MICHAEL N. FEUER
CITY ATTORNEY

January 14, 2015

The Honorable City Council
of the City of Los Angeles
Room 395, City Hall
200 North Spring Street
Los Angeles, CA 90012

Re: Proposed Ordinance Prohibiting Well Stimulation Treatments
Council File No. 13-1152-S1

Honorable Members:

On February 14, 2014, the City Council adopted an action directing City staff to prepare and present an ordinance prohibiting well stimulation treatments within the City of Los Angeles (City). Shortly thereafter, the Western States Petroleum Association and legal counsel for the California Independent Petroleum Association sent letters to our Office regarding the City's litigation exposure should the City enact such an ordinance. True and correct copies of the two letters are enclosed herewith.

On January 6, 2015, this Office transmitted a report to the Council recommending that discussions with, and advice from, legal counsel regarding the above-referenced matter be scheduled and held in closed session. That same week, legal counsel for the Western States Petroleum Association telephoned me and advised that his client would sue the City should it enact an ordinance prohibiting well stimulation treatments.

This Office is documenting the aforementioned to comply with the requirements of California Government Code Section 54956.9(e)(5).

If you have any questions regarding this matter, please contact Deputy City Attorney Saro Balian at (213) 978-8242 or Assistant City Attorney Terry Kaufmann Macias at (213) 978-8233.

Sincerely,

Saro Balian
Deputy City Attorney

Enclosures

manatt
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February 27, 2014

Client-Matter: 23362-030

VIA E-MAIL AND REGULAR MAIL

The Honorable Mike Feuer
Los Angeles City Attorney
200 N. Main Street
800 City Hall East
Los Angeles, CA 90012

Re: City Council Ordinance to Regulate Oil and Gas Operations

Dear Mr. Feuer:

I am writing on behalf of our client, the California Independent Petroleum Association ("CIPA"), to once again express our grave concerns regarding the potential legal repercussions that will ensue if the City of Los Angeles approves Agenda Item No 13-1152-S1 which calls for a prohibition on the use of well stimulation and hydraulic fracturing in the City of Los Angeles unless until some ill-defined standard of water safety is met. CIPA is a non-profit, non-partisan trade association representing approximately 500 independent crude oil and natural gas producers, royalty owners, and service and supply companies operating in California. Our members represent approximately 70% of California's total oil production and 90% of California's natural gas production. CIPA understands that the City of Los Angeles is considering adopting an ordinance that would impose a moratorium on the use of hydraulic fracturing and other types of well stimulation. Our clients are strongly opposed to the motion and believe there are significant legal issues that have been overlooked and must be studied before this matter is approved by the full Council. This letter focuses on whether such ordinances would be preempted by State law and/or result in a taking of property requiring compensation by the City.

I. Regulations Impacting The Economic Return of Property Can Give Rise To A Claim For Just Compensation

As noted in our earlier letter dated September 25, 2013, the proposal being considered by the Council that address hydraulic fracturing seeks to impose a moratorium on all forms of well stimulation or severely and arbitrarily restrict the use of well stimulation used to enhance oil production. Not all well stimulation is considered hydraulic fracturing, and some types of well stimulation have been employed by producers in the City for decades and continue to be used today. No widespread claims of damage to drinking water has been alleged by the City in the

last 100 years when some of the same well stimulation techniques have been continually employed. Any form of regulation that severely limits the use of well stimulation or bans it outright will potentially force the closure of a number of active wells within the City, forcing well operators and royalty holders to lose billions of dollars. As set forth below, CIPA believes that those who lose the value of their mineral assets as a result of City action will have a claim against the City for just compensation under both the federal and state Constitutions. The City should also note that royalty holders and oil reserves do not follow the City's boundaries, so some of the royalty holders that could be impacted are neighboring cities, school districts, public institutions as well as private citizens who all depend on this royalty income. The actions contemplated by the City will not only impact the oil producer or well owner, but also the tens of thousands of individuals and entities that are owed royalties.

