



RESPONSE TO THE SUNSET ADVISORY COMMISSION'S STAFF REPORT

SUBMITTED TO THE
SUNSET COMMISSION
NOVEMBER 2012



DAVID PORTER
COMMISSIONER

BARRY T. SMITHERMAN
CHAIRMAN

BUDDY GARCIA
COMMISSIONER


RAILROAD COMMISSION OF TEXAS


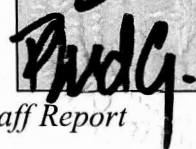
Barry T. Smitherman, Chairman
David Porter, Commissioner
Buddy Garcia, Commissioner

INTERNAL
Executive Office
Milton A. Rister
Executive Director

November 20, 2012

TO: Chairman Barry T. Smitherman
Commissioner David Porter
Commissioner Buddy Garcia

FROM: Milton A. Rister 
Executive Director

November 20, 2012		
APPROVED	DENIED	ABSTAIN
		
		

SUBJECT: Approve the Agency Response to the *Sunset Staff Report*

Attached for your review and approval is the Commission's *Response to Sunset Advisory Commission's Staff Report*. The Commission's response to the Sunset Staff Report is the next step in the Sunset review process. The document represents the unified position of the Commissioners, but does not preclude a Commissioner from responding individually on any of the recommendations found in the report. Commissioners will also have the opportunity to testify on the report before the Sunset Commission on December 18 and 19, 2012.

We are seeking approval to submit the attached document to the Sunset Commission no later than November 30, 2012, as well as delegation of authority to the Executive Director if any non-substantive changes are needed.

We are available to answer any questions you may have or if you require additional information.

Attachment A: *Response to Sunset Advisory Commission's Staff Report*

BARRY T. SMITHERMAN, CHAIRMAN
DAVID PORTER, COMMISSIONER
BUDDY GARCIA, COMMISSIONER



MILTON A. RISTER
EXECUTIVE DIRECTOR
(512) 463-7068

RAILROAD COMMISSION OF TEXAS

EXECUTIVE OFFICE

November 20, 2012

Ken Levine, Director
Sunset Advisory Commission
P.O. Box 13066
Austin, TX 78711-3066

Dear Mr. Levine:

I am pleased to submit the Railroad Commission of Texas' response to the Sunset Advisory Commission's Staff Report. The three state-wide elected Commissioners discussed the agency's response in an open meeting on November 20, 2012.

We look forward to working with you and your staff as the Sunset process continues first with the Sunset Commission's meetings in December and January, and then as the Legislature makes their decisions during the 83rd Legislative Session. Please let me know if we can provide any additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Rister", with a long horizontal flourish extending to the right.

Milton A. Rister
Executive Director

Enclosure: Response to the Sunset Advisory Commission's Staff Report

cc: Chairman Barry T. Smitherman
Commissioner David Porter
Commissioner Buddy Garcia

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INTRODUCTION

Texas is the nation's top energy producing state, and also leads the United States in many areas of energy technology and energy policy. From the drill bit to the burner tip, energy is vital for the Texas economy and for national security. The Railroad Commission has played a fundamental role for 121 years in helping Texas achieve its place as a world renowned energy leader through a long history of successful policy decisions issued by three statewide elected officials, who make up the Commission. The Sunset review process was a constructive and informative experience for the Railroad Commission, and, hopefully, for the Sunset Staff as well.

The Commission serves the citizens of Texas well by regulating the development of energy resources for the benefit of the Texas economy, as well as regulating utility rates while balancing important environmental protection concerns. The Commission is recognized as a world leader in developing workable regulation for the energy industry and for its leadership in ensuring that resource recovery operations meet or exceed environmental and safety compliance standards. Analysis by the Sunset Staff confirms what the agency recognizes: Texas is a leader in energy production and regulating this industry remains a vital responsibility of state government.

ISSUE 1: CHANGING THE RAILROAD COMMISSION'S NAME AND ADDRESSING THE APPEARANCE OF CONFLICTS OF INTEREST REMAIN CRITICAL TO ENSURING TRANSPARENT AND EFFECTIVE REGULATION.

