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California Oil and Gas Update

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CALIFORNIA OIL AND GAS UPDATE



By: Edward Renwick

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I. INTRODUCTION

The last year has been a busy one in the upstream California oil and gas business. The 2011 Preliminary Report of California Oil and Gas Production Statistics, which was issued in April 2012 by the California Department of Conservation, Division of Oil, Gas, and Geothermal Resources, reports that 4,033 notices of intention to drill were filed with the Division as contrasted with 2,081 in 2010.¹ Although the Preliminary Report for 2012 is not yet issued, anecdotal evidence suggests 2012 will be at least as active as 2011.

Much of the excitement involves California's Monterey and Santos Shales. The *Review of Emerging Resources: U.S. Shale Gas and Shale Oil Plays*, published in July 2011 by the United States Energy Information Administration estimates that those shales hold 64% of the

1. DIV. OF OIL, GAS, AND GEOTHERMAL RES., DEP'T OF CONSERVATION, 2011 PRELIMINARY REPORT OF CALIFORNIA OIL AND GAS PRODUCTION STATISTICS 2 (2012), available at ftp://ftp.consrv.ca.gov/pub/oil/annual_reports/2011/PR03_PreAnnual_2011.pdf.

undeveloped technically recoverable shale oil resources remaining in discovered shale plays in the United States as of January 1, 2009.²

II. CASE LAW

Despite the activity in California oil and gas fields, there have been no significant upstream oil and gas published cases reported in the last twelve months. The explanation for this may be two-fold. First, most California oil and gas fields were discovered many years ago, and most title disputes may have long ago been resolved. Second, California leases tend to be detailed and rely less on implied covenants than oil and gas leases in other states.³ However, the Author is aware of several lease disputes that are currently in or soon may be in the trial courts that eventually could reach the appellate courts.

At least two involve leases that were uneconomic for extended periods at substantially lower oil prices in past years but are now capable of producing in paying quantities. The issue presented is whether those leases have terminated.

Another involves hydraulic fracturing. On December 8, 2011, the Center for Biological Diversity and the Sierra Club filed a suit against the Bureau of Land Management to prevent leasing of 2,500 acres of federal lands in Monterey and Fresno Counties on the theory that it was done without a thorough analysis of the potential environmental impacts of hydraulic fracturing.⁴ The BLM found no significant impact.⁵ The lawsuit alleges that an Environmental Impact Statement (“EIS”) is necessary.⁶ As of this date, the Author is not aware of the status of the case.

III. LEGISLATIVE ACTION

A. Hydraulic Fracturing

Assembly Bill 591 would amend sections 3203, 3213, and 3215 of the California Public Resources Code and add section 3017.⁷ In brief, it would require the Division of Oil, Gas, and Geothermal Resources (“DOGGR”) to compile a list of chemicals or components used in the process of hydraulic fracturing and to map every well where hydraulic

2. U.S. ENERGY INFO. ADMIN., REVIEW OF EMERGING RESOURCES: U.S. SHALE GAS AND SHALE OIL PLAYS 5 (2011), available at <ftp://ftp.eia.doe.gov/natgas/usshale/plays.pdf>.

3. Earl Hightower, *The Oil and Gas Lease in California*, 3 UCLA L. REV. 424, 447 (1956).

4. Tia Ghose, *Environmental Groups Sue to Prevent Fracking in Calif.*, CALIFORNIA WATCH (Dec. 19, 2011), <http://californiawatch.org/dailyreport/environmental-groups-sue-prevent-fracking-calif-14138>.

5. *Id.*

6. *See id.*

7. Assemb. B. 591, 2011-2012 Reg. Sess. (Cal. 2011).

fracturing takes place.⁸ It was introduced in the regular session of 2011 and was held over.⁹ Due to negotiations with the industry, the bill contains a definition of hydraulic fracturing as well as confidentiality protection, which, according to the California Independent Petroleum Association, is satisfactory to the industry.¹⁰ As of August 16, 2012, it was in the Senate Appropriations Committee.¹¹

Another hydraulic fracturing bill, Senate Bill 1054, which would have required extensive notifications to mineral owners and others before entering the property and before hydraulic fracturing could commence, was refused passage in the Senate on May 31, 2012.¹²