The state and federal Constitutions prohibit government from taking private property for public use without just compensation. (Cal. Const., art. I, ß 19; U.S. Const., 5th Amend.; *Chicago, Burlington &c. R'd v. Chicago* (1897) 166 U.S. 226, 239 [applying the federal takings clause to the states].) In *Penna. Coal Co. v. Mahon* (1922) 260 U.S. 393, 415 (*Penna. Coal*), the United States Supreme Court recognized that a regulation of property that "goes too far" may effect a taking of that property. When a regulation does not result in a physical invasion and does not deprive the property owner of all economic use of the property, a reviewing court must evaluate the regulation in light of the "factors" the high court discussed in *Penn Central Transp. Co. v. New York City,* and subsequent cases. *Penn Central* emphasized three factors in particular: (1) "[t]he economic impact of the regulation on the claimant"; (2) "the extent to which the regulation has interfered with distinct investment-backed expectations"; and (3) "the character of the governmental action." *Penn Central Transp. Co. v. New York City* (1978) 438 U.S. 104, 124. Subsequent cases, as well as a close reading of Penn Central, indicate other relevant factors such as whether the regulation affects the existing or traditional use of the property and thus interferes with the property owner's "primary expectation" (*id.* at pp. 125, 136), and whether the regulation "permit[s the property owner] . . . to profit [and] . . . to obtain a 'reasonable return' on . . . investment" (id. at p. 136).

The regulatory proposal under discussion today by the Los Angeles City Council seeks to temporarily prohibit well stimulation giving rise to thousands of claims for just compensation by oil well operators and owners as well as royalty holders which could include neighboring governmental units. One proposal seeks to regulate the types of well stimulation currently in use in Los Angeles by amending current zoning laws. The proposal would severely restrict the types of production techniques currently employed by local producers, leading to a loss of value in the City's oil producing properties for which the well owner and the royalty holders must be compensated under long established law. Moreover, changes to the zoning law, or changes to the General Plan necessitated by changes to the zoning law can both be considered regulatory takings giving rise to a claim for compensation.

The long running litigation between the City of Hermosa Beach and MacPherson Oil is instructive in showing how a regulatory overreach can result in repercussions that could financially destroy a municipality. In that case, the City of Hermosa Beach adopted an ordinance that in essence prohibited oil production operations within the city limits. Using standard industry valuation techniques, Macpherson Oil was able to show that the financial loss resulting from the actions of Hermosa Beach could be as much as $850,000,000. When a court confirmed that Hermosa could be liable for that amount of compensation, the City agreed to settle the matter. What is notable is that in the MacPherson Oil dispute with Hermosa Beach, the reserves at issue in Hermosa Beach had not yet been developed. By contrast, actual production in the City of Los Angeles is long-standing, substantial and widespread. This distinction is critically important in so much as the financial exposure of the City of Los Angeles to damages from a taking claim by all impacted well owners and operators within the City along with the royalty holders would be massive since the level of actual current production in the City is five to six times higher than the estimated production figures used to establish damages in the Hermosa Beach case. Accordingly, the City of Los Angeles could be subject to a claim for compensation of several billion dollars should it adopt any proposal that creates operational prohibitions on downhole operations. It is clear that neither of the motions that have been introduced contemplated this very serious issue.

There are thousands of Los Angeles County residents that are royalty holders with a financial interest in currently active wells within the city limits. While their interests range from minimal to substantial, any action that results in a decrease in current production could financially harm thousands of the City Council's own constituents, many who are elderly and rely on royalty payments to make ends meet. As noted, those impacts go beyond City limits since the oil reserves don't stop at the boundary, and many other royalty holders, both individuals and institutions would also suffer compensable royalty losses. Finally, any proposal that causes a large decrease in oil production where previously allowed would result in a severe diminution of property value with a concurrent drop in property tax assessments leading to less revenue for the City. It does not appear that either of the motions considered today have contemplated the direct or indirect economic impacts of the proposal. Put simply, CIPA believes there are significant economic impacts associated with proposals to regulate hydraulic fracturing currently under consideration by the Council. It would be unwise, in our view, for the City to enact any such measures without the Council being fully informed about the severe legal and economic risks posed by the current proposals.