RECOMMENDATION 1.1: Change the name of the Railroad Commission of Texas to the Texas Energy Resources Commission, and continue the agency for 10 years.

The Commission generally agrees with this recommendation. The Commission agrees that its present name is potentially confusing and does not accurately describe the Commission's present duties. Changing the name of the Commission would help citizens better understand the Commission's duties and ensure increased transparency for its primary role in overseeing energy exploration and production in Texas—eliminating confusion regarding any ongoing role with railroads; however the Commission has concerns that changing the name could raise constitutional issues related to subsection (b) of section 30 of the State Constitution, and its continued applicability. Pursuant to Section 30a, Article 16, the Legislature could provide for three elected Commissioners to the newly named commission. The courts and the Attorney General would be free to interpret the validity and effect of legislation changing the Commission's name, and any challenges would likely greatly increase the indirect costs associated with a name change.

RECOMMENDATION 1.2: Limit the solicitation and receipt of campaign contributions by a Commissioner or any candidates seeking the office to a year and a half timeframe around the election, rather than throughout the full six-year term.

The Commission disagrees with this recommendation. The Commission should be held to the same standards as all other statewide-elected executive branch officials. A more specific response to this item will be at the discretion of individual Commissioners.

RECOMMENDATION 1.3: Prohibit a Commissioner from knowingly accepting contributions from a party with a contested case before the Commission.

The Commission disagrees with this recommendation. The Commission should be held to the same standards as all other statewide-elected executive branch officials. A more specific response to this item will be at the discretion of individual Commissioners.

RECOMMENDATION 1.4: Require the automatic resignation of a Commissioner that announces or becomes a candidate for another elected office.

The Commission disagrees with this recommendation. The Commission should be held to the same standards as all other statewide-elected executive branch officials. A more specific response to this item will be at the discretion of individual Commissioners.

RECOMMENDATION 1.5: Require the Commission to adopt a recusal policy in rule, including a requirement to explain the reason for any recusal from a decision in writing.

The Commission disagrees in part with this recommendation. The Commission has by rule adopted a recusal policy, codified in 1 T.A.C. Sec. 1.10. The Legislature has specifically committed the administration and enforcement of the State's ethics statutes to the Texas Ethics Commission and empowered only the Ethics Commission to adopt rules to administer those statutes. A rule that would require a Commissioner to state in writing the reason for a recusal decision goes beyond the requirements of Sec. 572.058 of the Government Code, which requires elected and appointed officers to disclose only the fact that a conflict exists, which disclosure shall be entered in the minutes, and to refrain from voting or otherwise participating in that matter.¹ The Commission should be held to the same standards as all other statewide-elected executive branch officials. A more specific response to this item will be at the discretion of individual Commissioners.

RECOMMENDATION 1.6: Require the Commission to use the State Office of Administrative Hearings to conduct independent hearings for its contested gas utility and enforcement cases.

The Commission disagrees with this recommendation. The Commission's gas utility rate cases were heard at SOAH for a brief period beginning in 2001. Gas utility consumers did not realize any appreciable benefits from having SOAH conduct gas utility hearings, while the Railroad Commission was burdened with unnecessary administrative obligations. The hearings returned to the Commission in 2003.

During the period when gas utility cases were heard by SOAH, neither the Commission, the gas utilities, nor the gas utility customers experienced any improvement in the manner in which cases were processed and decided. The cases were not processed more quickly or efficiently, the legal analysis performed by the SOAH administrative law judges was not more thorough or of greater quality, and the proposals for decision that were issued by SOAH were not better products than those historically produced by RRC hearings examiners. The transfer of gas utility contested rate cases did not represent an improved, more efficient, or better process, just a different and more costly one.

