

NAVIGATING THE BATTLEGROUND STATE

The implementation of SB 181—Colorado’s controversial new oil and gas law—poses significant challenges for the state’s oil and gas industry. But savvy operators will continue to adapt to the regulatory landscape, as they have done successfully in the past.

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Colorado is in the midst of a heated battle to determine the future of oil and gas development in the state, with proponents and opponents of the industry clashing in recent years at the ballot box, in the courtroom and in the Colorado General Assembly.

These clashes have intensified as significant increases in oil and gas production in Colorado, which has nearly quadrupled since 2010, continue alongside fast population growth in Denver and its surrounding suburbs. The increased proximity of Denver’s residential areas to well pads has spawned attempts by industry opponents to curb oil and gas production through several different avenues, including:

- Proposition 112, a 2018 ballot initiative that would have required 2,500-ft setbacks for new wells across the state; and
- *Martinez v. Colorado Oil and Gas Conservation*, a lawsuit that, if successful, would have overturned more than a decade’s worth of rulemaking by Colorado’s primary oil and gas regulatory body, the Colorado Oil and Gas Conservation Commission (COGCC).

After the defeat of Proposition 112 in the fall of 2018, and after the Colorado Supreme Court maintained the regulatory status quo in its *Martinez* decision in early 2019, industry opponents shifted their focus to the legislative arena. In the 2018 elections, Democrats—many of them critics of the industry—gained simultaneous control of the governor’s office and both houses of the Colorado General Assembly. Anti-industry activists capitalized on these majorities in the 2019 legislative session, immediately introducing Senate Bill 19-181 (SB 181), which was signed into law by Governor Jared Polis on April 16, 2019.

SB 181 mandates a host of changes to oil and gas regulation in Colorado, either through the bill itself or through the formal rulemak-

ing processes at the COGCC and other state agencies, such as the Colorado Department of Public Health and Environment (CDPHE). SB 181 leaves the technical details to the COGCC and CDPHE, but the fundamental changes to Colorado’s regulatory landscape are contained in SB 181 itself. Of those changes, two in particular have caught the industry’s attention:

1. The shift in the COGCC’s overall regulatory mission and priorities; and
2. The new ability of local governments to directly regulate oil and gas production and impose restrictions that are more stringent than those found in statewide laws and regulations.

While these changes appear daunting, Colorado’s industry is accustomed to adapting to a changing regulatory landscape. In the years before SB 181, the state adopted dozens of precedent-setting regulations affecting all aspects of the production cycle, many of which were among the toughest in the country, and the industry continued to boom. As SB 181 is implemented at the state and local level, the industry will be required to stay engaged and nimble as rules are finalized and their operational impact becomes more clear.

COGCC mission change

SB 181 fundamentally transforms Colorado’s approach to oil and gas regulation by revamping the mission of the COGCC. For decades, the primary goal of the COGCC was to “foster” the efficient development of oil and gas resources within Colorado in a manner consistent with various other considerations, including public HSE. The COGCC sought to balance these other considerations against the development of oil and gas resources where possible, but the COGCC’s overall mission was clear: promote the efficient production of Colorado’s oil and gas.

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SB 181 recasts the COGCC's mission.

Rather than fostering oil and gas development—language that no longer appears in the statutory description of the COGCC's mission—the COGCC's primary goal is now to “regulate” oil and gas development “in a manner that protects public health, safety and welfare, including the protection of the environment and wildlife resources.” This new mission puts greater emphasis on the protection of public HSE, backing away from the regulatory “balancing” that once defined the agency's work and is the standard approach to government regulation of industries with environmental impacts.

The COGCC's new mission is echoed in the restructuring and professionalization of the new-era COGCC mandated by SB 181. The COGCC was historically composed of nine volunteer commissioners, of whom at least three were required to have extensive experience in the oil and gas industry. As of July 1, 2020, the COGCC will have seven commissioners, each of whom will be a full-time state employee, and, in keeping with SB 181's de-emphasis of oil and gas development, only one commissioner will be required to have industry experience.

