

SUNSET ADVISORY COMMISSION

DECISION MATERIAL



*Railroad Commission
of Texas*

January 2011

Sunset Advisory Commission



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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 12-member Commission is a legislative body that reviews the policies and programs of more than 130 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency’s operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

Railroad Commission of Texas

SUNSET DECISION MATERIAL
JANUARY 2011

This document is intended to compile all recommendations and action taken by the Sunset Advisory Commission for an agency under Sunset review. The following explains how the document is expanded and reissued to include responses from agency staff and the public.

- *Sunset Staff Report, November 2010* – Contains all Sunset staff recommendations on an agency, including both statutory and management changes, developed after extensive evaluation of the agency.
 - *Hearing Material, December 2010* – Summarizes all responses from agency staff and the public to Sunset staff recommendations, as well as new policy issues raised for consideration by the Sunset Commission at its public hearing.
 - *Decision Material, January 2011* – Includes additional responses, testimony, or new policy issues raised during and after the public hearing for consideration by the Sunset Commission at its decision meeting.
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Summary

Summary

Despite being charged with overseeing Texas' oil and gas industry – a vital sector of the State's economy, and one that continues to be fraught with controversy – the Railroad Commission of Texas (Commission) has quietly fulfilled its mission for nearly 120 years. As the State's oldest regulatory agency, the Commission's early history is rooted in regulating railroad rates and tariffs, a function for which the agency also acquired its name. However, over time, state and federal law have stripped away the agency's involvement with railroads. Meanwhile, the Legislature has broadened its regulatory role to include the economic oversight of oil and gas production and, more recently, a greater focus on environmental protection. To illustrate the role of oil and gas production in Texas, Appendix A of this report details the amount of severance taxes paid by the industry.

For most of its lengthy tenure, the Commission primarily interacted with oil and gas producers and citizens, mostly in rural Texas, accustomed to the ways and impacts of oil and gas production. Today, however, as technological advances allow oil and gas exploration in areas of the state previously thought to be economically unfeasible, the Commission faces both a new set of regulatory challenges and a new constituency.

The Sunset review of the Railroad Commission has occurred in the midst of these game-changing events, as oil and gas exploration continues to move into urban and suburban areas of the state, followed by public outcries against such development. Sunset staff evaluated the structure and functions of the Railroad Commission within this new regulatory environment, and identified several critical concerns with the agency's oversight, funding, and enforcement processes, as outlined below.

Although historic, the three-member, elected Railroad Commission is an anomaly in Texas government. Few agencies have full-time boards and none of these boards have members elected on a statewide basis. In assessing this unique policy body, staff found no ongoing need for a three-member, elected structure. In fact, critics would argue that elected Commissioners pose a conflict for the agency's regulatory role, as the costs of a statewide campaign often rely on campaign contributions from the regulated industry. Compounding these concerns is the potential for voters and the public in general to be confused about the actual duties of the office given its outdated name. Interestingly, a recent unsuccessful candidate for the Commission even included railroad safety as part of his campaign platform.

Another unusual aspect of the agency's structure relates to its funding. While the estimated \$186 billion oil and gas industry makes a significant contribution to the State, the Commission relies on General Revenue to fund almost half of its more than \$50 million budget for this industry's oversight. In contrast, most other state regulatory agencies are required by statute or rider to be self-supporting. This current funding model also limits the

Advancements in the oil and gas industry put the Commission face-to-face with a new set of regulatory challenges and new public demands.

agency's ability to react as fluctuations in the industry occur, such as the need for more inspectors when drilling unexpectedly expands.

Enforcement, always a key focus of a Sunset review, revealed that the Commission pursues enforcement action in a very small percentage of the thousands of violations its inspectors identify each year. Part of the reason for the large number of violations is that the Commission's enforcement process is not structured to deter repeat violations. The Commission also struggles to present a clear picture of its enforcement activities, frustrating the public.

Sunset staff also examined Railroad Commission functions that may be similar to or duplicated by the work of other state entities. Specifically, with respect to the Texas Commission on Environmental Quality, staff found that current split jurisdiction between the two agencies does cause some confusion, but processes exist to address gaps in regulation. Review of other agency functions, such as the Railroad Commission's promotion of propane as an alternative fuel, did reveal significant duplication of efforts, as well as conflicts with its regulatory role.

To address the problems identified, this report contains various recommendations to reposition the State's oversight of the oil and gas industry, including a fundamental restructuring of the agency and its governing board. The cumulative impact of these recommendations aims to create an agency poised to provide robust oversight of oil and gas exploration and production. Although many different approaches to this end exist, these recommendations afford an opportunity to address the governance, organizational structure, and funding of the State's oil and gas regulator.

Another structural issue, identified as part of the Sunset review of the Public Utility Commission, relates to the Railroad Commission's regulation of gas utilities. With the Railroad Commission, Texas Commission on Environmental Quality, and Public Utility Commission concurrently under Sunset review, timing provided a unique opportunity to evaluate the State's method of providing utility oversight. While gas utility regulation has a long history at the Railroad Commission, Sunset staff found that the State could benefit from merging all its utility regulatory functions into PUC. Recommendations relating to the transfer of gas utility oversight and ratemaking can be found in the Supplement to the PUC Report, which is also included within this report.

The following material summarizes Sunset staff recommendations on the Railroad Commission of Texas.

Issues and Recommendations

Issue 1

The 19th Century Design of the Three-Member, Elected Railroad Commission No Longer Aligns With the Agency's Current-Day Mission.

Sunset staff determined that the functions of the Railroad Commission of Texas continue to be needed, and that a stand-alone agency is warranted to carry out these functions. However, the three-member, elected Commission, established in the late 1800s, is no longer necessary to oversee the functions of the agency today. An elected body raises potential questions of conflicts between the Commission as a regulatory agency and the oil and gas industry it regulates. In contrast, most state agencies are governed by part-time, appointed boards. Also, the antiquated agency name does not reflect its current functions

and confuses the public. A new state agency, governed by a five-member, appointed board and named the Texas Oil and Gas Commission, would address these issues.

Key Recommendation

- Establish the Texas Oil and Gas Commission, governed by a part-time, appointed board, to assume the regulatory role currently served by the Railroad Commission, and continue the agency for 12 years.

Issue 2

Using General Revenue to Regulate the Oil and Gas Industry Shifts Oversight Costs From the Industry to Taxpayers.

Unlike most regulatory programs, the Oil and Gas program at the Railroad Commission is not self-supporting. Instead, the program's \$52.5 million budget for fiscal year 2011 relies on about \$23.4 million in General Revenue. Of the remaining budgeted amount, about \$27.5 million appropriately comes from fees, fines, and other miscellaneous revenues levied on the oil and gas industry. In contrast, other regulatory agencies have statutory means to ensure fee revenues cover the costs of regulation. Modifying the agency's method of finance to rely on industry-paid fees, instead of General Revenue, would align the Commission's Oil and Gas program with most other regulatory programs in the state and provide the agency with needed flexibility to respond to industry changes.

Key Recommendations

- Require the Commission's Oil and Gas program to be self-supporting, and authorize the Commission to levy surcharges on the program's permits, licenses, certificates, or reports to achieve this purpose.
- Reconstitute the Oil Field Cleanup Fund as the Oil and Gas Fund, continued as a dedicated fund in General Revenue established to pay for the entire Oil and Gas program.

Issue 3

Current Enforcement Processes Hinder the Commission's Ability to Prevent Future Threats to the Environment and Public Safety.

The Commission enforces laws aimed at ensuring public safety and protecting the environment from adverse effects of oil and natural gas production. However, the Commission focuses on bringing violators into compliance, with only a very limited percentage of violations resulting in enforcement action or fines, an important aspect for deterring future violations. The Commission also lacks a clear system for pursuing enforcement action that is based on a consistent measure of severity or pattern of repeat offenses. In addition, unlike most state agencies, the Commission conducts its own enforcement hearings, rather than taking advantage of the independence that the State Office of Administrative Hearings offers.

As the oil and gas industry continues to affect significantly populated areas of the state, the Commission needs an enforcement process that leaves little room for the public to question the agency's appropriate and consistent handling of identified violations. A more defined enforcement process would help deter violations and make oil and gas regulation more effective.

Key Recommendations

- Require the Commission to develop, in rule, an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.
- Require the Commission to formally adopt penalty guidelines in rule.
- Transfer the Commission's enforcement hearings to the State Office of Administrative Hearings.
- Direct the Commission to revamp its tracking of violations and related enforcement actions tied to oil and natural gas production, and to develop a clear and consistent method for analyzing violation data and trends.
- The Commission should publish additional complaint and enforcement data on its website.

Issue 4

The Commission's Marketing of Propane Is No Longer Necessary.

The Railroad Commission is charged with ensuring the safe delivery of propane to both commercial and residential users. However, the Commission also promotes the use of propane, placing the agency in conflict with its regulatory role. In fact, no other regulatory agency in the state markets a product that it also regulates. In addition, the Commission's propane marketing function duplicates the work of other state and national organizations that promote propane and raises costs for consumers.

Key Recommendation

- Eliminate the Commission's statutory authority to promote the use of propane.

Issue 5

Texas' Interstate Pipelines Lack Needed Damage Prevention Oversight to Ensure Public Protection.

Texas has more than 214,000 miles of pipeline that traverse the state, including both intrastate pipelines that run within the state, and interstate pipelines that connect to other states. To help ensure public safety, Texas has established a damage prevention program to enforce against excavators and operators who damage intrastate pipelines. However, as the Commission only has statutory authority over intrastate pipelines, this program does not extend to interstate lines, leaving a large and potentially dangerous regulatory gap. By extending the Commission's damage prevention program to cover interstate pipelines, the State could help prevent the devastating effects of pipeline incidents, no matter which type of pipeline is involved.

