Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Los Angeles Should Block Its Own Ban On Fracking

Law360, New York (December 05, 2014, 10:52 AM ET) --

Jeffrey D. Dintzer

Over nine months have passed since the Los Angeles City Council approved a motion on Feb. 28, 2014, directing the city attorney to prepare an ordinance to ban all activities associated with oil and gas well stimulation, along with the use of waste disposal injection wells. While the prohibitive proposal was adopted with enormous anti-fracking fanfare, the city attorney and other relevant departments have been unable to craft an ordinance that satisfies the city council's expectations without imposing significant burdens on the Los Angeles economy.

Instead of drafting a ban on all well-stimulation activity by the oil and gas industry, the Department of City Planning issued a report to the city council in early November analyzing the city's oil and gas regulations. The DCP report wisely recommends updated land use and zoning regulations developed with the assistance of an outside technical expert in lieu of an outright ban. The DCP notes a moratorium on well stimulation would be especially inopportune at this time, given the city's lack of technical expertise, opportunities to update its oil and gas regulations and the evolving nature of comprehensive statewide well-stimulation regulations, such as SB 4.

The two lawmakers who sponsored the motion in February wrote they are "extremely disappointed" that the DCP issued the report instead of preparing an ordinance banning well-stimulation activity. Their disappointment is profoundly misplaced in our view and shows a desire to legislate through hyperbole as opposed to deliberative investigation of the facts. Rather than blast public officials facing the impossible task of shutting down the city's oil and gas operations, city lawmakers should listen to the thoughtful concerns voiced by the DCP and abandon the well-stimulation ban. Unlike the city council, the DCP understands the potential consequences of the ban demanded by the council.

The city council's motion is obviously meant to react to the widespread controversy surrounding the growth of hydraulic fracturing of oil and gas wells. But fracking is just one of many well-stimulation techniques used for conventional well work by the oil and gas industry. By banning "all activity associated with well stimulation," the city does not simply seek to prohibit the practice of fracking, it would in essence force the premature closure of every oil production facility in the city over time. Whether the city council acknowledges this risk or not, the motion amounts to a de facto ban on the use

of any well-stimulation or injection operations in the city's borders, both of which are essential to maintaining and operating conventional oil operations.

If enacted, the consequences of such a ban could be disastrous for the city. By functionally preventing all oil and gas injection and well-stimulation operations within Los Angeles, over time, existing wells would be forced to "shut in," robbing existing businesses and thousands of royalty owners of economic revenue. Property tax assessments would be adversely impacted as the value of the oil reserves and facilities would be minimal based on the lack of ability to capture and produce the reserves in place. Further, by proposing to dictate how oil and gas well operators conduct "downhole" activities, the prospective ordinance would be in significant conflict with — and thus preempted by — the comprehensive statewide regulations enacted by the legislature in the form of SB 4. Finally, in the unlikely event the motion is not facially overbroad or preempted by state law, the proposed ban will expose the city to substantial liability from operators and royalty owners seeking just compensation under the takings clauses of the federal and state constitutions.

The city council's motion is undeniably broad. The motion utilizes vague, undefined terms like well stimulation that could be used to prohibit routine well-maintenance activities. When used by industry, the term well stimulation generally refers to any downhole activity conducted to restore or enhance the productivity of the well. Maintenance activity, which is often intended to improve well productivity, could be included in this definition. The risk of overbroad enforcement of well-maintenance activities is magnified in Los Angeles because, as the DCP notes in its report, the city lacks the technical expertise to effectively regulate advanced well-stimulation techniques. That is one reason why the city's deviation from the terms of SB 4 is so notable. In developing SB 4, the legislature took significant care to separate maintenance operations that restore and enhance the productivity of the well from regulated "well-stimulation" operations. The failure to take a similarly nuanced approach by the city creates a myriad of legal and policy issues.

In addition to the threat an overbroad prohibition poses to the local oil and gas industry, the city's proposed ordinance would be unlikely to survive a preemption challenge. Local bans on fracking and other well-stimulation activities are most likely preempted by the comprehensive regulatory scheme established by California with SB 4. SB 4 not only establishes broad regulations of well-stimulation techniques, it mandates a statewide permitting scheme that explicitly allows well stimulation to continue while the state completes an independent scientific study of the practice.