II. California Law Concerning State Preemption of Local Regulation

The recent promulgation of regulations implementing the State's newly enacted SB4 confirms that it is the intent of state legislators and state regulators to pre-empt local laws related to well stimulation and fracking to ensure that a comprehensive state wide legislative program is effective. If each incorporated municipality or city can on its own ban well production using

well stimulation the result could be a cessation of oil production in the state, or lead to a patchwork of conflicting regulations that don't conform to the nature of oil production and exploration. Oil reserves are spread over many counties, cities, and municipalities and it is impossible to manage such reserves with complex, contradictory and competing local regulations. The state, which has regulated this industry since its inception sees the need for a uniform regulatory structure and SB4's proposed regulations achieve this result. For example, all the requirements of the legislation are to be carried out at the State level including the development of regulations on hydraulic fracturing and other well stimulation techniques, the undertaking of a scientific study overseen by the Secretary of the Natural Resource Agency to ascertain the health and environmental impacts of these activities, and the development of a State permitting program to govern them.

Existing state law comprehensively addresses oil and gas operations, including the drilling, construction, and operation of oil and gas wells, and the technical question of whether to inject fluids to improve reservoir productivity. (Pub. Resources Code, § 3000 et seq.; Tit. 14, Cal. Code Regs., § 1712 et seq.) To the extent that issues associated with oil and gas operations have not been fully covered by State law, the Legislature has vested discretion over technical decisions with the State Oil and Gas Supervisor ("Supervisor"). (Pub. Resources Code, §§ 3013, 3222.) Moreover, State law evidences an intent to maximize the productivity of oil and gas operations, while addressing potential environmental effects thereof. (Pub. Resources Code, § 3106.) State law has therefore extensively covered the field of oil and gas operations as it relates to downhole oriented matters such as well stimulation and hydraulic fracturing. Recent passage of SB 4 (Pavley) has further strengthened the scope of the state's regulation of well stimulation and further confirms that this subject has become exclusively a matter of State concern; as such local regulation on this subject would therefore be preempted. (*Morehart v. County of Santa Barbara* (1994) 7 Cal.4th 725, 751 [citations omitted.].)

Under California law, local government regulations that conflict with State general law are preempted. (Cal. Const., Art. XI, § 7.) The preemption may be express or by implication. (*Candid Enterprises, Inc. v. Grossmont Union High School Dist.* (1985) 39 Cal.3d 878, 885.) Express preemption exists where the Legislature has included in statute a statement of intent to preempt local regulations. (52 Ops.Cal.Atty.Gen. 166, 168 (1969).) Implied preemption exists under any of the following circumstances: (1) the subject matter has been so fully and completely covered by the State general law as to clearly indicate that it has become exclusively a matter of state concern; (2) the subject matter has been partially covered by State general law, but the context clearly indicates that State concerns will not tolerate local regulation of the same subject; or (3) the subject matter has been partially covered by State general law, and the subject is of such a nature that the adverse effects of local regulation outweigh the possible benefits to the local government. (*Morehart,* supra, 7 Cal.4th 725 at 751 [citations omitted.].) In determining whether the Legislature intended to occupy the entire field to the exclusion of all local regulation, a court will look to the "whole purpose and scope of the legislative scheme," not

just the language used in the statute. (*Tolman v. Underhill* (1952) 39 Cal.2d 708, 712.) A local regulation that is preempted by State law is void and unenforceable. (*People ex rel. Deukmejian v. County of Mendocino* (1984) 36 Cal.3d 476, 484.)

Consistent with its strong interest in oil and gas resources and intent to maximize the productivity of oil and gas wells, California has adopted statutes and regulations that comprehensively address oil and gas operations. The statutory provisions for oil and gas law are contained within Division 3 ("Oil and Gas") of the Public Resources Code, encompassing sections 3100 through 3865. These statutes address oil and gas operational issues in detail, including notice of intent to drill and abandon (§§ 3202, 3229); bonding (§§ 3204- 3207); abandonment (§ 3208); recordkeeping (§§ 3210-3216); blowout prevention (§ 3219); casing (§ 3220); protection of water supplies (§§ 3222, 3228); repairs (§ 3225); regulation of production facilities (§ 3270); waste of gas (§§ 3300-3314); subsidence (§ 3315 et seq.); spacing of wells (§§ 3600-3609); unit operations (§§ 3635-3690); and regulation of oil sumps (§§ 3780-3787).