Key Recommendation

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

Issue 6

Impending Retirements of Key Staff Could Leave the Commission Vulnerable to a Significant Loss of Institutional Knowledge.

The Commission needs a strong and highly skilled staff to effectively oversee the oil and natural gas industry. However, a large portion of the Commission's workforce, particularly its top management, is nearing retirement. Although the Commission has developed a Workforce Plan that identifies positions at risk of becoming vacant, the Commission has not implemented a succession plan that trains and develops employees to move into these positions. Not implementing a succession plan leaves the Commission vulnerable to a significant loss of experienced staff in key management and technical areas in the near future.

Key Recommendation

- The Commission should develop and implement a succession plan to prepare for impending retirements and workforce changes.

Gas Utility Regulation Transfer Supplement to the Sunset Staff Report on PUC

In the reviews of the Railroad Commission and TCEQ, Sunset staff found that the agencies' respective utility responsibilities have worked within those organizations and have benefitted from these relationships. At the same time, however, Sunset staff found that significant opportunities could be realized from realigning the regulation of gas utilities and water and wastewater utilities at PUC. Such a realignment would offer benefits from PUC's expertise in utility regulation, a structure for fair and independent decision making, and enhanced opportunities for each agency to focus on its core mission. The realignment would also address needed transitional provisions to work out details for coordinating interrelated responsibilities between the agencies, including pipeline safety concerns at the Railroad Commission and drinking water and environmental regulatory issues at TCEQ.

Key Recommendations Related to the Railroad Commission

- Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.
- Require the use of the State Office of Administrative Hearings in contested gas utility cases.

Fiscal Implication Summary

This report contains recommendations that would have an estimated positive fiscal impact to the State of more than \$27.7 million. The fiscal impact for each of these recommendations is summarized below, followed by a five-year summary chart showing the cumulative impact of the recommendations.

- **Issue 1** – The recommendations in Issue 1 to create the Texas Oil and Gas Commission with a part-time policy board would result in an estimated net savings to General Revenue of \$1,222,066 and a reduction of 13 full-time equivalent positions. Eliminating the three, elected Commissioners and their respective staff would result in a savings of \$1,372,066 and a reduction of 13 staff positions. Establishing a new Commission, with a new governing body, would result in costs of about \$100,000 associated with the name change and \$50,000 in travel expenses for part-time board members.

- **Issue 2** – Authorizing the Commission to levy surcharges for its Oil and Gas program to cover the costs of regulation would result in an estimated savings to General Revenue of \$23,353,796. Redirecting administrative penalties to the General Revenue Fund to avoid a potential conflict of interest would result in an additional \$2.5 million gain to General Revenue. These recommendations would have no impact on the Commission’s staffing levels.
- **Issue 3** – Requiring the Commission to develop an enforcement policy to guide referrals would likely increase the number of violations forwarded for enforcement, and updating the penalty guidelines would likely bring in more revenue. However, because penalty amounts generated depend on the number and seriousness of future violations, the potential fiscal impact could not be estimated. Transferring the Commission’s enforcement hearings to SOAH would have no significant fiscal impact to the State and no associated reduction of staff. The savings to the agency would be offset by the cost of conducting the hearings at SOAH.
- **Issue 4** – Elimination of the Commission’s propane promotion program would result in a savings to General Revenue of \$596,775 because the costs of the program are not fully covered by industry fees. This change would also result in a reduction of 10 full-time equivalent positions.

Railroad Commission of Texas

Fiscal Year	Savings to the General Revenue Fund	Gain to the General Revenue Fund	Net Positive Fiscal Impact to the General Revenue Fund	Change in the Number of FTEs From FY 2009
2012	\$25,172,637	\$2,500,000	\$27,672,637	-23
2013	\$25,172,637	\$2,500,000	\$27,672,637	-23
2014	\$25,172,637	\$2,500,000	\$27,672,637	-23
2015	\$25,172,637	\$2,500,000	\$27,672,637	-23
2016	\$25,172,637	\$2,500,000	\$27,672,637	-23

Agency at a Glance
(November 2010)

Agency at a Glance

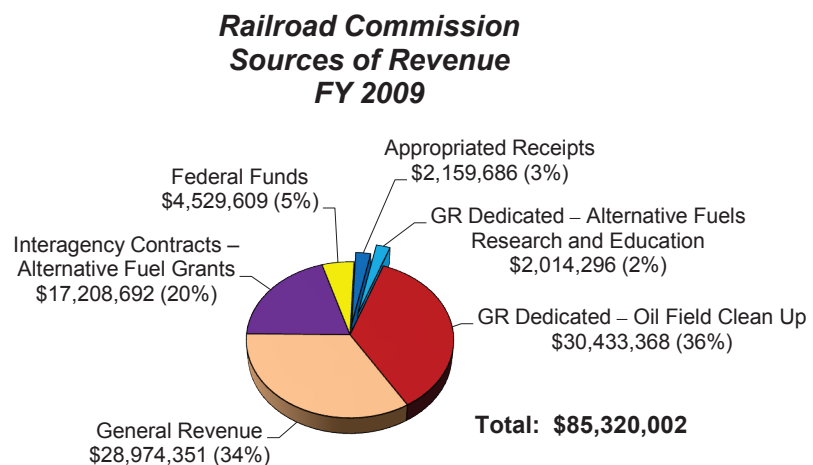
The Railroad Commission of Texas (Commission) serves as the State's primary regulator of the oil and gas industry. The agency's mission is to ensure the efficient production, safe transportation, and fair price of the State's energy resources, with minimal effects to the environment. To fulfill its mission, the Commission:

- oversees all aspects of oil and natural gas production, including permitting, monitoring, and inspecting oil and natural gas operations;
- permits, monitors, and inspects surface coal and uranium exploration, mining, and reclamation;
- inspects intrastate pipelines to ensure the safety of the public and the environment;
- sets gas utility rates and ensures compliance with rates and tax regulations; and
- promotes the use of propane and licenses all propane distributors.

Key Facts

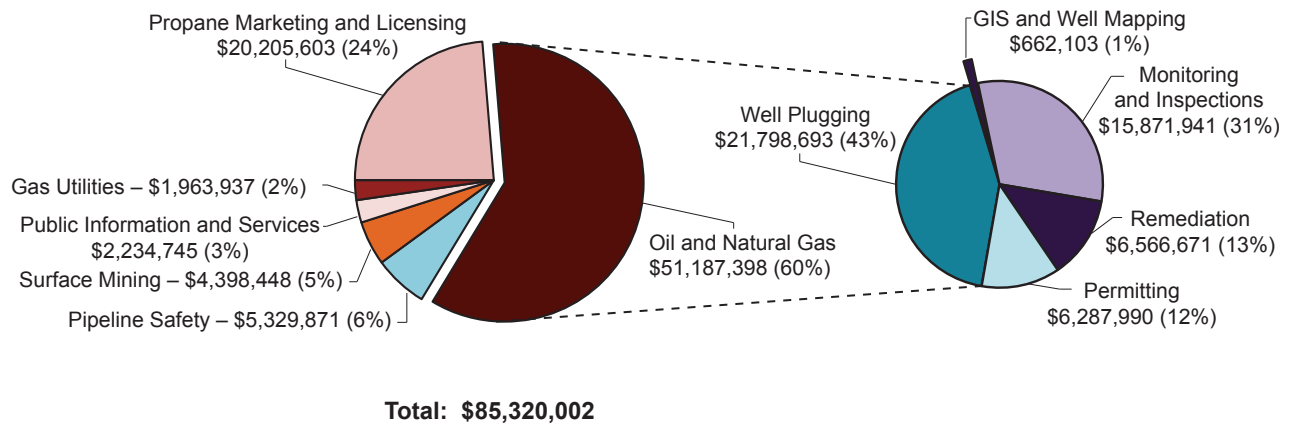
- **Commissioners.** The Railroad Commission consists of three statewide elected officials who serve staggered, six-year terms: Victor G. Carrillo, Chairman; Elizabeth A. Jones; and Michael L. Williams. Commissioners elect their Chair, and the Governor appoints a new member when a vacancy on the Commission occurs. The Commission met 20 times in fiscal year 2009.
- **Staff.** The Commission employs 662 staff, 279 of whom operate out of the Commission's 13 field offices. Most field staff perform inspections of oil, natural gas, and pipeline facilities. Additional information on the location and the number of employees at each of the 11 oil and natural gas district and pipeline safety regional offices is included in Appendices B and C.
- **Funding.** In fiscal year 2009, the Commission received an appropriation of \$85 million, including nearly \$29 million in General Revenue and about \$30 million in General Revenue dedicated to remediation of pollution related to oil and natural gas production. In addition, the Commission received more than \$17 million in state and federal grants that the Commission distributed to local governments as part of its Alternative Fuels Research and Education program. The pie chart, *Railroad Commission Sources of Revenue*, details the Commission's sources of funding in fiscal year 2009.

The pie chart on the following page, *Railroad Commission Expenditures by Program*, provides a breakdown of the Commission's \$85 million in expenditures in fiscal year 2009, with a more detailed breakout of the 60 percent of expenditures devoted to



permitting, inspecting, and remediating oil and natural gas operations. The Commission also spent 6 percent of its funds monitoring intrastate pipelines and 5 percent regulating surface coal mining and uranium exploration. The Commission expended an additional \$20 million, or 24 percent of its funds, marketing propane; most of these funds, however, were grants passed through to local governments and fleet operators.

