Q & A on House Bill 40 - Darby/Fraser

What does the Texas Constitution say about natural resources and local regulations?
- The Texas Constitution says that preserving and developing natural resources is a public right and duty. The Texas Supreme Court has determined clear legislative intent to protect and encourage the development of Texas natural resources.
- Also, the Texas Constitution says that a city’s ordinances can’t be inconsistent with the state constitution or the general laws enacted by the state legislature.

Historically, what has been the state’s role in regulating oil and natural gas industry?
- For more than 100 years, the Legislature - and its delegated agencies of the Railroad Commission and the Texas Commission on Environmental Quality - have enacted and imposed stringent state oil and gas and environmental regulations that simultaneously (1) allow development of the state’s natural resources (2) protect the environment and (3) allow for the oil and gas industry to grow jobs and anchor the Texas economy.

What role have cities played with regard to oil and natural gas regulation?
- The role of cities has also been important, as they have sought the orderly development of their jurisdictions by regulating surface activity related to oil and gas operations, such as reasonable setbacks and limitations on traffic, light or noise. Cities maintain this authority under HB 40.

Why does Texas need House Bill 40?
- Recently, municipal regulations have begun to erode state’s preeminent role in regulation oil and gas development.
- Outright bans on completion techniques, onerous setbacks designed to prohibit drilling, and duplicative regulation have created a patchwork of inconsistent regulation that undermines safe and efficient production of oil and natural gas.
- Many say that these types of ordinances will ultimately, after many years in court, be found either unconstitutional or subject to substantial taking claims, but the Legislature cannot wait or ignore the direction of the Constitution.
- The regulatory authority for the cities and the state need to be reaffirmed by the legislature to resolve any ambiguity in what cities can do to regulate oil and gas activity without harming the priorities of the state or the taking of private property.
- In the absence of HB 40, a patchwork of oil and gas regulation is likely, an outcome that would not serve the public interest and further hamstring the mainstay of the Texas economy.

What exactly does House Bill 40 do?
- HB 40 affirms that regulation of oil and gas operations like fracking and production is under the exclusive jurisdiction of the state.
- HB 40 establishes municipalities and political subdivisions may continue to exercise their authority over aboveground activity related to oil and gas operations, provided that it is commercially reasonable and does not effectively prohibit an oil and gas operation.

HB40 cont’d on p.4
Our staff at PPROA will be getting back to a more normal routine as the Texas Legislative season is over except for a few bills that have extensions. I believe our industry came out fairly well in state issues. However, we are anticipating an ongoing battle over the Environmental Protection Agency’s ruling regarding the “Waters of the United States” (WOTUS).

The EPA and the U.S. Army Corps of Engineers recently released the final rulemaking to revise the definition of WOTUS. The 297-page rulemaking would require a federal permit for any activity that results in a discharge into any body of water covered by the new definition of WOTUS, including small streams and wetlands. The Independent Petroleum Association of America disagrees with the need for the rule and has spoken out against expanded federal jurisdiction for years. From farming to golf course management and home building to energy development, this new federal mandate will require landowners to obtain additional government permits and fulfill bureaucratic regulatory requirements. Increased federal jurisdiction over nearly all waters in the United States will create substantial permitting and compliance burdens for few environmental benefits. The impacts of this rule go far beyond American energy development as the rule hurts all American landowners. There are serious concerns about retroactive applications of the rulemaking and added costs on business operations. This regulatory regime will result in far more significant economic impacts and unintended consequences than the Obama Administration is leading the American people to believe.

Please make plans to attend PPROA’s Summer Event on June 13th at the Piehl Ranch in Bushland! Our goals are to bring our members and vendors together for a fun and informal outing and to give our spouses, friends and lady co-workers an opportunity to become more involved in our organization. We will provide food, beer, wine and setups. We will award prizes for a prairie golf chipping contest, a cow patty toss and our cow calling contest. Dress up in your best Roy Rogers and Dale Evans outfits because there will also be a prize for each of those. Our goal is to sell 150 couples tickets or 250 individual tickets. Invite your staff and your friends for what will be a really fun time!

Please mark your calendar for our upcoming Annual Meeting – September 22-24, 2015. We are really excited and honored to have George P. Bush as the keynote luncheon speaker, and Dr. Daniel Fine as our breakfast speaker.

We will also be having an Industry Expert Panel to provide Q & A on what took place in the Texas and US legislature this year and how it will affect our industry going forward; a seismologist to report on the science of earthquakes and oil and gas drilling; and an industry economist and strategist will speak to the future of our industry for the next three years.

