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Calif. Anti-Fracking Ordinances On Shaky Legal Ground

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Since Beverly Hills garnered notoriety in April for enacting California's first municipal ban on hydraulic fracturing, the state's municipalities have continually pushed the envelope on legally unstable prohibitions of decades-old advanced well-stimulation techniques for oil and natural gas production. Fracking offers substantial benefits for the state and is but one of many advanced well-stimulation techniques used for conventional well work in the industry. Fracking and other advanced techniques promise to unlock previously inaccessible oil and natural gas from California's shale formations, which are possibly the largest deep-shale reserves on the planet.

Yet, the growth of fracking and other well-stimulation techniques has generated significant local backlash. The indefinite moratorium enacted by the city of Compton — a city that does not house even a single well stimulated by fracking within its borders — is a case study in the legal risks posed by hasty, reactionary bans on fracking and other techniques.

The Compton ordinance does not limit its prohibition to fracking, but broadly includes any "well-stimulation treatment." Even more brazenly, the prohibition applies to any well drilled from any location that extends below Compton, not only to wells drilled from the city's surface. In late July, the Western States Petroleum Association brought suit against Compton, challenging the prohibition as unconstitutional and preempted by state law. While Beverly Hills may have passed the state's first fracking ban, it is no wonder why Compton was the first California city sued over its fracking prohibition.

The case against the constitutionality of subsurface enforcement of the Compton prohibition is straightforward. Compton may only regulate activities that occur on the surface within its borders. The California Constitution provides that a "city may make and enforce within its limits ... ordinances and regulations not in conflict with general laws." The city's ordinance attempts to enforce a prohibition on well-stimulation techniques applied outside city limits. The city's ban on fracking is us at odds with its baseline governing authority.

Fortunately for Compton, the WSPA lawsuit limited its overbreadth challenge to subsurface enforcement. The city's draconian ban on all well-stimulation techniques, instead of particular techniques like fracking, could further entrench Compton in costly legal battles. Compton defined "well-

stimulation treatment" to include any process intended to enhance the "permeability of the underground geologic formation." As defined, this term includes any downhole activity designed to increase permeability (i.e., the ability of the geologic formation to transmit fluids). If the well is damaged during drilling, and oil and natural gas are unable to flow into the well bore, operators in Compton are helpless. Restoring well productivity would involve increasing permeability, an activity explicitly prohibited by the ordinance.

Such an overbroad prohibition poses an incredible threat to the local oil and gas industry. The Los Angeles City Council, for example, approved a motion in February directing the city attorney to prepare an ordinance much like Compton's, which would ban all oil and natural gas well-stimulation activities. The proposed Los Angeles ordinance could spell the end of century-old conventional production of oil and natural gas. If adopted, the city's expansive ban would be highly susceptible to a facial legal challenge for overbreadth, and potentially cost the city billions of dollars in legal liability, by some estimates.

The cause for Compton's concern lies in the Takings Clause of the U.S. and California Constitutions. Acquiring the property rights and operational capacity necessary to conduct fracking and well-stimulation operations can be an expensive investment for operators, while simultaneously providing significant benefits to royalty owners. Prohibitions like the ordinance enacted by Compton threaten the integrity of these investments, thereby exposing municipalities to claims that the local regulations have deprived fracking operators and royalty owners of the economically beneficial uses of their property. Indeed, fracking is meant to access energy resources that cannot otherwise be extracted from the underlying property. Municipal actions like in Compton could constitute a taking of private property without just compensation in violation of the U.S. and California constitutions.

Among the types of takings recognized by the U.S. Supreme Court is a "regulatory taking," where instead of physical dispossession of property, the government deprives the property owner of all economically beneficial use of the property. By prohibiting all well-stimulation techniques and eliminating the benefit of energy extraction from private property within Compton's borders, the municipal prohibition could effect a regulatory taking. Should a court conclude such a broad prohibition on fracking operations unconstitutionally takes the right to extract natural resources, Compton would be required to provide costly just compensation to oil and natural gas companies.

While regulatory takings claims are often difficult to establish, complete bans on all well-stimulation techniques could easily implicate takings issues. Due to the "denominator problem" — where courts analyze regulatory takings claims based on the economic value of the property as a whole, rather than on distinct profitable activities, such as fracking — the well operator or royalty owner would have to establish the only economically beneficial use of the land is energy extraction through fracking or other well-stimulation techniques. But given the fact that advanced well-stimulation treatments are used on otherwise inaccessible resources, it is not difficult to imagine just such an operator or royalty owner.