Railroad Commission Expenditures by Program – FY 2009



- **Oil and Natural Gas Production Oversight.** The Commission oversees the exploration and production of oil and natural gas from drilling and producing to well plugging and remediation.

Permitting. Statute requires all operators involved in the exploration or production of oil and natural gas to provide the Commission with basic organizational information and adequate financial surety; ensure water quality and prevent production-related pollution; and prevent waste and protect the correlative rights of mineral owners. In fiscal year 2009, the Commission issued more than 18,500 new drilling permits.

Compliance. The Commission monitors more than 375,000 oil and natural gas wells, 280,000 of which are actively producing. Field inspectors witness the pouring of surface casings, inspect drilling rigs, respond to complaints and pollution violations. In cases of ongoing pollution or where an operator refuses to come into compliance with State regulations, the Commission has the authority to enter a lease and shut off production. In fiscal year 2009, the Commission performed more than 128,000 oil and natural gas facility inspections, identified more than 80,000 violations, pursued over 550 enforcement actions, and assessed more than \$2 million in penalties. Appendix D details the Commission’s oil and natural gas inspection process.

Well Plugging and Site Remediation. In 1991, the Legislature created the Oil Field Cleanup Fund to pay for the State to plug and clean up abandoned and polluted production sites. In fiscal year 2009, the Commission plugged 1,460 orphaned wells and remediated 323 abandoned and polluted sites. An estimated 8,000 orphaned wells remain unplugged. Additionally, the Commission oversees pollution cleanups performed by the oil and gas industry, ensuring that cleanups do not become State-managed projects, and provides incentives to landowners to remediate production-related pollution by granting landowners a release of liability in exchange for successful remediation. In fiscal year 2009, the Commission monitored 563 operator-initiated cleanup efforts and granted eight landowners a release of liability for successfully remediating their property.

- **Pipeline Safety.** To ensure the integrity of Texas' 170,000 miles of regulated intrastate pipeline, field staff conduct pipeline safety inspections; audit pipeline operators and their records; and investigate pipeline accidents. Appendix E details the Commission's pipeline safety inspection process. In fiscal year 2009, field staff conducted more than 2,100 pipeline safety inspections, identified approximately 2,500 violations, completed 14 enforcement actions, and collected approximately \$63,000 in penalties. The Commission also develops educational programs on pipeline safety for contractors and enforces damage prevention rules, completing more than 3,200 enforcement actions, and collecting nearly \$1 million in penalties for damage prevention violations in fiscal year 2009.
- **Gas Utility Oversight and Rate Setting.** The Commission ensures that customers have equal access to fairly natural gas by overseeing gas utility rates for about 200 gas utility companies operating in Texas. The Commission has exclusive jurisdiction over gas utility rates in unincorporated areas and appellate jurisdiction over rates set inside municipalities. In addition, the Commission audits gas utility companies to ensure compliance with rate and tax regulations; prevents discrimination among gas utilities by ensuring equal access to pipelines; and offers dispute resolution for parties in the natural gas industry. In fiscal year 2009, the Commission processed 80 docketed cases relating to the gas utility industry and conducted 140 field audits.
- **Coal and Uranium Mining.** The Commission regulates surface coal and uranium exploration and mining to help prevent harmful effects to land and water resources, and to ensure the reclamation of mined land. To oversee these mining activities, the Commission evaluates permits, inspects and monitors mining sites, and investigates complaints against mining operators.

Coal Mining. The Commission oversees 24 coal mining operations in Texas, completing 450 inspections and pursuing nine non-safety related enforcement actions in fiscal year 2009. The Commission, using federal funds, also provides assistance for reclaiming abandoned coal mines, with more than 90 percent of all abandoned coal mines currently in some phase of reclamation.

Uranium Exploration. The Commission permits the exploration of uranium using in situ leaching, issuing two new permits and renewing 16 existing permits in fiscal year 2009. Beyond exploration, the Texas Commission on Environmental Quality oversees in situ uranium mining production. For surface mining of uranium, the Railroad Commission has the authority to issue permits, although no such permits currently exist in Texas.

- **Propane Oversight and Promotion.** All businesses and employees involved in supplying, transporting, or distributing propane in Texas must obtain a license from the Commission, after meeting specified training and testing requirements. The Commission also inspects propane facilities and enforces propane-related laws and rules. In fiscal year 2009, the Commission issued more than 3,500 licenses, conducted more than 300 training courses and 3,500 exams, performed some 16,000 inspections, and identified 13,000 violations that resulted in 77 propane-related enforcement actions.

The Commission also promotes the consumption of propane, a function funded by delivery fees paid by the propane industry and from state and federal grants. Marketing activities include providing rebates to purchasers of propane appliances and offering grants to local governments and fleet operators who replace old vehicles with new propane fueled vehicles. In fiscal year 2009, the Commission issued more than 4,000 consumer rebates and awarded more than 500 grants, totaling more than \$17 million.

Issues

Issue 1

The 19th Century Design of the Three-Member, Elected Railroad Commission No Longer Aligns With the Agency's Current-Day Mission.

Background

Authorized by constitutional amendment in 1890 and legislatively created the following year, the Railroad Commission of Texas (Commission) is the primary regulator of Texas' important oil and gas industry. Originally created to regulate the rates and operations of railroads and other common carriers, the Commission received responsibility for overseeing oil and gas pipelines, also deemed common carriers, in 1917.¹

As Texas' oil and gas industry boomed, the need for regulating production and transportation of such energy resources followed. Using the pipeline link to oil and gas production, the Legislature continued to give the Commission oil- and gas-related oversight duties and slowly removed other, non-energy resource functions. The Legislature completed this refocusing when it transferred all railroad regulatory functions to the Texas Department of Transportation in 2005.²

Today, the Commission's role is to ensure responsible energy resource production – protecting the rights of mineral owners and preventing pollution, while maximizing hydrocarbon recovery – by permitting oil and natural gas drilling, overseeing oil and natural gas production sites, remediating land polluted during the course of drilling for oil or natural gas, and ensuring the safe transportation of such products through the State's pipeline system. In addition to these core functions, the Commission oversees surface mining operations, sets rates charged by gas utilities, and encourages the use of propane as an alternative fuel.

Three statewide elected officials comprise the Railroad Commission, although the first four Commissioners were Governor-appointed. Voters amended the Texas Constitution in 1894 to require that the board be made up of elected officials who serve staggered, six-year terms, with one Commissioner seeking election every two years.³

When a vacancy occurs, the Governor appoints a new member until the next general election, however the Commissioners elect their own Chair. The accompanying chart, *Railroad Commission of Texas*, details the current Railroad Commissioners and their respective terms. The Commission employs 662 staff and operated with a fiscal year 2009 budget of approximately \$85 million, about one-third of which comes from General Revenue.

Railroad Commission of Texas

Commissioner	Term Expires
Victor G. Carrillo, Chairman	2010
Elizabeth A. Jones	2012
Michael L. Williams	2014

Findings

Texas has a continuing need to regulate the production, transportation, and distribution of oil, natural gas, and other critical energy resources.

- **Oil and Natural Gas Production Oversight.** Unregulated production of oil and natural gas can detrimentally affect the environment and significantly hinder future product recovery efforts. Improper drilling and well maintenance can easily allow oil, underground saltwater, and other drilling byproducts to contaminate soil and fresh water supplies. To prevent this possibility, the Commission monitors more than 375,000 oil and natural gas wells, about 280,000 of which are actively producing. Using a risk-based schedule and in response to complaints, Commission staff regularly inspect well drilling operations and producing wells. Commission staff also often witness critical steps in the drilling process, such as pouring the cement casing that shields the earth and underground water supply from drilling fluids and produced hydrocarbons.

Other activities associated with drilling for oil and natural gas, such as enhanced recovery processes, hydraulic fracturing, and drilling waste disposal, can also have significant environmental impacts. For these functions, the Commission's authority to permit underground injection wells is federally delegated and reviewed by the Environmental Protection Agency every two years. Given the controversy surrounding such recovery techniques and disposal methods, the State has a continued interest in retaining local control and playing a strong role in regulating these activities.

Although the Commission's rules set out requirements that aim to prevent pollution, spills do happen. Accidents and more willful actions, such as failing to plug inactive wells, contribute to pollution and, in fiscal year 2009, the Commission cited more than 18,000 water protection violations. Fluctuations in the price of oil and natural gas also contribute to more willful violations, particularly when smaller, independent operators lack the resources to plug inactive wells. In 1991, the Legislature created the Oil Field Cleanup Fund financed by production-related fees and fines that the Commission uses primarily to plug abandoned wells and remediate abandoned, polluted land.

For many years, the number of abandoned wells and polluted sites that fell to the State's liability remained high. During the agency's last Sunset review in 2001, the Legislature added significant statutory provisions, including requiring universal bonding for oil and gas producers, in an attempt to lessen the State's burden in managing abandoned sites that pose an environmental threat. The Legislature's and Commission's focused efforts to bring existing orphaned wells into compliance has resulted in a decrease of about 10,000 abandoned wells during the past eight years. In

The Commission monitors 375,000 oil and natural gas wells in Texas.

Efforts to remediate polluted sites have considerably lessened environmental threats.

fiscal year 2009 alone, the Commission plugged 1,460 abandoned wells that posed an active pollution threat and remediated 323 sites polluted as a result of oil and gas production activities. Although such efforts have resulted in, and should continue to result in, a decreased number of unplugged wells and contaminated land, the need to remediate pollution will likely always exist.