“Shake it up” is our plan for this year’s annual meeting. While we will maintain many of the traditional events, be looking for some new events too!
The 84th Texas Legislature is officially over. There may be summer extensions to complete some bills but as a whole, for our industry, we can say it is finished. Some good things came out of this session one being the municipality bill or HB 40 has passed and was signed into law by Governor Abbott. HB 2595 prohibits anyone from submitting a petition, certification or verification requesting the enactment or repeal of an ordinance if it enactment or repeal would restrict the right of any person to use or access their person’s private property that would limit the use of real property for economic gain nor can you hold an election to do the same. Both the crude and LNG export resolutions passed the House. SCR 13, the crude export resolution, passed 142 to 1 and SCR 32, the LNG export resolution, passed 143 to 0.

The US House passed a bill to remove the Lesser Prairie Chicken from being listed as an endangered species until 2021. As soon as we have an update on these two bills and other pending legislation, we will let you know. All in all there was nothing that “hurt” the industry but we look forward to continuing to be strong advocates for our industry at all times.

Our industry never seems to get a break! As soon as the legislature passed HB40, which provided consistent language to municipalities regarding hydraulic fracturing, we are now having to defend ourselves against the unproven theory that our industry incites earthquakes. SMU released “statements” indicating injection wells caused 4.0 earthquakes in Azle, Mansfield and Irving, Texas.

The Texas Railroad Commissioner Ryan Sitton was quick to react and directed Commission staff to work with seismic researchers at Southern Methodist University to schedule a public meeting in response to their recently published study in Nature Communications titled, “Causal factors for seismicity near Azle, Texas.”

The following statement is attributed to RRC Commissioner Ryan Sitton:

“This hearing will help us gain a better understanding of the Azle data and determine what measures, if any, should be taken. I appreciate SMU’s work on this issue and look forward to an “engaging, thorough discussion that considers all scientific evidence available.”

“As a Texas Railroad Commissioner, one of my primary duties is to ensure that Texans have confidence in the way energy is developed in our state. Since November 2013, certain areas of Texas have experienced elevated levels of seismic activity, and residents are concerned that this may be caused by oil and gas related activities.

“Since that time, the Commission has held hearings in Azle and Austin, hired an in-house seismologist and adopted disposal well rule amendments that are designed to address disposal well operations in areas of historical or potential seismic activity. I want the public to know that the Commission is constantly monitoring the situation, and will consider any evidence and data that suggests possible causation between oil and gas activities and seismic events, so that we can take appropriate action if necessary.

In light of SMU’s study, I am calling for invited testimony from the Azle operators and SMU research team to present their respective research on this important issue at the Railroad Commission as soon as possible.”

As always, please call with any questions! Until next time.........
Do cities still have a role in oil and gas regulation under House Bill 40?
- Yes. For the first time ever, state statute specifies cities’ authority to regulate aboveground activity related to oil and gas operations including fire and emergency response, traffic, lights, noise, imposing notice, and reasonable setbacks.

What does “commercially reasonable” mean?
- In HB 40, the definition of “commercially reasonable” is based on “the objective standard of a reasonably prudent operator and not on an individualized assessment of an actual operator’s capacity to act.” The definition is not subjective.
- In other words, the individual financial circumstances of an individual operator is not what is considered when determining what is “commercially reasonable.”
- By design, HB 40 is intended to and in fact encourages operators and the cities to sit down together to plan and coordinate the orderly development of minerals in the communities.

How was the bill revised to address various stakeholders’s concerns?
- HB 40 is a product of compromise.
- Our House and Senate committees heard hours of testimony, which informed some substantive changes that made the bill better.
- For example, after hearing from various stakeholders, the House Energy Resources committee more clearly defined “commercially reasonable” to reflect the objective standard that is well-established in Texas oil and gas case law.
- The committee substitute added a “Safe Harbor” provision that says an ordinance will be considered commercially reasonable if the ordinance has been in effect for at least five years and has allowed the oil and gas operations at issue to continue during that period.
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2015 Texas Legislative Session Wrap Up

There were a total of 6,290 bills introduced of which 4,215 were House Bills and 2,075 were Senate Bills which does not include resolutions and constitutional amendments.

The budget for 2016-2017 is approximately $209.4 Billion. It is made up of $106.6 Billion in state revenue, $67.9 Billion in federal matching funds and the rest is “other funds”. The Railroad Commission did very well in the budget. In HB 2, the Supplemental Budget, TexNet received $4.5 million to begin earthquake research.