B. *Underground Injection Control (“UIC”) Program*

Senate Bill 711 has been introduced to cure a problem in the California UIC program.¹³ In California, wells used to inject fluids associated with oil and gas production operations are regulated by the DOGGR under chapter 1 (commencing with section 3000) of division 3 of the Public Resources Code.¹⁴ In 1982, DOGGR entered into a primacy agreement with the United States Environmental Protection Agency pursuant to section 1425 of the Federal Safe Drinking Water Act,¹⁵ providing DOGGR with primacy in regulation of class II injection wells in California.¹⁶ Approximately two years ago, having issued permits for the reinjection of unused produced gas for many years, the DOGGR questioned whether it had the power to do so. The bill’s purpose is to confirm that the State of California does have regulatory authority over wells used to dispose of waste fluids, including the injection of gas, from oil and gas wells and waste-water from gas plant operations.¹⁷ As of July 2, 2012, it had passed the Senate and was in the Assembly.¹⁸

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. S. 1054, 2011-2012 Reg. Sess. (Cal. 2012).

13. S. 711, 2011-2012 Reg. Sess. (Cal. 2012).

14. CAL. PUB. RES. CODE §§ 3000–3473 (West 2012).

15. 42 U.S.C. §§ 300h to 300h-8 (2006).

16. *UIC Application Guidance*, CAL. DEP’T OF CONSERVATION, http://www.conservation.ca.gov/dog/general_information/Pages/UICApplicationGuidance.aspx (last visited Nov. 1, 2012).

17. Cal. S. 711.

18. *SB 711 Assembly Bill – Status*, CAL. LEG., http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0701-0750/sb_711_bill_20120703_status.html (last visited Nov. 1, 2012).

IV. REGULATORY ACTION

A. *New Director of Department of Conservation*

California's Governor, Jerry Brown, has appointed a new Director of the California Department of Conservation, Mark Nechodom,¹⁹ who in turn has appointed Tim Kustic as the new Supervisor of the DOGGR.²⁰ There is a back-story here. Last year, as we reported, permits for wells to dispose of oil field waste-water into depleted oil reservoirs, which are issued by DOGGR, were being held up by the Director of the California Department of Conservation.²¹ Of course, this caused a high level of concern throughout the California oil and gas industry. With the new appointments, permits are now being issued.²²

B. *California Cap and Trade Law*

California is the first state in the United States to adopt a law requiring the state to implement a cap and trade plan.²³ According to its web site, the California Air Resources Board has now designed a California cap-and-trade program that it believes is enforceable and meets the requirements of the implementing law, commonly referred to as "AB 32."²⁴ A very short description of a very complicated program is that large emitters will have to buy permits (called allowances) from the state.²⁵ Each permit allows for a given amount of greenhouse gas emissions each year with the amount declining every year.²⁶ Companies that cut emissions and have excess allowances can sell them on the open market.²⁷ Companies that cannot cut emissions will have to buy allowances on the open market.²⁸ The program started on January 1, 2012, with an enforceable compliance obligation begin-

19. *Governor Brown Announces Appointments*, CA.COM, <http://gov.ca.gov/news.php?id=17364> (last visited Oct. 9, 2012).

20. Tim Kustic, *State Oil and Gas Supervisor*, CAL. DEP'T OF CONSERVATION, <http://www.conservation.ca.gov/index/AboutUs/Pages/TimKustic.aspx> (last visited Nov. 1, 2012).

21. *Oil, Gas & Geothermal - Injection Wells*, CAL. DEP'T OF CONSERVATION, http://www.conservation.ca.gov/dog/general_information/Pages/class_injection_wells.aspx (last visited Nov. 1, 2012).

22. *Id.*

23. SYLVIA BURKE, *CAP-AND-TRADE IN THE UNITED STATES – UP IN THE AIR* 298 (2011).

24. *Cap-and-Trade Program*, CAL. AIR RES. BD., <http://www.arb.ca.gov/cc/capandtrade/capandtrade.htm> (last visited Nov. 1, 2012).

25. *Id.*

26. *Id.*

27. Felicity Barringer, *A Market in Emissions is Set to Open in California*, N.Y. TIMES, Nov. 14, 2012, at B5, available at http://www.nytimes.com/2012/11/14/business/energy-environment/california-to-hold-auction-of-greenhouse-gas-emissions.html?_r=0.

28. *Id.*

ning with 2013 green house gas emissions.²⁹ An auction is scheduled for November 14, 2012.³⁰

29. *Cap-and-Trade Program Implementation*, CAL. AIR RES. BD., <http://www.arb.ca.gov/cc/capandtrade/implementation/implementation.htm> (last visited Nov. 1, 2012).

30. *Auction Notice*, CAL. AIR RES. BD. (Sept. 14, 2012), http://www.arb.ca.gov/cc/capandtrade/auction/november_2012/auction_notice.pdf.