The current recommendation by Sunset Staff would transfer all contested enforcement cases and all contested gas utility rate cases to SOAH. The RRC has enormous in-house expertise among its technical staff, attorneys, and hearings examiners that is absolutely critical to the effective administration and enforcement of its various regulatory programs. Such in-house expertise allows the RRC to allocate and channel its resources as necessary to address significant regulatory issues and fulfill its regulatory responsibilities in the most efficient and proficient manner possible, including through the conduct of contested-case hearings, to best serve the citizens of the state of Texas and ensure protection of the environment. The contested-case hearing processes in place at the Commission protect the fundamental rights of all stakeholders, provide an equal opportunity to fully participate in contested-case proceedings, and ensure that Commission decisions

1 Ethics Advisory Opinion No. 298 (1996).

are in fact fair, evidenced-based and lawful. Of particular importance is the ease of access afforded by the Commission's process that allows individual consumers or small business operators to represent themselves through the hearing process. Should the process transfer to SOAH, it is likely that individuals currently representing themselves would require legal counsel to navigate the SOAH process.

Fiscal Implications—The Sunset Staff report asserts that the transfer to SOAH of the Commission's contested enforcement and gas utility hearings will not have a fiscal impact to the State. The recommendation will result in an increase to SOAH's budget of approximately \$440,000 and the addition of four FTEs; with corresponding reductions at the Commission. The fiscal analysis for this recommendation assumes that any increased costs to SOAH can be offset by corresponding reductions in the Commission's budget; however the recommendation also assumes that the Commission will enter into a contract with SOAH. Based upon the Commission's previous experience contracting with SOAH, the Commission anticipates the cost of that contract to be nearly \$750,000 per year.

ISSUE 2: SELF-FUNDING OF THE OIL AND GAS PROGRAM IS WORKING WELL, BUT WOULD BENEFIT FROM REMOVAL OF THE \$20 MILLION CAP ON THE OIL AND GAS REGULATION AND CLEANUP FUND.

General Response—*The Commission is generally in agreement with this recommendation.* The Oil and Gas Regulation and Cleanup Fund serves a much larger purpose than when it was originally constituted as the Oil Field Clean Up Fund, with significantly more revenue deposited in the new fund each year. Senate Bill 2 from the 82nd Legislature, First Called Session, replaced General Revenue appropriations for oil and gas regulation with appropriations to the newly created Oil and Gas Regulation and Cleanup Fund (OGRC) funded by oil and gas industry fees and surcharges. Much of this revenue depends on the financial health of the oil and gas industry, which typically follows the broader economy. Eliminating the \$20 million cap would allow the Commission to better plan for and adjust to inevitable changes in the regulated industries.

RECOMMENDATION 2.1: Eliminate the cap on the Oil and Gas Regulatory and Cleanup Fund.

The Commission agrees with this recommendation. The RRC regulates dynamic industries that support the state's economy—industries that often shield Texas from economic turmoil that other states may experience. As such, the RRC needs the financial ability to respond to changing market and economic conditions that affect the industries it regulates in a dynamic manner. The Commission agrees with the Sunset Staff report that removing the \$20 million cap will provide the agency with the financial flexibility to meet changing economic conditions within the industry. This flexibility, while dependent on legislative appropriations, could allow for funding of potential technological initiatives and match staffing needs with the growing needs of the oil and gas industry.

RECOMMENDATION 2.2: Abolish the Oil Field Cleanup Fund Advisory Committee.

The Commission neither agrees, nor disagrees with this recommendation.

Fiscal Implications—While this recommendation will not have a direct fiscal impact on the State, the financial management flexibility it will allow the Commission is critical to the long term success of the self-supporting funding model implemented by the 82nd Legislature.

ISSUE 3: THE COMMISSION'S CURRENT PIPELINE SAFETY FEE DOES NOT COVER THE PROGRAM'S COSTS, LIMITING THE AGENCY'S ABILITY TO ENSURE PUBLIC SAFETY WITHIN A GROWING OIL AND GAS INDUSTRY.

General Response—The Commission agrees with the recommendations of the Sunset Staff. This recommendation would allow the Commission a predictable yet flexible method by which to fund pipeline safety activities and, in conjunction with the existing pipeline safety and regulatory fee that is currently paid by distribution customers, would establish greater equity in the funding of pipeline safety activities. The program needs to grow along with the industry to accommodate the increasing mileage of jurisdictional pipeline, to ensure continued compliance with program requirements, and to retain highly skilled technical staff. The Commission's pipeline safety inspectors and damage prevention specialists perform routine and specialized inspections, conduct incident investigations, and present public awareness programs. In addition, staff members pursue enforcement activities related to rule violations.