Overview PPROA and the oil and gas industry had a really good session. The following are bills of particular importance that passed:

The biggest issue, local city oil and gas ordinances HB 40, was signed into law. HB 40 makes it clear that the state has jurisdiction over the drilling of wells and cities may only address surface operations that are commercially reasonable.

Tax proposals by the Senate that would have hurt business were averted and the end result was the passage of a 25% tax rate reduction in the Franchise Tax. See, HB 32.

Transportation Funding for state roads was increased by $2.5 Billion from the motor vehicle sales tax. This will require a constitutional amendment that will be voted on in November 2015. County roads will see funding continue via Reinvestment Zones and revenues from oil and gas produced under the county roads. In the past those revenues went to the state. See, HB 4025 and HB 2521.

Oilfield theft of crude and condensate or HB 3291 passed. This bill gave law enforcement the ability to use the lack of Railroad Commission permits or authorizations to prosecute crude and condensate thefts. Make sure your security people have copies!

Crude and LNG Export Resolutions passed. SCR 13 lifted the export ban on crude oil. SCR 32 sped up permitting of LNG Export Facilities.

Tort bills that passed. Let your lawyers know about these.
HB 1692. New and Improved Forum Non Conveniens statute.

SB 735. Can’t use a person’s net worth in determining punitive damages

Missed Opportunities. Here are some bills that almost passed:
HB 1552. The Allocation Bill.

HB 2595. The Initiative and Referendum bill on local ordinances that impact private property rights.
HB 3288. The electricity congestion rights bill. Look for an interim study.

**Bad Bills that ed Bills that were successfully defeated.**
HB 2003 & 4023. These bills would have changed 100 years of accommodation law on surface v. subsurface. Expect an interim study on this issue.

HB 2582. Transfer endangered species from the comptroller to the commissioner of agriculture.

HB 3068. Bad Division Order bill. Please let your division order analysts know that it did not pass.

Bad Disposal Well Bills. We had eight bad disposal well bills. Some would have put a per barrel fee on produced water injected. All were defeated.

**Veto Period.** Governor Abbott has signed a number of the bills noted above and in the track. Abbott has until Father’s Day, **June 21, to veto a bill.**

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1 On an individual basis, please note that the property tax homestead exemption was raised from $15,000 to $25,000.

2 HB 2521 has a September 1, 2017 effective date so there will be a delay in getting the funds to the counties.
CASENOTE

XH, LLC v. Cabot Oil & Gas Corp., No. 12-12-00338-CV, 2014 WL 2505541 (Tex. App.—Tyler May 30, 2014, no pet.)(mem. op.), held that the parties’ express provision governing priority of interpretation would be given effect to resolve conflicting area of mutual interest (“AMI”) provisions in a Purchase Agreement (“PSA”) and its attached joint operating agreement (“JOA”). Under the PSA, Seller conveyed to Purchaser 80% of Seller’s interest in certain leases, reserving an overriding royalty interest (“ORI”) to Seller on the assigned leases. Seller subsequently conveyed the ORI to Cabot. Purchaser contended Cabot was subject to the AMI agreement and obligated to offer to Purchaser the opportunity to purchase Purchaser’s proportionate share of the ORI that Cabot acquired from Seller.

The PSA included an AMI provision (“PSA AMI”) and an attached JOA. The JOA also included an AMI provision (“JOA AMI”). The PSA AMI provision provided that “[a]ll leases subsequently acquired by either party . . . will be subject to the Area of Mutual Interest provision provided in the Joint Operating Agreement . . . .” The JOA AMI provision, in Article XVI, provided that “[i]n the event that any party or parties acquire any oil and/or gas interest (which shall be deemed to include royalties, mineral interests, and other payments out of production) or oil and gas leases or other contract rights which allow the Participation for oil and/or gas, within the AMIs as herein above defined, then the non-acquiring party or parties shall have the right to acquire their proportionate interest . . . .” In the definitions section of the JOA, “Lease” is defined as “oil and gas leases or interests therein . . . .” but the defined term is limited to its use in the JOA. Article XVI of the JOA also provided that “[i]n the event of any conflict between the provisions of the [JOA] and the [PSA], the provisions of the [PSA] shall prevail and control.”