In addition to its role protecting the environment, the Commission is responsible for protecting correlative rights and preventing waste. The Commission allocates how much oil or natural gas an operator can produce from an active well within a certain period of time. This function no longer serves so much as a means to control production or the market, as it does an enforcement tool, allowing the Commission to stop noncompliant operators from producing. The Commission also reviews spacing requirements when granting an initial drilling permit to ensure that drilling activities in one area do not infringe on another mineral owner's ability to recover oil and natural gas deposits from their land.

- **Pipeline Safety.** Texas, by far, has the most miles of pipeline transporting gas, hazardous liquids, and carbon dioxide to different points throughout the state and across state borders. Through its federally delegated pipeline safety program, the Commission oversees more than 170,000 miles of intrastate pipelines, including gathering lines, large transmission lines, and distribution lines that bring natural gas directly to consumers. On a regular basis, Commission staff inspect pipeline infrastructure integrity and audit pipeline companies to ensure proper safety standards are followed.

The need for a State pipeline safety program has never been stronger, as was seen in several recent pipeline explosion incidents in both Texas and California. In fiscal year 2009, the Commission inspected about a third of the pipeline systems under the agency's jurisdiction. In addition to these State efforts, the federal government also maintains a regional office in Texas to oversee the remaining lines that provide out-of-state transportation.

- **Surface Mining Regulation.** Similar to the regulation of oil and natural gas production, the Commission's role in overseeing surface coal mining provides needed environmental protection. In fact, Texas is the largest consumer of coal, mainly for power generation purposes, and the sixth largest producer of coal. To this end, the Commission oversees coal mining operations from the pre-mining, planning stage through the final reclamation process, ultimately ensuring that mined land is restored its pre-mining, productive condition.

Coal mining oversight is required by federal law, and if the State did not operate this program, the federal government would regulate Texas' surface mining operations. Although mining companies must post

The need to remediate pollution caused by oil and gas production will always exist.

The Commission oversees more than 170,000 miles of pipeline carrying gas and hazardous liquids.

The Commission oversees 24 coal mines that supply an energy source for electricity generation.

bond that equals 100 percent of reclamation costs, the Commission also administers a program to reclaim abandoned mine lands. The Commission oversees 24 permitted coal mining operations and has successfully restored abandoned mine lands in 17 Texas counties.

The Commission also permits uranium exploration mined through the in situ method, which involves drilling similar to oil and gas production drilling. The agency oversees 18 permits, working to ensure that proper casing and other preventative techniques preserve water quality throughout the exploration process.

- **Gas Utility Oversight.** About 200 investor-owned utilities gather, transport, and distribute natural gas to domestic, commercial, and industrial end users in both cities and rural areas. Since, in most cases, these companies operate as monopolies, the State has an interest in ensuring such utilities charge fair rates. Whether the Railroad Commission oversees this process or not is another question, which is further discussed below and in the supplemental issue to the Public Utility Commission report continuing that agency.
- **Promotion and Oversight of the Propane Industry.** The Railroad Commission also promotes the use of propane as an alternative fuel, licenses individuals and companies involved in its sale and distribution to the public, and performs safety-related inspections of businesses that sell propane. Although the State no longer needs to promote the use of propane as an alternative fuel, as is discussed in Issue 4 of this report, the State does have a continuing interest in ensuring that such products are safely distributed to consumers.

Although most states oversee oil and gas production through an environmental agency, the magnitude of Texas' oil and gas industry continues to warrant a separate oversight structure.

Texas is unique in regulating the oil and gas industry through an independent agency, though this marked difference is likely explained by the Commission's long tenure and history as one of the first such state regulatory agencies. Most other oil and gas regulatory agencies were created long after the Railroad Commission or have since been combined with the state environmental agency as a result of the strong link between oil and gas production oversight and environmental protection. Similarly, most states administer their gas utility ratemaking function through a public utility commission and not the agency that oversees oil and gas production.

During the Sunset review of the Railroad Commission, staff evaluated the continuing need for an independent agency to oversee the oil and gas industry, as most of the Railroad Commission's core functions share similar aspects with the activities of other state agencies. This current review also presented a unique chance to review similarities among agencies, since the Texas Commission on Environmental Quality and the Public Utility Commission

Texas was one of the first states to regulate the oil and gas industry.

are also under review in the same timeframe. Although maintaining the current, independent agency approach is not essential, as is discussed in the material below, complications exist with wholesale consolidations and most program transfers, outside of gas utility ratemaking and oversight.

- **Texas Commission on Environmental Quality (TCEQ).** Many of the Railroad Commission's programs, namely oil and gas regulation and oversight of surface mining, have a key environmental protection component. This clear link presents the question of whether the State would be better served, from an environmental protection vantage point, if TCEQ assumed the Railroad Commission's current oil, gas, and surface mining oversight activities.

Clear benefits do exist under this scenario, as some of the agencies' programs have split or unclear jurisdictions, and may even result in duplicative efforts. For example, the Railroad Commission currently has authority to regulate in situ uranium mining exploration, but TCEQ oversees the actual mining process. Likewise, the Railroad Commission has responsibility for preserving water quality in oil and gas production, but TCEQ, because of federal delegation requirements, retains the authority to regulate air emissions from oil and gas production. Also, both agencies administer site remediation programs, but hold jurisdiction based on the pollution source.

Despite the advantages of transferring components of Railroad Commission programs, clear disadvantages exist and outweigh the above benefits. Effective regulation depends on an agency's ability to take swift enforcement action when violations of the law or agency rule occur. The Railroad Commission holds this enforcement card with its authority to curtail a well's production. Transfer to TCEQ would remove this tool for environmental regulation. In addition, the Railroad Commission would maintain many oversight functions, and thus still have a need for field inspectors. In an attempt to solve one duplication of efforts, a new one would assuredly arise.

Consolidating the Railroad Commission within TCEQ would be the more likely option to many, however this move has significant downfalls. Particularly, oversight of the oil and gas industry involves many activities that reach far beyond TCEQ's environmental work. For example, the Railroad Commission's oil and gas oversight functions include protecting correlative rights, an activity that, at times, may even be in conflict with a strict environmental protection approach. In addition, through more than 100 years of regulating the oil and gas industry, the Railroad Commission has developed expertise in overseeing the industry and, although improvements are needed, no glaring problems exist that would warrant such a wholesale transfer.

- **Public Utility Commission (PUC).** Public utility regulation is currently split between the Railroad Commission, TCEQ, and PUC, and an

Consolidating oil and gas regulation within TCEQ could provide some benefits, but is not without significant pitfalls.

opportunity to merge these utility functions currently exists. Although the Railroad Commission began as a rate oversight agency, the Commission's core mission has evolved with time, yielding a primary role overseeing oil and gas production. Meanwhile, PUC has a well-developed ratemaking function, complete with an organizational structure and in-house expertise that supports efficiency. In short, PUC can effectively oversee gas utilities, allowing the Railroad Commission to focus on oil and gas production oversight, a duty that is more important now than ever given the growth of production in Texas' natural gas fields. The separate issue addressing PUC's continuation and duties provides a full discussion of this opportunity for consolidation.

Having three full-time, elected Railroad Commissioners is unnecessary and can pose conflicts for the agency's regulatory role.

- **Outdated Structure.** Nearly 120 years ago when voters amended the Texas Constitution to provide for an elected Commission, railroads were the primary means of transportation for people and products. As a result, having three statewide elected officials oversee the rates and operations of railroads ensured the public's interests in such an important function were well represented. However, the Legislature slowly removed the Commission's rail oversight functions during the last 50 years, completing the process with the final transfer of the Commission's remaining regulatory authority over railroads to the Texas Department of Transportation (TxDOT) in 2005. Even though TxDOT now serves as the State's regulatory authority for rail safety, the governing body originally created for this function is still the Railroad Commission.

Today, this policymaking structure created in 1894 to oversee transportation no longer aligns with the modern-day programs housed at the Railroad Commission. In fact, a three-member, elected Commission falls outside the State's standard approach to policymaking. The composition of the Railroad Commission is an anomaly as the only state agency headed by a three-member, full-time elected body. Policy boards composed of three Governor-appointed, full-time commissioners are typical for more recently created major regulatory agencies, including the Public Utility Commission, the Texas Commission on Environmental Quality, and the Texas Workforce Commission.

However, the Railroad Commission's current duties do not necessarily warrant the need for three, full-time Commissioners. Despite the important role the Commissioners play in overseeing an industry as large and complex as the oil and gas industry, the Commissioners' meeting responsibilities do not indicate the need for full-time positions. For example, in fiscal year 2009, the Railroad Commission held 20 conferences (public meetings), totaling about 28 hours. These hours represent time spent on some of the Commission's more significant and time-intensive

The Railroad Commission has no regulatory duties related to railroads.

The Railroad Commission, with its three-member, elected board, is an anomaly in Texas government.

functions, such as ratemaking and taking enforcement action against noncompliant entities. In contrast, the Public Utility Commission met for a total of about 136 hours and the Texas Commission on Environmental Quality met for a total of about 56 hours.

Clearly, the Railroad Commissioners' workload is reflected in many activities beyond public meetings. Commission members spend significant numbers of hours preparing for meetings, hearings, developing policy, and other matters. However, other oversight bodies, such as the Texas Transportation Commission and the Public Safety Commission have significant oversight and decision-making responsibilities, yet carry out these duties with part-time appointed policy bodies. Finally, maintaining three, full-time Commissioners, each with their own staff is costly to the State. The agency's operations, funded mainly by General Revenue, included a budget of about \$1.1 million in fiscal year 2010 to fund the Commissioners' salaries and their staffs.