RECOMMENDATION 3.1: Authorize the Commission to create a pipeline permit fee to help support its Pipeline Safety program.

The Commission agrees with this recommendation.

RECOMMENDATION 3.2: Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the costs of administering its Pipeline Safety program, including administration costs and benefits.

The Commission agrees with this recommendation.

Fiscal Implications—The Commission agrees with the Sunset Staff that this recommendation would result in savings to the General Revenue Fund. Revenue from the newly created T-4 pipeline permit fee would be used to offset the General Revenue the Legislature currently appropriates to the Commission for its Pipeline Safety program.

ISSUE 4: WHILE CHANGES HAVE BEGUN, THE COMMISSION CONTINUES TO NEED STATUTORY DIRECTION TO IMPROVE THEIR ENFORCEMENT PROCESS.

General Response—The Commission agrees with the Sunset Staff recommendations for this issue, and has already implemented many of the recommendations detailed in the report. The Commission's compliance-based approach serves the public safety of the state's citizens, the state's environment, and the state's economy well. A rule-based system can work well as part of an oil and gas enforcement system, but the nuance and flexibility offered by a compliance-based system should not be lost to the structure of a rules-based system, which has the potential to just as easily hinder the ability of the Commission to prevent future threats to the environment and public safety. Penalty guidelines were formally adopted by the Commission in August 2012, as 16 TAC §3.107.

RECOMMENDATION 4.1: Require the Commission to develop an enforcement policy to guide staff in evaluating and ranking oil- and natural gas- related violations.

The Commission agrees with this recommendation. In April 2011, the Commission revised a 2008 document and directed its district offices to use the *Notice of Violation (NOV) Guidance Document* as an internal guide to field inspections and enforcement policy. The document ranks violations from "minor" to "major," and classifies violations based on the risk to public safety or the risk of pollution. The Commission will continue to refine the *Notice of Violation (NOV) Guidance Document*, as needed to reflect changing energy extraction and delivery techniques used by the oil and gas industry.

RECOMMENDATION 4.2: Require the Commission to formally adopt penalty guidelines.

The Commission agrees with this recommendation. The Commission believes no further action is necessary as penalty guidelines were formally adopted by the Commission in August 2012, as 16 TAC §3.107.

Fiscal Implications—The Commission agrees with the Sunset Staff that this recommendation is likely to generate additional revenue from penalties for the General Revenue Fund.

ISSUE 5: THE COMMISSION'S MARKETING OF PROPANE FUEL IS NO LONGER NECESSARY.

General Response—While the Commission neither agrees, nor disagrees with this recommendation, the Commission's statutory authority does extend to any environmentally beneficial alternative fuel whose industry supports the Commission's work. The AFRED marketing program successfully supports an alternative fuel that is both vital and beneficial to the state. As the nation's largest producer of propane, the more propane that finds its highest and best use as fuel, the greater the total economic and environmental benefit to the state

RECOMMENDATION 5.1 Eliminate the Commission's statutory authority to promote the use of propane and to charge a delivery fee for this purpose.

The Commission neither agrees nor disagrees with this recommendation. If the Legislature chooses to eliminate the propane marketing component of the Commission's alternative fuels program, the Commission recommends leaving in place the authority to apply its program model to any alternative fuels should funding become available.

Fiscal Implications—Eliminating the AFRED program would decrease the capacity of the State to apply for and receive alternative fuels grant funding.

ISSUE 6: TEXAS' INTERSTATE PIPELINES LACK NEEDED DAMAGE PREVENTION OVERSIGHT TO ENSURE PUBLIC PROTECTION.