California courts look for a "conflict" between state and local laws to determine whether local land use regulations are preempted. Local regulations may be preempted by state laws through explicit language, a contradiction between the state and local laws, or a state law so comprehensive that no room exists for additional regulation at the local level. SB 4 does not contain an explicit preemption clause, but the ban on well stimulation proposed by the Los Angeles City Council contradicts the unequivocal statewide policy to promote well stimulation and enters a regulatory field entirely occupied by the state.

The contradiction between the city council's motion and SB 4 cannot be doubted: Los Angeles proposes to ban an activity expressly permitted by the state. As an obvious hypothetical, the state could permit a particular fracking operation in Los Angeles under SB 4 that would otherwise be prohibited by the city. This contradiction between well-stimulation activities permitted by the state and simultaneously prohibited by local governments formed the basis for several Colorado district court rulings issued in July and August that state law preempts local bans on fracking. In addition to the contradiction with state law created by the proposed ban on well stimulation in Los Angeles, the ban would intrude on an area of industry comprehensively regulated by the state under SB 4.

The possibility of a preemption lawsuit should not be taken lightly. As the DCP emphasizes in its report, the Compton City Council was forced in late September to withdraw its own motion to ban well-stimulation activities after the Western State Petroleum Association brought a preemption challenge.

Even if Los Angeles chose to defend its proposed well-stimulation ban against legal challenges for overbreadth and preemption, the city would face significant liability. Acquiring the property rights and operational capacity to conduct well stimulation can be an exceptionally expensive investment for operators, with significant benefits to royalty owners. By eliminating the value of these operational investments, the motion proposed by the city council could constitute a taking of private property without just compensation in violation of the U.S. and California Constitutions.

Among the takings recognized by the U.S. Supreme Court is a regulatory taking, where the government deprives the property owner of all economically beneficial use of the property. By prohibiting all well-stimulation activities — and eviscerating the benefit of energy extraction from private property in the city's borders — the city council motion could effect a regulatory taking. Should a court conclude such a broad prohibition on well-stimulation activities unconstitutionally takes the right to extract mineral resources, the city would be required to bite the bullet of just compensation to oil and gas companies, as well as the royalty owners that hold the mineral rights and have a legal right to pursue economic development of their property interests. By some estimates, given the scope of oil and gas operations in Los Angeles, the payment of this just compensation could result in several billions of dollars of legal liability for the city.

Here too, the risk is very real. Tiny San Benito County — one of the smallest counties in the state — is already facing a claim for $1.2 billion by Citadel Exploration Inc. for lost oil extraction value on its property after voters approved an initiative on Nov. 4 banning well-stimulation techniques and injection operations by oil and gas operators. It is notable that the $1.2 billion estimate is attached to an oil reservoir that currently has only several dozen wells in operation. In contrast, current production within Los Angeles amounts to more than 5,000 barrels per day attributable to several hundred wells. The claims by operators wronged by the proposed Los Angeles ordinance would undoubtedly command even greater amounts.

Well-stimulation activities, including fracking, promise enormous economic benefits for California. To fulfill that promise, the state has enacted comprehensive regulations to sustainably develop the use of well-stimulation techniques by the oil and gas industry. Reactionary local bans on all well-stimulation and injection operations, such as the ban proposed by the Los Angeles City Council, threaten to undermine the growth of this increasingly vital industry. Even worse for the city, such a prohibition could force the city into costly legal battles concerning overbreadth and preemption, as well as liability for taking private property without just compensation.

Fortunately for the people of Los Angeles, the DCP has thoughtfully weighed the risks of the ban proposed by city council and dutifully urged caution by the city's lawmakers. The city council should take this unique opportunity to exercise restraint on the basis of the DCP report rather than risk the grave costs the ban could impose on the people of Los Angeles. Oil and gas operations have been safely occurring across the Los Angeles Basin for more than 100 years. The city can and should proceed deliberatively in analyzing the policy and legal implications of this subject. One hundred years of safe oil production is testament to the fact that the city has the benefit of time and does not need to recklessly plunge ahead without heed to the consequences.

—By Jeffrey D. Dintzer and Nathaniel P. Johnson, Gibson Dunn Crutcher LLP

Jeffrey Dintzer is a partner and co-chairman of Gibson Dunn & Crutcher's environmental litigation and mass tort practice group in the firm's Los Angeles office. Nathaniel Johnson is an associate in Gibson Dunn & Crutcher's Los Angeles office.