- **Appearance of Conflicts.** Although statewide elected officials clearly represent the public, critics consistently raise concerns that the appearance of conflicts may arise when such individuals head a regulatory agency. Elected officials rely on campaign contributions to seek office, re-election or otherwise, creating an opportunity for regulated entities to help elect commissioners they believe will be sympathetic to their issues. In contrast, Governor-appointed, part-time policymaking boards or commissions govern most Texas state agencies and have long been established as a way of ensuring accountability for state agencies and their activities.

The agency's name no longer reflects its core mission and misleads the public at a time when clear accountability is essential.

Although deeply rooted in history and widely recognized by other governmental entities that also oversee oil and gas production, the agency's name – the Railroad Commission – does not accurately describe its functions. In fact, the Legislature invalidated the agency's name in 2005 when the last rail oversight functions were transferred from the Commission to the Texas Department of Transportation.

The Commission's name is not transparent to the general public, leading to no intuitive understanding of the significant role the agency plays as the State's primary regulator of the oil and gas industry. Despite this industry's long history and clear presence throughout the state, the need for an easily identified State regulator never really presented itself as it does today. Now more than ever, the agency's confusing name is of increasing concern as drilling encroaches on suburban and urban areas of the state, and with that exploration, greater numbers of Texans are affected by oil and gas production who may wish to contact the agency with complaints and concerns.

Maintaining three full-time Commissioners, each with their own staff, is costly to the State.

The public's ability to file a complaint is hampered by the agency's confusing name.

Recommendation

Change in Statute

1.1 Establish the Texas Oil and Gas Commission, governed by a part-time, appointed board, to assume the regulatory role currently served by the Railroad Commission, and continue the agency for 12 years.

This recommendation would create the new Texas Oil and Gas Commission to perform the functions of the Railroad Commission of Texas. To accomplish this recommendation, the Railroad Commission would be abolished as an agency, thus removing the requirement for three statewide elected officials, as is prescribed in the Texas Constitution. The recommendation is not a reflection of or based on the performance of current or former members of the Railroad Commission of Texas and is focused solely on an evaluation of its current statutory structure.

Terms of the current Railroad Commissioners would end on the date a majority of the Texas Oil and Gas Commission members are appointed by the Governor. Under this recommendation, the Railroad Commission's current statutory duties, including oversight of oil and gas exploration and production, pipeline safety, and surface mining operations, would be transferred to the Texas Oil and Gas Commission. Disposition of the agency's continued role in performing other functions, such as gas utility oversight and promotion of propane as an alternative fuel, are discussed in the issue continuing the Public Utility Commission, contained in a separate report included on page 55 of this report, and Issue 4 of this report respectively. The newly created Oil and Gas Commission would be continued for the standard 12-year period. The following information provides additional detail related to implementing such a recommendation.

- **Appointed Board.** Clearly, many workable models exist for oversight of a state agency, each with advantages and disadvantages. Under this recommendation, the Governor would appoint each of the five, part-time Commission members, with the advice and consent of the Senate, as is typical for most executive branch agencies. To dispel any appearance of impropriety, but allow for expertise in decision making, three of the five Commission members would represent the general public and the remaining two members would be required to have oil and gas industry experience. Each Commission member would serve a staggered, six-year term and the Governor would designate a member to serve as chair for a two-year term. The Commission would be required to meet at least quarterly, but could meet monthly, or more, if workload necessitates.
- **Name Change.** Under this recommendation, the Commission would be required to adopt a timeframe for phasing in the agency's new name, so as to spread out the cost associated with updating letterhead, signs, publications, and other official agency documents.
- **Across-the-Board Recommendations.** As part of this recommendation, standard Sunset across-the-board requirements would be applied to the Texas Oil and Gas Commission to ensure open, responsive, and effective government. Such standards do not currently exist because of the unique elected official status of the Railroad Commission. A listing of the across-the-board recommendations that would apply to the Texas Oil and Gas Commission is provided below.

Public Membership. This recommendation would prohibit a person from serving as a public member of the Commission if the person or the person's spouse uses or receives a substantial amount of tangible goods, services, or money from the oil and gas industry, other than compensation or reimbursement authorized by law for Commission membership, attendance, or expenses. In

addition, this recommendation would prohibit a person employed by or participating in the management of a business entity or other organization regulated by or receiving money from the Commission from being a public member on the Commission.

Conflict of Interest. This recommendation would define “Texas trade association” and prohibit an individual from serving as a member of the Commission if the person or the person’s spouse is an officer, employee, or paid consultant of a Texas trade association in the field that performs operations that are within the jurisdiction of the Commission. This language is currently in statute, but only applies to certain, high-level Commission employees.

Unbiased Appointments. This recommendation would require the Governor to make appointments to the Commission without regard to race, color, disability, sex, religion, age, or national origin of the appointee.

Presiding Officer. This recommendation would authorize the Governor to designate the Texas Oil and Gas Commission’s presiding officer.

Grounds for Removal. This recommendation would specify the grounds for removal for Commission members and the notification procedure for when a potential ground for removal exists.

Commission Member Training. This recommendation would clearly establish the type of information to be included in the Commission member training. The training would need to provide Commission members with information regarding the legislation that created the Commission; its programs, functions, rules, and budget; the results of its most recent formal audit; the requirements of laws relating to open meetings, public information, administrative procedure, and conflicts of interest; and any applicable ethics policies.

Dispute Resolution and Rulemaking Procedures. This recommendation would ensure the Commission develops a plan that encourages alternative dispute resolution and negotiated rulemaking procedures and applies them to its rulemaking, internal employee grievances, and other appropriate potential conflict areas.

Fiscal Implication Summary

This recommendation would result in a net, estimated savings of \$1,222,066 per year to the General Revenue Fund, based on savings of \$1,372,066, less costs of \$150,000, as described below.

This overall estimate includes a savings of \$1,372,066 from eliminating the three Railroad Commissioners, their direct assistants, and related travel costs. Eliminating the three Railroad Commission members would result in an annual savings of \$530,351 for full-time salaries and benefit payments, based on salary levels prescribed in the General Appropriations Act. Eliminating the 10 Commissioner assistant positions would result in an approximate savings of \$824,715, based on fiscal year 2009 expended staff salary and benefit payments.⁴ Additional savings of approximately \$17,000, also based on expenditures in fiscal year 2009, would result from elimination of travel expenses paid for Commission members and their assistants.

The cost of establishing a part-time, five-member board is estimated to be no more than \$50,000 annually, for associated travel and per diem expenses related to board meetings.

Establishing a new agency name would not have an immediate fiscal impact to the State. The Oil and Gas Commission would phase in such updates to agency materials. Based on the fiscal implication of previous legislative recommendations to change the agency’s name, the eventual costs are estimated to be approximately \$100,000.

In addition, the recommendation to continue the Texas Oil and Gas Commission for 12 years would require the continuing legislative appropriation of about \$85 million annually to cover the costs of its operations.

Railroad Commission of Texas

Fiscal Year	Approximate Savings to the General Revenue Fund	Approximate Costs to the General Revenue Fund	Approximate Net Savings to the General Revenue Fund	Change in the Number of FTEs From FY 2009
2012	\$1,372,066	(\$150,000)	\$1,222,066	-13
2013	\$1,372,066	(\$150,000)	\$1,222,066	-13
2014	\$1,372,066	(\$150,000)	\$1,222,066	-13
2015	\$1,372,066	(\$150,000)	\$1,222,066	-13
2016	\$1,372,066	(\$150,000)	\$1,222,066	-13

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¹ Texas Constitution, art. X, sec. 2.

² Article 6445, Vernon’s Texas Civil Statutes, Ann.

³ Texas Constitution, art. XVI, sec. 30.

⁴ The General Revenue savings of \$530,351 and \$824,715 would result from a reduction in appropriations to both the Railroad Commission and benefits budgeted outside the agency’s appropriation.

Responses to Issue 1

Overall Agency Response to Issue 1

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. However, the three Commissioners did provide written and oral testimony on Issue 1, as summarized below, representing their individual opinions but not that of the agency as a whole.

Recommendation 1.1

Establish the Texas Oil and Gas Commission, governed by a part-time, appointed board, to assume the regulatory role currently served by the Railroad Commission, and continue the agency for 12 years.

Chairman Williams' Response to 1.1

Chairman Williams opposes the five-member, part-time appointed Commission as recommended by Sunset staff, instead supports moving to a single elected Commissioner. Chairman Williams points out that there is a need to be nimble to keep up with today's society, but the current three-member Commission model is not nimble enough because it requires all three Commissioners to come up with a response. He also points out that the new design should provide for a clear consistent message from the leadership at the top and should focus accountability. One concern of moving to five part-time members is that power is moved to the Executive Director and away from the agency's leadership since the Executive Director is in the building every day.

Chairman Williams' Modifications

1. Change the law to provide for one elected Commissioner instead of the current three-member, elected model.
2. Change the name of the Commission to the Texas Energy Commission.

(The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to 1.1

Commissioner Carrillo supports renaming the agency to something that better reflects the agency's mission and alerts the public to this mission, but prefers renaming the agency the Texas Energy Commission because of the agency's broader energy focus. However, Commissioner Carrillo would support the decision to rename the agency the Texas Oil and Gas Commission.

Commissioner Carrillo stridently disagrees with the recommendation to move from an elected board to a five-member, Governor-appointed board. Commissioner Carrillo states that the energy sector is critically important to the Texas economy, and such a change would result in a relinquishment of overall enforcement, legal, regulatory, and safety authority to a part-time board not responsive directly to Texas voters.

