the bill removed COGCC’s ability to delay all new permits, however. The final version of the bill signed by Governor Polis allows the COGCC to delay its final determination regarding a permit application only if the COGCC determines pursuant to “objective criteria” that the permit application requires additional analysis to ensure the protection of public health, safety, and the environment.[32] The COGCC must make these criteria available for public comment within 30 days and, following the public comment period, the criteria will become effective.[33]

SB-181 makes several other important changes to oil and gas regulation in Colorado. The bill requires the COGCC to establish rules to minimize emissions of methane, volatile organic compounds, and nitrogen oxides and to consider adopting more stringent rules regarding emissions controls.[34] Previously, the COGCC had worked with state’s air quality regulator to establish emissions limits for the oil and gas industry. SB-181 also mandates changes in the composition of the COGCC itself. Prior to the bill’s passage, the COGCC consisted of nine members, three of whom were required to have substantial experience in the oil and gas industry.[35] Under the new law, the number of COGCC members who must have significant industry experience is lowered from three to one.[36] In addition, no later than July 1, 2020, the COGCC will be restructured to consist of seven members, none of whom may have “an immediate conflict of interest or who may not be able to make balanced decisions about oil and gas regulation in Colorado.”[37] Previously, all COGCC members on a part-time basis; now, five of the seven will serve on the Commission full time.[38]

Conclusion

SB-181 makes large-scale changes to the oil and gas regulatory landscape in Colorado. The bill shifts the state’s regulatory priorities away from fostering the efficient, balanced development of oil and gas; provides local governments with new and significant regulatory powers; and makes mandatory pooling orders significantly more difficult to obtain. As a consequence, the industry will be required to focus keenly on local politics in the areas in which they operate. The debate is not over, however. Ballot initiatives have already been proposed to repeal some or all of the new legislation, including some sponsored by resource-friendly local governments whose economies depend heavily on the oil and gas industry. Operators will also be closely monitoring the promulgation of new and revised state-level regulations required by SB-181 in an effort to anticipate and address some of its potentially strict effects. In the meantime, SB-181 provides oil and gas opponents significant new regulatory tools that could potentially slow oil and gas development in Colorado, especially near its major cities and suburban areas.

[1] <https://www.denverpost.com/2019/04/16/colorado-oil-gas-bill-signed-gov-jared-polis/>

[2] <https://www.eia.gov/state/analysis.php?sid=CO#21>

[3] <https://www.nytimes.com/2018/05/31/us/colorado-fracking-debates.html>

[4] <https://www.sos.state.co.us/pubs/elections/Initiatives/titleBoard/filings/2017-2018/97Final.pdf>

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- [5] https://cogcc.state.co.us/documents/library/Technical/Miscellaneous/COGCC_2018_Prop_112_Init_97_GIS_Assessment_20180702.pdf
- [6] <https://www.cpr.org/news/story/record-breaking-political-spending-swamps-colorado>
- [7] <https://elections.denverpost.com/results/county-break-down/?Prop-112/7618>
- [8] <https://www.5280.com/2018/11/a-blue-wave-crashes-into-colorado-in-the-2018-midterms/>
- [9] <https://www.denverpost.com/2019/04/16/colorado-oil-gas-bill-signed-gov-jared-polis/>
- [10] *City of Longmont v. Colo. Oil & Gas Ass’n*, 369 P.3d 573, 585 (Colo. 2016) (“The Oil and Gas Conservation Act and the Commission’s pervasive rules and regulations, which evince state control over numerous aspects of fracking, from the chemicals used to the location of waste pits, convince us that the state’s interest in the efficient and responsible development of oil and gas resources includes a strong interest in the uniform regulation of fracking.”).
- [11] Senate Bill 19-181 §4.
- [12] Senate Bill 19-181 §12.
- [13] Senate Bill 19-181 §12.
- [14] Senate Bill 19-181 §4.
- [15] Tex. Nat. Res. Code Ann. § 81.0523 (“The authority of a municipality or other political subdivision to regulate an oil and gas operation is expressly preempted, except that a municipality may enact, amend, or enforce an ordinance or other measure that: (1) regulates only aboveground activity ... (2) is commercially reasonable; (3) does not effectively prohibit an oil and gas operation ... and (4) is not otherwise preempted by state or federal law.”).
- [16] Colo. Rev. Stat. §34-60-102(1)(a)–(b)
- [17] *Id.* (*emphasis added*); *see also* <https://www.denverpost.com/2019/04/16/colorado-oil-gas-bill-signed-gov-jared-polis/>
- [18] Senate Bill 19-181 §6.
- [19] *Id.*; *see also* <https://leg.colorado.gov/bills/sb19-181>
- [20] Senate Bill 19-181 §6.
- [21] *See* <https://coloradosun.com/2019/04/16/senate-bill-181-oil-gas-law-colorado-signed/>; *see also* <https://www.law360.com/publicpolicy/articles/1150786/colo-law-expanding-oil-gas-rules-gets-gov-s-signature>

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- [22] Senate Bill 19-181 §18.
- [23] Senate Bill 19-181 §6.
- [24] Colo. Rev. Stat. §34-60-116(6)
- [25] Colo. Rev. Stat. §34-60-116(7)(c)
- [26] Senate Bill 19-181 adds this restriction.
- [27] Senate Bill 19-181 §14.
- [28] *Id.*
- [29] *Id.*
- [30] <https://www.natlawreview.com/article/know-primer-colorado-s-senate-bill-181>
- [31] *Id.*
- [32] Senate Bill 19-181 §12.
- [33] Senate Bill 19-181 §12.
- [34] Senate Bill 19-181 §3.
- [35] Colo. Rev. Stat. §34-60-104(2)(a)(I)
- [36] Senate Bill 19-181 §8.
- [37] Senate Bill 19-181 §9.
- [38] *Id.*



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