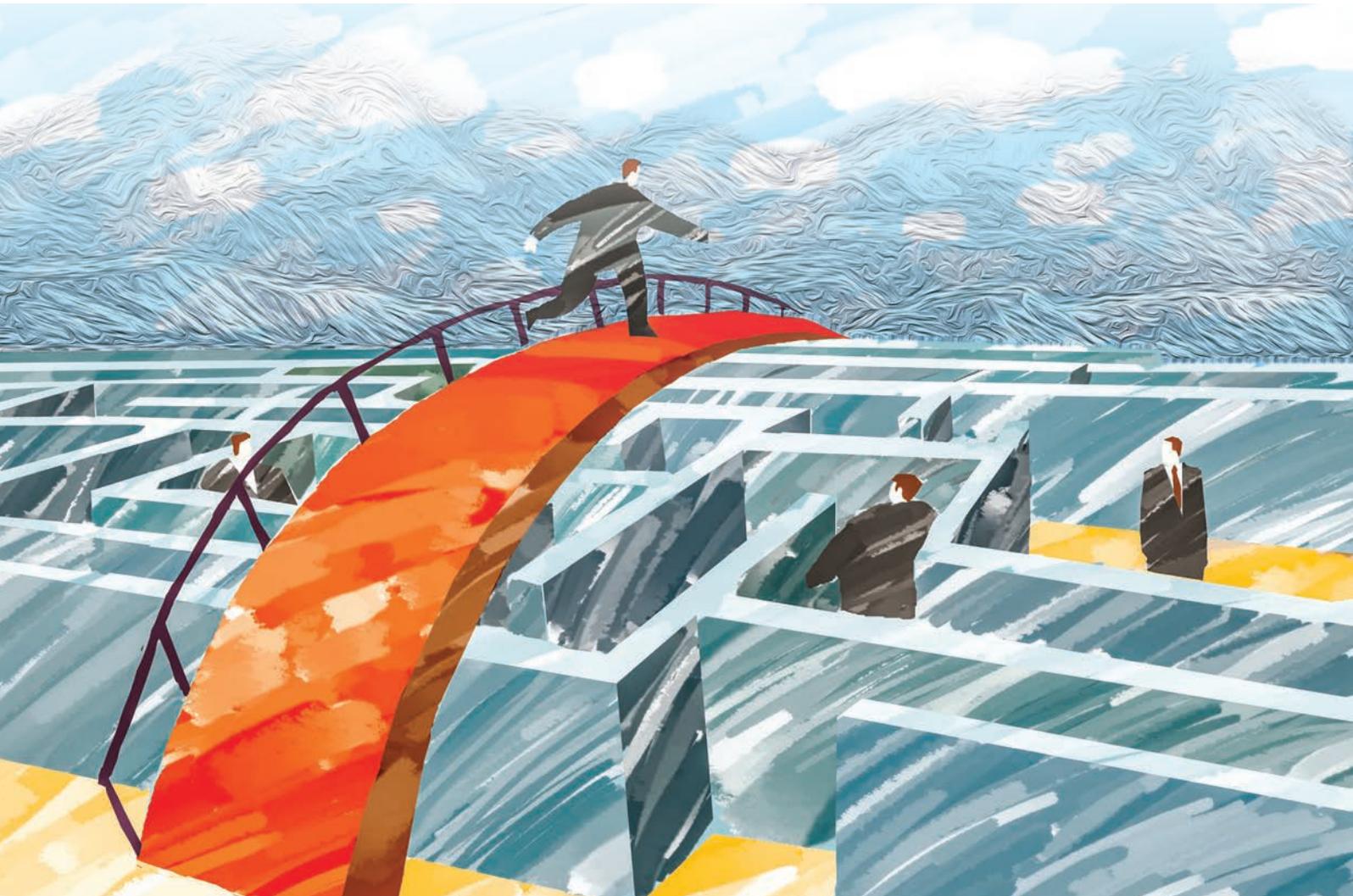
SB 181 also requires the COGCC to adopt regulations that reflect its new mission. The COGCC had intended to complete all of its rulemaking processes (including the mission change rulemaking process) prior to the

COGCC's restructuring on July 1. However, these processes have suffered numerous delays since the adoption of SB 181. This is due in part to the contentious nature of rulemaking under the COGCC, which has grown increasingly heated since SB 181 was passed, and because of the COVID-19 pandemic, which prevented the COGCC from holding hearings that allowed members of the public to speak in person about the proposed rules. The COGCC's mission change rulemaking hearings are scheduled to take place in August and September of this year.