Because the PSA and JOA were executed at the same time, for the same purpose, and in the course of the same transaction, the court held that they should be read and construed together. However, this principle is simply a device for ascertaining and giving effect to the intention of the parties and cannot be applied arbitrarily and without regard to the realities of the situation. The court held that the two AMI provisions were unambiguous. The PSA AMI was limited to subsequently acquired leases, and the JOA AMI was broader and included subsequently acquired oil and gas interests. There was no language in the JOA indicating that the JOA AMI provision was intended to supplement the PSA AMI provision, and the expanded definition of “lease” found in the JOA was expressly limited to its use in the JOA. “Similarly, the language of the [PSA] fails to indicate that the acquisitions covered by its AMI provision may be supplemented by the AMI provision in the JOA or that its references to ‘leases’ is merely an example.” The court concluded that the two provisions were in conflict, that they could not be harmonized, and that the court must follow the parties’ determination that the PSA would control. Therefore, the ORI acquired by Cabot was not subject to the AMI agreement as expressed in the two documents.

The court then held that its decision would be the same even if the two provisions could be harmonized. This part of the opinion is based upon another provision in the JOA that provides the JOA AMI is not applicable to any acquisition of an interest that, prior to or at the time of its acquisition, was subject to the JOA. Because the ORI was created after the JOA had taken effect, and was therefor subject to the JOA, the court held that the AMI did not apply to the ORI.

The terms and provisions of the assignments to Purchaser and to Cabot were not discussed in the opinion, and there was apparently no issue as to whether or not Cabot acquired its ORI subject to the PSA and/or the JOA.

PSAs and JOAs are frequently executed together as part of a single transaction. There are often many other documents attached and included in the PSA, such as the form of assignment. The parties generally do think of them as part of a single agreement, and there is clear precedent that the courts will harmonize the documents in a single transaction. When the parties include a provision prioritizing the documents for interpretation in the event of an irreconcilable conflict, the PSA is often listed first, because it is often perceived as the most “important.” This case illustrates that this choice may be a mistake. There is not likely to be an irreconcilable conflict about who is buying what for how much, but the ancillary documents often provide more detailed provisions governing the rights of the parties after closing and as to the particular matters covered by the ancillary documents. Of course another way to avoid conflicting provisions is to expressly prioritize those specific provisions, or perhaps even better, to avoid having two provisions on the same subject. If the parties in this case did not include any provision resolving conflicts, would the court have been more likely to harmonize the two AMI provisions and reach the opposite result? Would the result have been different if the provision referred to “any irreconcilable conflict” instead of “any conflict”?

Jeff McCarn may be contacted at (806) 345-6340 or jmccarn@bf-law.com
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Keynote speaker
George P. Bush, Commissioner General Land Office

George Prescott Bush is a native Texan, born in Houston on April 24, 1976. He was elected Texas Land Commissioner on Nov. 4, 2014, earning more votes than any other statewide candidate on the ballot. Commissioner Bush took office on Jan. 2, 2015.

As Texas Land Commissioner, Bush works to ensure Texas veterans get the benefits they've earned, oversees investments that earn billions of dollars for public education and manages state lands to produce the oil and gas that is helping make America energy-independent.

Commissioner Bush also watches over the Alamo and preserves historic archives at the General Land Office that date back to the Spanish Empire.

Commissioner Bush has dedicated his life to public service, working as a public school teacher in Miami after graduating from Rice University and serving in Operation Enduring Freedom in Afghanistan as an officer in the U.S. Naval Reserve.

Commissioner Bush is a successful businessman. He joined Akin Gump Strauss Hauer & Feld LLP after earning his Juris Doctorate at the University of Texas School of Law. He subsequently co-founded Pennybacker Capital LLC, a real estate private equity firm, in 2007, and St. Augustine Partners LLC, a Fort Worth-based investment firm focused on oil and gas transactions and consulting for private businesses.

Commissioner Bush is also committed to helping fellow Texans in his private life. He co-chaired a $30 million capital campaign for Big Brothers Big Sisters in North Texas and served as the co-chairman of the Dallas/Fort Worth Celebration of Reading. He was the Tarrant County chairman for Uplift Education — a highly successful Dallas-based public charter network focused on closing the achievement gap in inner-city public schools. He also served on the Board of Trustees for the Bob Bullock Texas State History Museum in Austin.

Commissioner Bush is the grandson of President George H.W. Bush, the son of former Florida Governor Jeb Bush and the nephew of President George W. Bush. He lives in Austin with his wife, Amanda, and their two sons, Prescott and Jack.

Breakfast speaker
Dr. Daniel I. Fine, New Mexico Center for Energy Policy

Dr. Daniel Fine is the Associate Director of the New Mexico Center for Energy Policy and is a Senior Policy Analyst in the New Mexico State Department of Energy Minerals and Natural Resources.