Notably, State law already addresses operational activities that involve the use of well stimulation. For example, unless prohibited in an applicable lease or contract, State law authorizes a lessee or operator, with the approval of the Supervisor, to use reasonable and prudent methods to explore for and remove all hydrocarbons, including "the injection of air, gas, water, or other fluids into the productive strata, the application of pressure heat or other means for the reduction of viscosity of the hydrocarbons, the supplying of additional motive force, or the creating of enlarged or new channels for the underground movement of hydrocarbons into production wells." (Pub. Resources Code, § 3106, subd. (b).) State oil and gas law also contains provisions to address potential effects from hydraulic fracturing, including requirements pertaining to well casings, blowouts, and bore hole integrity (e.g., cementing). (Pub. Resources Code §§ 3208, 3219, 3220, 3270, 3300-3314, 3600-3609.) State law includes extensive regulation of possible environmental effects from oil and gas operations, including provisions that would address potential impacts from well stimulation. For example, the Supervisor is directed to prevent, as far as possible, damage to life, health, property and natural resources, and damage to underground and surface waters suitable for irrigation or domestic purposes by the infiltration of, or the addition of, detrimental substances. (Pub. Resources Code, § 3106(a).)

Conclusion

In summary, under both the federal and state Constitutions, local regulations that have the effect of stopping or impacting oil production at wells currently in service give rise to claims for compensation from both well owners and royalty holders. Based on current production levels in the City, claims for diminution of value against the City could easily be in the billions of dollars. The recent experience of the City of Hermosa Beach on matters of well valuation should be carefully studied by the Council before proceeding with a proposal that would give rise to similar claims. As noted above, CIPA believes there are other issues related to property tax impacts the

City must review before taking any action on this topic. In addition, State law comprehensively covers the subject of oil and gas operations, including whether to use methods to stimulate reservoir productivity. This comprehensive regulation of oil and gas operations is consistent with the State's strong interest in oil and gas resources, and intent to maximize the recovery of hydrocarbons from oil and gas reservoirs. The recent passage of SB 4, which creates a State regulatory framework for hydraulic fracturing and other well stimulation techniques confirms the State's continued desire to regulate issues related to oil and gas production at the State level. Thus, when looking at the "whole purpose and scope of the legislative scheme," it is evident that the Legislature intended to preempt local regulation on the subject of oil and gas operations.[1] (*Tolman v. Underhill* (1952) 39 Cal.2d 708, 712.) A local regulation that attempts to impose a moratorium on or severely limit the use of hydraulic fracturing or other forms of well stimulation, is preempted by State law and unenforceable, and would most certainly be challenged on such basis.

CIPA appreciates the opportunity to provide our input on this topic and looks forward to addressing this issue cooperatively. Should you have any questions regarding the above analysis, please give me a call at (310) 312-4353.

Sincerely,

Craig A. Moyer

CAM:ls

cc: Los Angeles City Council

[1] The California Office of the Attorney General reached a similar conclusion when considering the issue of State preemption of local regulation of oil and gas operations in the mid-1970s. (59 Ops.Cal.Atty.Gen. 461, 478 (1976) ["Where the statutory scheme or Supervisor specifies a particular method, material, or procedure by a general rule or regulation or gives approval to a plan of action with respect to a particular well or field or approves a transaction at a specified well or field, it is difficult to see how there can be any room for local regulation . . . We observe that these statutory and administrative provisions appear to occupy fully the underground phases of oil and gas activity."].)

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Western States Petroleum Association
Credible Solutions • Responsive Service • Since1907

Catherine H. Reheis-Boyd
President

February 28, 2014

The Honorable Mike Feuer
200 North Spring Street
800 City Hall East
Los Angeles, CA 90012

RE: File No. 13-1152-S1Regulation of Well Stimulation and Hydraulic Fracturing in the City of Los Angeles

Dear Mr. Feuer

The Western States Petroleum Association ("WSPA") understands that the Los Angeles City Council, on the recommendation of its Planning and Land Use Management ("PLUM") Committee, has been asked to consider the development of regulatory controls over hydraulic fracturing in the City of Los Angeles. In addition, the Committee has recommended that the City Attorney, in consultation with the Planning Department, be asked to prepare and present a zoning ordinance that would impose a ban on all well stimulation activities in the City (including hydraulic fracturing, gravel packing and acidizing) pending the adoption of these new regulatory controls. For the reasons set forth below, we urge the City Council to decline to take any action on these recommendations.