Commissioner Carrillo's Modification

3. Create a hybrid form of agency management, such as the Texas School Land Board, whereby the chair is elected and two part-time commissioners are appointed by the Governor and either the Lieutenant Governor or Speaker of the House. Retain the elected position as a full-time, paid position, and an accompanying budget to allow hiring one key staff member. Part-time commissioners would retain the ability to access agency staff, but would not be paid state employees. Require the commissioners to be either a licensed geoscientist, petroleum engineer, or attorney.

(The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

Commissioner Jones' Response to 1.1

Commissioner Jones opposes moving from an elected, three-member board to a five-member, Governor-appointed board. Commissioner Jones states that the Texas Department of Transportation's model is not right for an agency that is responsible for the oversight of the energy industries in Texas. Commissioner Jones also states that although some energy producing states do have appointed regulatory agencies, Oklahoma has a three-member elected Commission and that Texas is different from other states because it is the number one producer of oil and natural gas and is in the top five for coal production.

Commissioner Jones also states that part of the Commission's job is judicial in nature and not unlike the function of an appellate panel. She believes that it is important to give litigants involved in hearings, at the very least, a three-judge panel to which to appeal decisions made at the administrative level. (The Honorable Elizabeth Ames Jones, Commissioner – Railroad Commission of Texas)

For Changing the Commission Structure

Senator Wendy R. Davis, Member – Texas Senate

Calvin Tillman, Mayor, DISH

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Robert J. Vann II, Fort Worth

Andy Wilson, Research Associate – Public Citizen, Austin

Against Changing the Commission Structure

Michael C. Burgess, M.D. – 26th Congressional District of Texas

David Porter, Commissioner Elect – Railroad Commission of Texas

Mel LeBlanc, Councilman – Arlington City Council, Arlington

Jeff Applekamp, Director of Government Affairs – Gas Processors Association, Tulsa, Oklahoma

Betty J. and Clyde W. Collins, Fort Worth

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Charles Erwin, Hico

T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall

Charles Morgan, Executive Director – Citizens for Environmental Cleanup, Fairfield

Douglass Robison, Chief Executive Officer and Chairman – Permian Basin Petroleum Association, Midland

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Bill Stevens, Executive Vice President – Texas Alliance of Energy Producers, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Bob Thompson, Austin

Modifications on Changing the Commission Structure

Elected options

4. Establish a single, elected Commissioner to assume the regulatory role currently served by the three Railroad Commissioners. (Senator Glenn Hegar, Jr., Chairman – Sunset Advisory Commission)
5. Reorganize the Commission to be run by one elected Commissioner. (T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall)
6. If the current Commission structure were to be changed, require one elected Commissioner. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin)
7. While preferring the current configuration, if changed, then require one elected official and two appointed officials, provided that the appointees are qualified, with a preference for engineers, geoscientists and attorneys. (Bob Thompson, Austin and Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)
8. Maintain the elected Commissioners and consider expanding the size of the Commission to help address problems with drilling in cities. (Betty J. and Clyde W. Collins, Fort Worth)

9. Establish a five-member elected Commission. (Ann Ewing, President – South Texas Opposes Pollution, Corpus Christi)

Appointed options

10. Establish a part-time, appointed board, but with three members instead of the recommended five to ensure the board conducts business in open, public meetings. (Andy Wilson, Research Associate – Public Citizen, Austin and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin)
11. If the Legislature chooses an appointed board, mandate that at least one appointed commissioner represent land owners and one represent mineral owners. Additionally, designate that the other commissioners each represent certain segments such as a major industry group, a smaller industry group, and maybe a pipeline group. (Morgan O’Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin and Molly Rooke, Dallas)

Other

12. Remove the Commissioners. (Robert Hobbs, Fort Worth)
13. Require full-time Commissioners. (Darlia Hobbs, Fort Worth)

For Renaming the Commission

Michael C. Burgess, M.D. – 26th Congressional District of Texas

Senator Wendy R. Davis, Member – Texas Senate

Calvin Tillman, Mayor, DISH

Rita Beving, North Texas resident – Farmers Branch

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Esther McElfish, President – North Central Texas Communities Alliance, Fort Worth

Urban “Obie” O’Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Robert J. Vann II, Fort Worth

Andy Wilson, Research Associate – Public Citizen, Austin

Against Renaming the Commission

Jeff Applekamp, Director of Government Affairs – Gas Processors Association, Tulsa, Oklahoma

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Modifications on Renaming the Commission

14. Consider renaming the Railroad Commission a name that reflects its rate-setting authority should the agency retain rate-setting responsibilities. (Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington)
15. Rename the Commission the Texas Energy Commission or the Texas Oil and Gas Commission, as suggested by Sunset staff. (Rita Beving, North Texas resident – Farmers Branch)
16. While neutral on changing the name of the agency due to constitutional as well as federal and state delegation concerns, if the name were changed, it should be changed to the Texas Energy Commission. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin)

For Continuing the Agency for 12 Years

Michael C. Burgess, M.D. – 26th Congressional District of Texas

Mel LeBlanc, Councilman – Arlington City Council, Arlington

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Against Continuing the Agency for 12 Years

Betty J. and Clyde W. Collins, Fort Worth

Doreen Geiger, Fort Worth

Larry McGuire, Crowley

Modifications on Continuing the Agency for 12 Years

17. Continue the agency for two years, instead of the 12-year timeframe. (Betty J. and Clyde W. Collins, Fort Worth and Doreen Geiger, Fort Worth)

Staff Recommended Action

Adopt Recommendation 1.1.

Issue 2

Using General Revenue to Regulate the Oil and Gas Industry Shifts Oversight Costs From the Industry to Taxpayers.

Background

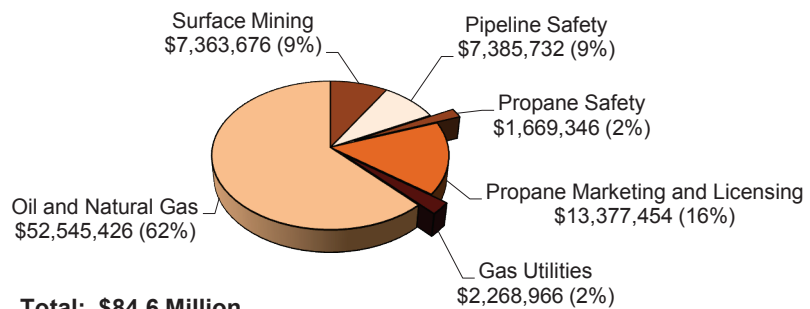
The Railroad Commission's (Commission) Oil and Gas program is the largest of its six programs, accounting for 62 percent of the agency's budget in fiscal year 2011 as shown in the associated pie chart, *Railroad Commission Budget by Program*. The program, which dates back to the early 1900s, is responsible for oversight of the state's oil and gas resources and protection of the environment from oil and gas activities.

One study estimates the total direct economic impact of the Texas oil and gas industry at about \$186 billion dollars.¹ In addition, the oil and gas industry employs 189,000 Texans whose salaries average more than \$129,000 annually.²

In fiscal year 2009, the Commission reports issuance of 18,546 oil and gas drilling permits. This figure, along with a reported 280,000 active oil and gas wells in Texas in fiscal year 2009, demonstrates the size of the industry.³

The program addresses these responsibilities through permitting various oil and gas activities such as well drilling; inspecting operations to see that the industry complies with Commission rules and taking enforcement action; plugging abandoned oil and gas wells; and remediating abandoned oil and gas sites. In addition, the Commission manages oil and gas records and informs the public in various ways about activities in its Oil and Gas program. The pie chart, *Oil and Gas Program Budget*, depicts funding for these activities.

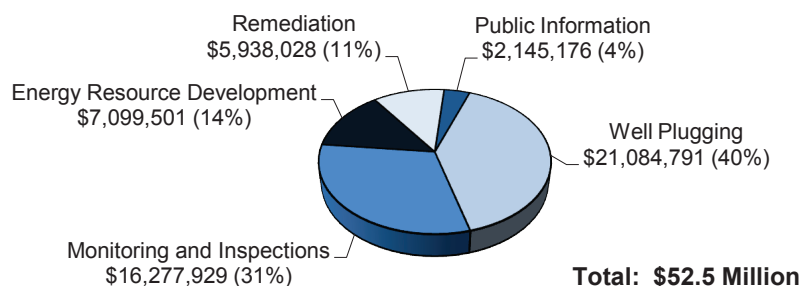
**Railroad Commission Budget by Program*
FY 2011**



Total: \$84.6 Million

* Based on budgeted data, including benefits and indirect costs such as administrative support.

**Oil and Gas Program Budget*
FY 2011**

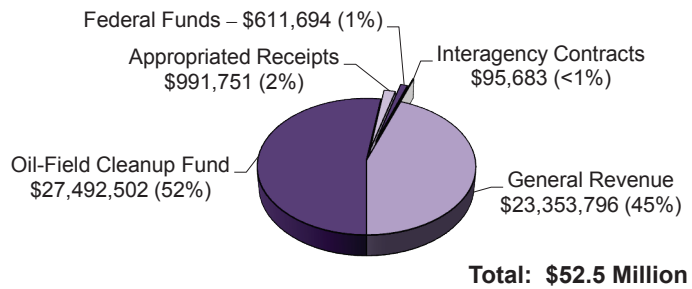


Total: \$52.5 Million

* Based on budgeted data, including benefits and indirect costs such as administrative support, allocated to the Oil and Gas program.