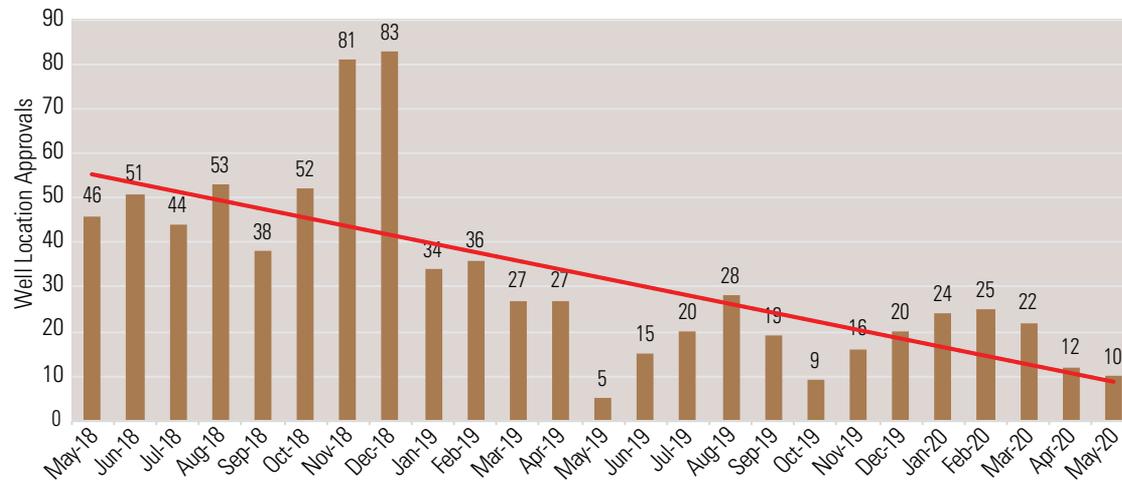
Local regulatory control

The other fundamental change ushered in by SB 181 is the new role local governments will play in industry regulation. Under SB 181, local governments can adopt their own oil and gas regulations for the first time, even when the COGCC or CDPHE enacts statewide regulations governing the same topics. If a municipality approves rules that are stricter than statewide counterparts, SB 181 allows the municipality's rules to override statewide rules. This new ability to preempt statewide rules gives local governments unprecedented power over oil and gas production within their territories and will require the industry to work with regulatory bodies at both the state and local levels.

Local control over oil and gas production is a historical break with Colorado's previous approach to oil and gas regulation, and it runs counter to the regulatory frameworks found in other states. For example, Texas passed a law



Colorado Well Approval Permits



Source: Colorado Oil and Gas Conservation Commission

in 2014 forbidding a municipality from passing ordinances regulating oil and gas in response to a ban on hydraulic fracturing passed by the city of Denton. The Texas law grew out of the concern that allowing municipalities to regulate oil and gas production would lead to an impractical patchwork of local regulations.

Before SB 181, Colorado lawmakers shared this concern, believing it would be difficult for oil and gas operators to juggle competing sets of local regulations. Under SB 181, however, Colorado's top priority is regulating oil and gas to ensure public health and safety, with significantly less emphasis placed on ensuring a uniform regulatory landscape. Local control over the industry is a natural consequence of Colorado's reordered regulatory priorities.

SB 181's effect on the industry

SB 181 was designed as a long-term solution to the state's oil and gas wars, but the full effect of the law has yet to be felt. SB 181 requires multiple extensive rulemaking processes, and full implementation of the law will take many more months to complete. However, in the year since SB 181 was signed into law, it has already affected the industry in critical ways.

Increased permitting scrutiny and permitting moratoria. One of SB 181's largest impacts has been a decline in permitting activity. Immediately after SB 181 was signed into law, the COGCC adopted interim guidelines imposing more stringent review of applications for drilling permits and well location permits. Because the purpose of these guidelines was to ensure that the COGCC's analysis of new permit applications complied with the new law's overall mandate, they offer a window into a world in which SB 181 is implemented in full.

At the same time, several cities and counties in Colorado enacted temporary permitting moratoria. These moratoria were designed to halt oil and gas activity while statewide and local regulations were finalized and to ensure that any permits granted post-SB 181 complied with the new regulations. However, the state and local rulemaking processes have suffered repeated

delays, allowing municipalities to extend their permitting moratoria for nearly a year.

The combination of the COGCC's stringent review of permitting applications and local permitting moratoria has led to significantly fewer approved permits. In the 12 months after SB 181 was enacted, the COGCC's approval of well location permits was down by more than 50%. For example, the COGCC approved just 215 well location permits from May 2019 through April 2020, compared to the 442 and 572 well location permits approved by the COGCC over the same time periods in 2017 and 2018, respectively. Further, the decline in well location permitting in the 12 months after SB 181 cannot be attributed to one or two slow months—since SB 181 was signed into law, monthly approvals of new well locations have remained consistently lower compared to the previous 12 months.

Approvals for drilling permits are also down compared to previous years. According to a report by the University of Colorado's Leeds School of Business, the COGCC approved an average of 203 drilling permits per month through October 1, 2019, a decrease of about 54% compared to the 443 drilling permits per month approved over the same period in 2018. This trend has continued, with the COGCC approving an average of 144 drilling permits per month from November 2019 through May 2020.