General Response—The Commission agrees with the recommendations of the Sunset Staff. This recommendation would authorize the Commission to amend its pipeline damage prevention rules to apply to interstate, as well as intrastate, pipelines; and to enforce rule violations that affect both types of pipelines. Such a change would allow for uniform enforcement throughout the state, with the potential to decrease pipeline-related damages through increased awareness and education.

RECOMMENDATION 6.1 Authorize the Commission to enforce damage prevention requirements for interstate pipelines.

The Commission agrees with this recommendation.

Fiscal Implications—The Commission agrees with the Sunset Staff Report that this recommendation would not result in a significant fiscal impact to the State. Any additional administrative penalties would result in a gain to the General Revenue Fund.

ISSUE 7: THE COMMISSION'S MINERAL POOLING AND FIELD SPACING HEARINGS LACK CERTAIN PROCEDURAL SAFEGUARDS FOR MINERAL OWNERS.

General Response—The Commission neither agrees nor disagrees with the recommendations of the Sunset Staff. This issue focuses on both the Mineral Interest Pooling Act (MIPA) and the Railroad Commission's spacing rule, 16 T.A.C §3.37, but the recommendations are not uniformly applied to both the pooling scenario and the spacing scenario, which could cause further confusion for citizens rather than ensure procedural safeguards as intended.

RECOMMENDATION 7.1 Authorize a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled.

The Commission agrees in part with this recommendation. In most instance this recommendation will affect parties that are typically small lot owners who have not indicated a desire to participate in the well proposed by the operator but who would be compelled to pool their mineral interests into the well if the operator's MIPA application is granted—a so-called “Reverse MIPA” case—all of which have thus far involved the Barnett Shale in Tarrant County. The Commission agrees that in a so-called “Reverse MIPA” application it would be reasonable to allow the respondent to appear and participate by telephone. Allowing these respondents to participate by phone would reduce the inconvenience to them of participating in the hearing while still allowing them to articulate their arguments and concerns.

MANAGEMENT ACTION 7.2 Authorize the Commission to develop a fee schedule, by rule, for increased charges associated with re-filing previously withdrawn permits.

The Commission neither agrees nor disagrees with this recommendation. Repetitive filing of permits can lead to confusion and does increase the cost and time required to review and process permits.

The Sunset Staff report includes the development of a fee schedule for increased charges associated with re-filing previously withdrawn permits as a management action—a non-statutory recommendation. The Commission's statutory authority to assess a fee for review of a Rule 37 spacing exemption is Texas Natural Resources Code, sec. 85.2021 (b), which requires a \$200 nonrefundable fee. The Mineral Interest Pooling Act, Texas Natural Resources Code, Chapter 102, does not provide the statutory authority for the Commission to charge any fees for actions related to MIPA filings. Without statutory changes, the Commission will be unable to implement this recommendation.

Fiscal Implications—The Sunset Staff report indicates that the Commission would have the option of allowing participation by phone. The Commission believes that, in appropriate cases, this telephonic hearing option serves the same positive purposes as conducting hearings in the locale but would be far more efficient and cost-effective. In traditional cases brought under the Mineral Interest Pooling Act (“MIPA”), both the applicant and the respondent actively desire to participate in the drilling of a well to produce their respective minerals. In these traditional cases, both parties typically have technical evidence to present and both sides typically put on multiple witnesses to lay out their case. These cases do not lend themselves to telephonic hearings. However, as both parties are in favor of developing their minerals and drilling the well at issue, there has never been an objection to conducting these traditional MIPA cases in Austin

ISSUE 8: THE RAILROAD COMMISSION'S KEY REPORTING REQUIREMENT CONTINUES TO SERVE A USEFUL PURPOSE.

General Response—The Commission's report on the Oil and Gas Regulation and Cleanup Fund provides valuable information to many of the agency's constituents. It is a useful quarterly snapshot of both the Commission's own activities, and by association the level of oil and gas industry activity taking place throughout the state. As such, it is also a good early indicator of the state's economic activity.

RECOMMENDATION 8.1 Continue requiring the Commission to submit its report on the Oil and Gas Regulatory and Cleanup Fund to the Legislature.

The Commission agrees with this recommendation.