About \$23.4 million, or 45 percent, of the fiscal year 2011 budget for the Oil and Gas program comes from General Revenue, as shown in the pie chart, *Oil and Gas Program Revenue Sources*. The chart also shows another \$27.5 million, or 52 percent, of the Oil and Gas program budgeted from the Oil Field Cleanup Fund. This dedicated fund in General Revenue is comprised of fees, fines, and miscellaneous revenues associated with regulation of the oil and gas industry.

**Oil and Gas Program Revenue Sources*
FY 2011**



* Based on budgeted data, including benefits and indirect costs such as administrative support.

The text box, *Major Purposes of the Oil Field Cleanup Fund*, summarizes the Fund's

statutory uses for oil field clean up. More than 90 percent of the Oil and Gas program's \$21.1 million budget for well plugging and \$5.9 million budget for site remediation is allocated from this Fund. The remainder of the money budgeted from the Fund supports other statutorily authorized Oil and Gas program expenditures. The Legislature created an advisory committee in 2001 to monitor the Fund.

Major Purposes of the Oil Field Cleanup Fund

- Conducting site investigations or environmental assessments to determine the nature and extent of contamination caused by oil and gas wastes and the measures needed to control or clean them up.
- Controlling or remediating oil and gas wastes or other substances regulated by the Commission that are causing, or may cause, pollution of surface or subsurface water.
- Plugging abandoned wells and administering or enforcing permits, orders, and rules related to the Commission's authority to prevent pollution.

Source: Texas Natural Resources Code, sec. 91.112.

Findings

The Oil and Gas program's significant use of unreimbursed General Revenue does not follow the self-supporting example of other major regulatory programs.

As shown above, about \$23.4 million, close to half the Oil and Gas program's budget for fiscal year 2011, comes from General Revenue that is not reimbursed by fees or other collections. This use of General Revenue does not follow the standard for most regulatory agencies, whose regulatory programs are self-supporting. Ideally, funding from General Revenue for regulatory functions and staff, including benefits, should be offset by fees or other collections from the regulated industry and deposited to General Revenue.

The Legislature has followed this self-supporting standard for regulatory agencies listed in the regulatory section of the General Appropriations Act, from small professional licensing agencies to large agencies like the Texas

Department of Insurance.⁴ In other sections of the Act, various other agencies with major regulatory programs also have self-supporting requirements or practices, including the Texas Alcoholic Beverage Commission and the Texas Department of Agriculture.^{5,6} Most Railroad Commission programs, such as Propane Marketing and Licensing, Propane Safety, Surface Mining, and Pipeline Safety, also have provisions limiting or offsetting some level of appropriations from General Revenue to revenues collected from associated fees or other sources.⁷

The Legislature has used different approaches to make regulatory agencies either completely or largely self-supporting, as the following examples for three regulatory agencies show.

- **Texas Alcoholic Beverage Commission (TABC).** The General Appropriations Act requires appropriations to TABC, the State’s regulator of the alcoholic beverage industry, to be fully offset from fees, fines, and other revenues.⁸ Statute sets up a flexible system for achieving this mandate by setting fees for about 70 liquor permits and beer licenses and then authorizing TABC to collect a surcharge on them, with that surcharge being variable as set by agency rule.⁹ The surcharge allows TABC to adjust revenues collected to cover legislative appropriations. A surcharge is typically a substantial portion of total revenues submitted by a licensee. For example, a two-year license for a package store permit is \$1,000, and the surcharge on that license is currently \$426.

Statute requires that surcharges set by TABC not overly penalize any segment of the industry or impose an undue hardship on small businesses.¹⁰ The agency has developed a formula for determining surcharges based on agency time required for processing a license or permit, the number of licensees in that category, and other factors. The last time the agency changed surcharges was in 2005.

- **Texas Department of Insurance (TDI).** This agency, the State’s regulator for the insurance industry, is limited by the General Appropriations Act to appropriations funded from revenues it generates.¹¹ In TDI’s case, the Legislature has authorized maintenance taxes to be assessed by TDI on nine lines of insurance. Revenues from the maintenance taxes flow to a dedicated account in General Revenue. Statute gives TDI the flexibility to adjust these maintenance taxes annually to match appropriations from the dedicated account. The agency takes into account fund balances remaining at the end of a fiscal year along with non-maintenance tax revenue in setting the tax rates for the next year. This “self-leveling” mechanism ensures that revenues collected match the legislatively set appropriations from the dedicated account.
- **Texas Commission on Environmental Quality (TCEQ).** As the State’s primary agency with regulatory authority over air and water quality, TCEQ is largely, although not totally, supported through fees designed to cover program costs. About 86 percent of TCEQ’s fiscal year 2010

TABC sets surcharges on permits and licenses to adjust collections to appropriations.

Statute allows TDI to adjust maintenance taxes to match appropriations.

operating budget comes from 101 fees, with only 3 percent from General Revenue and the remaining amounts primarily through federal funds and interagency contracts. Revenue from all but seven of the fees are deposited in 14 dedicated accounts in General Revenue, and amounts in these accounts, including fund balances, overall total more than appropriations from them. This agency has less flexibility than TABC or TDI to adjust fees to meet appropriations. For example, while the agency sets 72 fees by rule, another 29 fees are either fixed or capped in statute. No across-the-board mechanism exists to adjust revenues to meet appropriations, such as TABC's surcharge authority or TDI's maintenance tax.

Key aspects of the funding structure for the agency's Oil and Gas program significantly impair its ability to be self-supporting.

- **Inflexible Fees.** Most of the Commission's fees related to oil and gas regulation are set in statute at a fixed amount or percentage rate. Most of these fees have not been raised in nine or more years. The chart, *Major Fees for the Oil and Gas Program*, shows the revenues that these fees are expected to bring in for fiscal year 2011 and the Commission's flexibility to adjust them.

Major Fees for the Oil and Gas Program

Fee Type	FY 2011 Estimated Revenues	Fee Design for Major Fees*	Flexibility	Last Changed in Statute
Oil & Gas Well Drilling Permits	\$9,500,000	Fixed Statutory Amounts	No	2001
Oil Field Cleanup Regulatory Fee on Gas	\$4,552,000	Fixed Statutory Rate	No	2001
Organization Report Fees	\$3,500,000	Depends on activity. Varies between fixed statutory amount and statutory range.	Minimal	2003
Oil Field Cleanup Regulatory Fee on Oil	\$1,985,000	Fixed Statutory Rate	No	2001
Oil & Gas Compliance Certificate Reissue Fee	\$1,020,000	Fixed Statutory Amount	No	2003
Rule Exception Fee	\$380,000	Fixed Statutory Amount	No	2001
Waste Disposal Facility, Generator, and Transporter Fees	\$170,000	Fixed Statutory Amount for non-hazardous oil and gas waste; set by Commission for hazardous oil and gas waste	Moderate	1991

* Excludes late fees.

Unlike TABC or TDI, the Commission has no statutory authority to add surcharges to existing fees or vary a tax rate. To meet current funding needs, the Commission must seek additional General Revenue appropriations, not a desirable course of action with the State's severe

budget shortfall, or seek statutory adjustment of fixed fees for the Oil and Gas program. These actions place additional work on the Legislature and limit the Commission's ability to respond quickly to dynamic changes in the industry, such as the rapidly expanding drilling boom in the Barnett Shale area and other parts of the state.

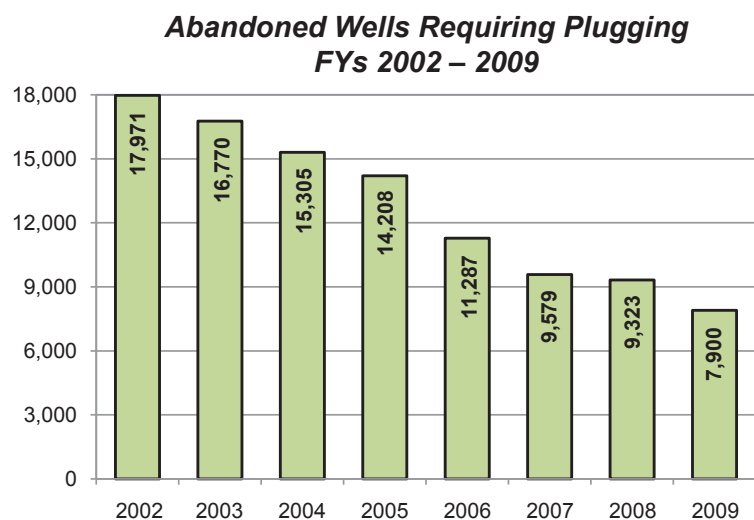
- **Fees Not Clearly Available for all Program Activities.** Another unique aspect of the funding for oil and gas regulation is that State law dedicates all fees, fines, and other miscellaneous collections associated with the Oil and Gas program to the Oil Field Cleanup Fund and its dedicated cleanup purposes. Under current law, an increase in oil- and gas-related fees would provide additional funding for cleanup activities authorized by statute. As a result, a change in law would be necessary to ensure that fee revenues could replace General Revenue for all program purposes, such as monitoring and inspections.

Commission funding cannot quickly respond to dynamic changes in the industry.

While the need for cleaning up oil and gas sites continues, the purpose of Oil Field Cleanup Fund Advisory Committee has been accomplished.