It is not clear if the declines in permitting activity are only temporary or if they reflect a new normal after SB 181. Approval rates for drilling and well location permits may increase as the COGCC and local governments finalize their respective regulations and the various permitting moratoria expire. On the other hand, if permit approval rates remain low, the industry may have to revisit and reshape its current approach to permitting. As has always been the case, flexibility and engagement with regulators will be crucial.

A potential patchwork of local regulations. Although the rulemaking process is not complete, so far some local governments in

Colorado have used their newfound powers under SB 181 to adopt regulations different from those of their neighbors, creating the regulatory patchwork feared by Colorado's oil and gas industry. The neighboring counties of Weld and Boulder, for example, have taken diametrically opposed approaches. Weld County, which accounted for nearly 88% of Colorado's aggregate oil production in 2019, has expedited new production in the county, going as far as attempting to create its own permitting department that would bypass the statewide permitting system. Boulder County, on the other hand, enacted a moratorium and is seeking to strengthen its existing oil and gas regulations and expand its regulatory authority. Indeed, activists have filed a lawsuit asking the Boulder County District Court to give its stamp of approval to the notion that the county can impose fracking bans and permanent drilling moratoria that under prior state law would have been preempted by state law.

The differences among regulations adopted by other counties are likely to be less extreme than the divide between Weld and Boulder. Even so, producers with leases, wells or other mineral interests in more than one county will need to stay on top of competing sets of local regulations, in addition to statewide regulations adopted by the COGCC and CDPHE. Compounding these difficulties are the different speeds at which cities and counties have adopted these regulations, with certain municipalities finalizing regulations within months after SB 181 was passed and others yet to enact final regulations. Even when state and local regulations are finalized, court challenges to the new rules are likely. While it may take some time before the state and local regulatory landscape is settled, the industry can take comfort in the fact that the vast majority of Colorado's crude oil production is located in possibly the most industry-friendly county in the state: Weld County.

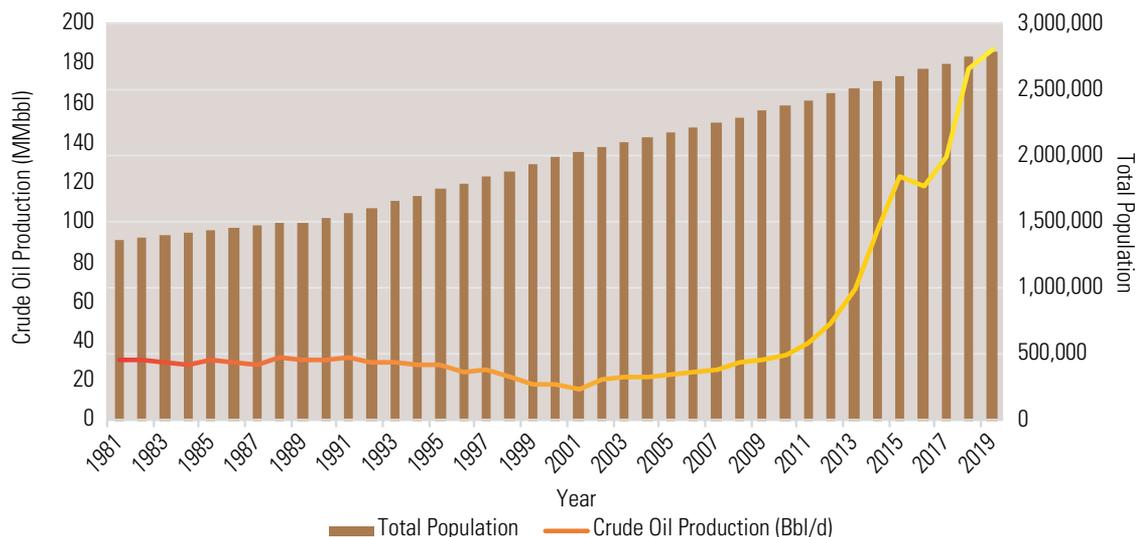
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Looking ahead

SB 181 represents a significant departure from the regulatory scheme that had existed in the state for decades. For the industry itself, SB 181 has brought new regulatory and legal challenges that will continue to evolve as the law is implemented statewide. But this is not the first time Colorado has seen significant changes to the way in which the industry operates. In this environment, success will require the industry to remain nimble and engaged, at both the state and local level. The key will be to understand the details of the new regulations and the political forces behind them—an increased desire by regulators and affected communities to protect public health and environment while maintaining responsible access to the state's energy resources. □

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Annual Colorado Crude Oil Production And Denver Metro Area Population Growth



Source: U.S. Energy Information Administration, macrotrends.net