WSPA represents companies that account for majority of exploration and production, refining, marketing and transportation of crude oil and refined petroleum products in California and five other western states. As part of this role, WSPA is actively involved in legislative developments affecting the oil industry at all levels of government, including local counties and municipalities. Some of WSPA's members currently conduct oil and gas production operations in the City of Los Angeles, which involve, or may involve, the use of well stimulation techniques. These operations have been carried out safely and in accordance with applicable laws, regulations and permit requirements for many years, without any evidence of environmental harm. WSPA members, as well as hundreds of other smaller, independent oil

producers and oil service companies, will be directly and adversely affected by the proposed actions.

WSPA is very concerned that these actions are being taken in haste, without adequate notice and opportunity for public input, without knowledge or study of pertinent facts, without due consideration of crucial policy questions raised by a ban on well stimulation, and without regard to the severe and pervasive economic impacts that will flow from these recommendations, if implemented. From a legal perspective, we also note that all "downhole" aspects of well stimulation, including issues relating to well integrity, water supply and water disposal, are comprehensively regulated by the Public Resources Code, thus preempting local regulation of these activities. As you are no doubt aware, the Pubic Resources Code was amended last year by Senate Bill 4 (Ch. 313, Stats. 2013) to expressly regulate well stimulation treatments. A discussion of pertinent aspects of this new law are mentioned below. Significantly, Ventura County Counsel was recently directed by its Board of Supervisors to conduct a legal analysis of the County's authority to enact zoning ordinances pertaining to hydraulic fracturing. County Counsel concluded that regulation of hydraulic fracturing, including water supply issues and chemical usage, is preempted by SB 4. These legal conclusions were presented to the Board of Supervisors in a public meeting on December 17, 2013.

Hydraulic fracturing is a safe and proven oilfield technology that has been in use for over 60 years. Over that time, hydraulic fracturing has never been associated with any confirmed case of groundwater contamination or any other environmental harm. However, due to the keen public interest in this technology and the great promise that it holds for energy independence, WSPA has supported sensible regulation of hydraulic fracturing. To this end, we are working closely with the Department of Conservation and the Division of Oil, Gas, and Geothermal Resources to ensure the expeditious implementation of SB 4. Specifically, this new law requires:

- Development of a new regulations, including a new permitting program, specific to well stimulation
- An independent scientific study of the impacts of well stimulation
- Mandatory disclosure of chemical and water use by operators
- Augmented well integrity testing and standards, which will strengthen California's already nation-leading well construction standards
- Water monitoring plans
- Notification of neighboring land owners and tenants of well stimulation activities
- And the availability of well water testing for adjacent land owners and tenants

In addition to the new regulations, the Department of Conservation is currently in the process of developing a statewide EIR on well stimulation. This EIR will encompass the City of Los Angeles, and will study activities, define impacts, and identify feasible mitigation measures for potentially significant environmental impacts.

We understand that the PLUM Committee was particularly concerned with issues related to water use and supply associated with hydraulic fracturing. CEQA guidelines require that environmental reviews study not only potential water quality impacts, but also water supply and reliability issues related to the project under review. Based on our own research as well as research conducted by the state Department of Conservation, WSPA is confident that the statewide EIR will ultimately conclude that hydraulic fracturing activities have only a minimal, insignificant impact on water supply and reliability. The average hydraulic fracturing job (completed between 2011-2013) uses between 116,000-130,000 gallons of water, which is equal to approximately half an acre-foot of water. In addition, our research shows that in 2012, a total of 202 acre feet of water were used to hydraulically fracture 568 wells. By comparison, a single golf course uses approximately 312,000 gallons of water per day, and the agricultural sector in California uses 34 million acre feet a year. Even if local regulation of hydraulic fracturing were not preempted, any prohibition based on water use would clearly be unjustified.

In conclusion, we urge the City Attorney and the City Council to decline to take any action based on the PLUM Committee's recommendations. It is clear that the State of California has defined a robust path to develop regulations applicable to hydraulic fracturing, review environmental impacts, and ensure public disclosure of these activities. In our view, redundant, and potentially conflicting, regulation at the local level is both unnecessary and legally inappropriate. And any attempt to ban hydraulic fracturing, whether temporarily or permanently, would be directly contrary to state law.

Thank you for considering WSPA's comments. Please contact me at 916-498-7750 or cathy@wspa.org if you have any questions or would like additional information regarding our comments.

Sincerely,

CC: Members of the Los Angeles City Council

CITY ATTORNEY
ENVIRONMENTAL LAW DIVISION
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FEB 25 2014