Notably, some courts have started to analyze the denominator problem more favorably for the oil and natural gas industry. The Ohio Supreme Court has decided, for example, that a "mineral estate," such as an interest in oil or natural gas extraction, could be considered the relevant property interest for a regulatory takings analysis, where the mineral estate was purchased separately from other interests in the property.[1] If fracking operators or royalty owners own interests in fracking independent of other interests in the property, they could thus establish a colorable regulatory takings claim. California does not yet have clear precedent on the proper approach to the denominator problem, and this recent shift in doctrine could open the door for a successful challenge.

Even though regulatory takings claims are tough to prove, the risk lies entirely with the city. Municipal prohibitions on fracking and other well-stimulation techniques are likely preempted by expansive state regulations. The WSPA has specifically included this claim in its lawsuit against Compton.

Local fracking bans are probably preempted by the comprehensive regulatory scheme established by California with SB 4. SB 4 requires the California Natural Resources Agency to complete an independent scientific study of well-stimulation techniques, including fracking. While the study is conducted, California has sensibly allowed fracking to continue under a statewide permitting system. By permitting fracking, the state has effectively balanced the powerful economic advantages of fracking with concern for its citizenry and environment. Further, by vesting authority in a statewide regulator, SB 4 aims to avoid the uncertainty that could plague a fracking industry exposed to a patchwork of local regulations.

In California, courts look for a "conflict" between state and local laws to determine whether municipal land use regulations are preempted.[2] Local laws may be preempted by state laws through explicit language in the state law, a contradiction between the local and state law, or a state law so comprehensive there is no room for additional regulation. SB 4 does not include an explicit preemption clause, but municipal prohibitions on fracking both contradict the unequivocal California-wide policy to promote fracking and enter a regulatory field fully occupied by the state.

Natural resource regulations are traditionally made and enforced by state agencies. The state is charged with regulating downhole operations, such as the extraction of oil and natural gas, while cities are confined to regulating surface activities. Moreover, municipalities are creatures of state law, and only have as much authority as the state provides. This hierarchy explains the basis for preemption of municipal laws by state regulations in the first place.

Municipal prohibitions on fracking contradict SB 4 by banning an activity expressly permitted by the state, and are thus preempted. As an obvious hypothetical, California could permit a particular fracking operation that is otherwise prohibited by a municipal ordinance like that enacted in Compton. Even if a city did not go so far as to regulate all downhole activity below its surface, any prohibition on surface well-stimulation activities would undoubtedly undermine the propriety of downhole extraction of oil and natural gas. This contradiction between fracking activities expressly permitted by the state and subsequently prohibited by municipalities formed the basis for a Colorado district court ruling in late July that state law preempts local bans on fracking.

In addition to contradicting the fracking permitting scheme established by SB 4, local regulations on fracking undeniably intrude on an area of industry comprehensively regulated by the state. By interfering with California's statewide regulatory scheme, municipal prohibitions would likely support a preemption challenge.

Such a preemption challenge would be especially likely to succeed against an ordinance like Compton's, which only intends the prohibition to remain in effect until the City Council is satisfied the available evidence demonstrates well-stimulation practices pose no significant risk to the public health, safety and welfare. SB 4 requires the Natural Resources Agency to conduct an exhaustive scientific study of the fracking across the state. But to effectively study the issue, some fracking or well stimulation must occur. Municipal bans on fracking in the name of research not only interfere with the thoughtful scientific study crafted by the state of California, they undermine the very purpose for the municipal moratorium itself.

Fracking offers enormous economic potential for California. To seize on that potential, the state enacted comprehensive regulations to sustainably develop the industry. Reactionary municipal prohibitions on all well-stimulation techniques threaten to eviscerate the growth of this increasingly vital industry. Even worse for municipalities, such prohibitions could generate costly legal battles over municipal authority and preemption, as well as liability for taking private property without just compensation.

California has taken steps to realize the opportunity offered by the fracking industry. At a minimum, municipalities should let the statewide regulatory process unfold before taking significant, unnecessary legal risks that could cost the city dearly.

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[1] State ex rel. Shelly Materials Inc. v. Clark Cnty. Bd. of Comm'rs, 875 N.E.2d 59, 67 (Ohio 2007).

[2] Big Creek Lumber Co. v. Cnty. of Santa Cruz, 38 Cal. 4th 1139 (2006).