He is a long time research associate at the Mining and Minerals Resources Institute (MIT). Fine is also a policy adviser on nonconventional oil and gas. He is co-editor of Resource War in 3-D: Dependence, Diplomacy and Defence, has contributed to Business Week, the Engineering and Mining Journal and the Washington Times. He has given testimony on strategic natural resources before the U.S. Senate Committees on Foreign Affairs and Energy and Natural Resources.
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GUEST COLUMN

No News is Good News

If you are like the majority of Americans, you probably filed your income tax return on or before April 15th. Check that off your list and now you are done dealing with the government until next year, right? Well maybe. Just like a few people win the lottery a few of us will go to our mailbox sometime before next tax season and discover a letter from the Internal Revenue Service (IRS). There are a lot of reasons that the IRS might send you a notice. What should one do if one is so lucky as to receive said notice?? Well I went on the IRS website and pulled off some of their tips for dealing with a notice.

- First and foremost, do not panic! You can probably take care of a notice by responding to it.
- Second, an IRS notice typically will be about your federal tax return or tax account. It will be about a specific issue, such as changes to your account. It may ask you for more information. It could also explain that you owe tax and that you need to pay the amount that is due.
- Third, each notice has specific instructions, so read it carefully. It will tell you what you need to do.
- Fourth, you may get a notice that states the IRS has made a change or correction to your tax return. If you do, review the information and compare it with your original return.
- Fifth, if you agree with the notice, you usually don’t need to reply unless it gives you other instructions or you need to make a payment.
- Sixth, if you do not agree with the notice, it’s important for you to respond. You should write a letter to explain why you disagree. Include any information and documents you want the IRS to consider. Mail your reply with the bottom tear-off portion of the notice. Send it to the address shown in the upper left-hand corner of the notice. Allow at least 30 days for a response. (Probably much longer—my comment)
- Seventh, you won’t need to call the IRS or visit an IRS office for most notices. If you do have questions, call the phone number in the upper right-hand corner of the notice. Have a copy of your tax return and the notice with you when you call. This will help the IRS answer your questions. (Also bring along a lot of patience as they may not answer the phone right away—me again)
- Eighth, always keep copies of any notices you receive with your other tax records.
- Ninth, be alert for tax scams. The IRS sends letters and notices by mail. The IRS does not contact people by email or social media to ask for personal or financial information.
- Finally, for more on this topic visit IRS.gov. Click on the link ‘Responding to a Notice’. Also, see Publication 594, The IRS Collection Process. You can get it on IRS.gov/forms at any time.

Now here are a few of my own tips:
- For those of you who used a paid preparer, be sure and visit with your tax professional before you respond to the notice. If you prepared your own return using a software package - well I guess like the commercial says "talk to the box".
- Do not ignore the notice. Trust me, the IRS is not just going to go away. As a corollary to that, give your tax professional a copy of the first notice. Giving them copies of the fourth or fifth notice makes it much harder to resolve the matter. Again, don’t ignore the first notice!!
- Remember, you are a U.S. Citizen and the IRS works for you (Just keep repeating that).
- Who knows, the next time you go to the mailbox, you may get lucky and it will only be a jury summons waiting for you.

Tax thought for the month:
"The taxpayer – that’s someone who works for the federal government but doesn't have to take a civil service examination." ~Ronald Reagan

Mike Connor, Managing Partner, Connor McMillon Mitchell Sheenum
Share your photos with us!

Do you have any photos (a typical day, not so typical, working hard, having fun, selfies) on a job site? Send it to us and we may include it in a future issue. Don’t forget to say who or what is in the photo, where and when it was taken.
Active Drilling Locations By County - PPROA Service Area
Texas Panhandle/western OK, SW KS - 5/29/15 RigData, Inc.

Beckham
- Cactus Unit
- Apache EnerVest

Cimarron
- Murfin
- Le Norman Jones
- EnerVest

Ellis
- Nomac
- Le Norman
- Power Rig
- Jones

Hardeman
- Steinberger
- Eagle

Hemphill
- Atlas
- Le Norman
- Cactus
- Apache EnerVest
- La Munyon
- Le Norman
- Nomac
- Le Norman
- Patterson
- Mewbourne
- Unit
- BP America

Moore
- Spradling
- North Country Pantera

Ochiltree
- Latshaw
- BP America
- Patterson Mewbourne
- Unit BP America

Potter
- Horizon
- Le Norman
- Patterson Apache

Roberts
- Unit BP America

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- Le Norman

Seward
- Duke Palmer

Texas
- Kenai Bright Horizon

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PPROA PIPELINE
3131 Bell St., Suite 209
Amarillo, TX 79106
(806) 352-5637
pproa@pproa.org

RRC District 10 Production Data
April 2014 - March 2015

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source: http://webapps.rrc.state.tx.U.S./PDQ