In 2001, the Legislature increased funding going to the Oil Field Cleanup Fund and made other program changes to strengthen the State's well plugging and site remediation activities. At the same time, the Legislature created the Oil Field Cleanup Fund Advisory Committee (Committee) to meet quarterly with the Commission, monitor the effectiveness of the fund, review recommendations for legislation proposed by the Commission, and receive information about rules relating to the Fund.¹² Statute establishes this 10-member Committee composed of two legislators, five industry representatives, two members from the academic community, and a public member.¹³

Now, almost 10 years later, the Committee has accomplished its advisory purpose. Although the need for plugging abandoned wells and cleaning up abandoned oil field sites continues, the Railroad Commission's efforts are on track. Illustrating its progress, the number of abandoned wells requiring plugging has diminished from about 18,000 in fiscal year 2002 to 7,900 in fiscal year 2009, the last year for which complete data is available, as shown in the graph, *Abandoned Wells Requiring Plugging*.



Meeting records of the Committee support this conclusion. Apparently, the Committee met once in 2009 and, so far, only once in 2010, missing its quarterly meeting requirement. In a recording of the 2009 meeting, several

members commented that the Commission's plugging and cleanup activities were on track, complimented the Commission for its work, and said that the Committee's task appeared to be largely accomplished or at least did not require quarterly meetings any longer.¹⁴

Recommendations

Change in Statute

2.1 Require the Commission's Oil and Gas program to be self-supporting, and authorize the Commission to levy surcharges on the program's permits, licenses, certificates, or reports to achieve this purpose.

This recommendation requires the Oil and Gas program to be self-supporting, and sets up surcharges adjustable by the Commission as the means to achieve that end. In addition to currently required fees, the Commission would have the authority to add, at its discretion, surcharges to licensing-related activities of the program. The Commission would adjust the surcharges to meet the self-supporting statutory directive in this recommendation, and the surcharges would be collected at the time of application. For purposes of this recommendation, strategies in the 2010-2011 biennium making up the Oil and Gas program include Energy Resource Development, Oil and Gas Monitoring and Inspections, Oil and Gas Remediation, Oil and Gas Well Plugging, and Public Information and Services.

Under this recommendation, the agency would establish a methodology for developing the surcharge that reflects the time taken for the regulatory work associated with the licensing-related activity; the number of individuals or entities over which cost could be spread; the impact of the surcharge on operators of all sizes, as measured by number of oil or gas wells; existing balances in any dedicated fund to be carried forward; and other factors it considers to be important to the fair and equitable levying of a surcharge. The methodology would be established in rule, ensuring the opportunity for affected entities and the general public to comment on them. The Commission would set the actual surcharges by Commission order at amounts determined, in aggregate, to cover the costs of the Oil and Gas program.

Surcharges give the Commission the flexibility to make the Oil and Gas program self-supporting as conditions and budgetary needs change. Ultimately, the Legislature still would control Oil and Gas program expenditures through the appropriations process. However, the Legislature would no longer need to spend its limited time dealing with fee issues since the agency could adjust its revenues for the program.

Change in Appropriations

2.2 Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the direct and indirect costs of administering its Oil and Gas program, including benefits.

This language would be placed in the Commission's appropriation pattern as new rider language. The rider would require that fees and other miscellaneous revenues associated with the Oil and Gas program cover, at a minimum, all program costs, including direct and indirect administrative costs as well as benefits, as similar riders limit appropriations to other regulatory agencies. As with a number of these riders, if revenues are insufficient to cover these costs, the Legislative Budget Board and Governor may direct the Comptroller's office to reduce the appropriation authority to be within the

amount of fee revenue expected to be available. As indicated in Recommendation 2.1, appropriations strategies making up the Oil and Gas program include Energy Resource Development, Monitoring and Inspections, Remediation, Well Plugging, and Public Information.

Change in Statute

2.3 Reconstitute the Oil Field Cleanup Fund as the Oil and Gas Fund, continued as a dedicated fund in General Revenue established to pay for the entire Oil and Gas program.

Statute would be amended to transform the General Revenue-dedicated Oil Field Cleanup Fund into the General Revenue-dedicated Oil and Gas Fund. The renamed and restructured fund would receive fees and other miscellaneous revenues currently deposited to the Oil Field Cleanup Fund, as well as the new surcharges. Revenues in the Fund could be used for any aspect of the Oil and Gas program, including administrative support and personnel benefits. Fund balances in the Oil Field Cleanup Fund would transfer to the renamed and restructured fund. These changes would enable the Fund to replace General Revenue expenditures for the Oil and Gas program while helping to keep oil- and gas-related fees dedicated to the regulation of the oil and gas industry.

2.4 Contingent on the transition to the dedicated Oil and Gas Fund, redirect fines previously deposited in the Oil Field Cleanup Fund to General Revenue.

Currently, statute directs certain fine revenues related to oil and gas regulation to the Oil Field Cleanup Fund. Projected revenues from this source are estimated at \$2.5 million for fiscal year 2011. Reconstituting the dedicated fund to support the entire Oil and Gas program would make fine revenues available for general administrative support of the Oil and Gas program and not just direct program expenditures. Sunset typically takes the approach that fines levied by an agency should not be made available for such support, thus avoiding any allegations that an agency is abusing its fine authority to increase its revenues. In keeping with this standard, fines would be redirected to General Revenue and not deposited in the reconstituted Oil and Gas Fund.

2.5 Abolish the Oil Field Cleanup Fund Advisory Committee.

This statutory advisory committee, created in 2001, has served its purpose and is no longer needed. Under this recommendation, statute establishing the Committee would be repealed. This action would eliminate the expenditure of time and energy by both the Commission and the long-serving members of the Committee.

Fiscal Implication Summary

Based on these recommendations and the Commission's fiscal year 2011 budget, including benefits and indirect costs, General Revenue would sustain savings of \$23.35 million and revenue gains of \$2.5 million for a total positive fiscal impact of \$25.85 million.

- **Recommendation 2.1** would require the Oil and Gas program to be self-supporting and would give the Commission statutory authority to levy surcharges on the program's licensing-related activities to meet this end. Based on the fiscal year 2011 budget, including benefits, savings to General Revenue would total \$23,353,796 per year.
- **Recommendation 2.2** would not allow the Commission to spend money appropriated in support of the Oil and Gas program beyond the amount of fees and other revenues collected for the program.

- **Recommendation 2.3** would reconstitute the current dedicated Oil Field Cleanup Fund into the new dedicated Oil and Gas Fund, and estimated balances of \$5.76 million from the old fund would transfer to the new fund.
- **Recommendation 2.4** would redirect about \$2.5 million in fines from the dedicated account to General Revenue, thereby resulting in a revenue gain to General Revenue. New fees, surcharges, or other collections would be added to the dedicated fund to replace this \$2.5 million loss.
- **Recommendation 2.5** would abolish the Oil Field Cleanup Fund Advisory Committee and would have no direct fiscal impact because the Committee takes no funding to operate.

To meet the requirement to be self-supporting, the Commission would need to apply substantial surcharges to make up for the loss of General Revenue funding for the Oil and Gas program. The following chart, *Example Surcharges for the Oil and Gas Program*, provides examples of the level of surcharges that might need to be placed on drilling permits and organization reports. The Commission routinely processes drilling permits and organization reports, making them appropriate subjects for surcharges.

Example Surcharges for the Oil and Gas Program

Item	Current Average Fee*	Example Surcharge Basis	Average Surcharge	Revenue Gain From Surcharge
Drilling Permit Fee	\$267 per well	50% of fee(\$133) plus \$0.10 per foot of well depth (average of \$886 per well)	\$1,019 per well	\$14.4 million
Drilling Permit Fee – Additional Charge for Horizontal Drilling	N/A	\$0.10 per foot of horizontal drilling (average of \$250 per applicable well)	\$250	\$1.0 million
Organization Report Filing Fee	\$495 per filing	\$25 per well	\$1,394 per filing	\$9.9 million

* Drilling permit fees vary depending on depth of wells, and organization report filing fees vary depending on the number of wells a company operates. Thus, fees listed are averages.

Various other Commission fees could have surcharges attached, although they would likely yield much less because of fewer permits or items processed. The regulatory fee on oil and the regulatory fee on gas would not be subject to surcharge since revenues result from a percentage rate applied to production and not to any specific Commission activity before that point. Final amounts from the surcharges could be quite different from those used for illustration and are dependent on legislative appropriations, Commission decisions on methodology as adopted in rule, and surcharges as ordered by the Commission.

The chart below summarizes the positive fiscal impact of this issue to General Revenue based on the Commission's budget for fiscal year 2011, but actual changes in revenues would depend on legislative appropriations to the Commission. Additional revenues from fees, surcharges, or other collections would be added in an equal amount to the dedicated Oil and Gas Fund. Recommendations would not change the number of staff that the Commission employs.

Railroad Commission of Texas

Fiscal Year	Savings to the General Revenue Fund	Revenue Gain to the General Revenue Fund	Net Positive Fiscal Impact to the General Revenue Fund
2012	\$23,353,796	\$2,500,000	\$25,853,796
2013	\$23,353,796	\$2,500,000	\$25,853,796
2014	\$23,353,796	\$2,500,000	\$25,853,796
2015	\$23,353,796	\$2,500,000	\$25,853,796
2016	\$23,353,796	\$2,500,000	\$25,853,796

.....

1 Price Waterhouse Coopers, *The Economic Impacts of the Oil and Natural Gas Industry on the U.S. Economy: Employment, Labor Income, and Value Added* (September 2009), p 17. Online. Available: www.api.org/Newsroom/upload/Industry_Economic_Contributions_Report.pdf. Accessed: October 18, 2010.

2 Texas Oil and Gas Association, *Fueling the Texas Economy*, Austin, Texas (brochure).

3 Railroad Commission of Texas, *Oil Field Cleanup Program Annual Report – Fiscal Year 2009* (Austin, Texas, 2009), p.2. Online. Available: www.rrc.state.tx.us/environmental/ofcfund/expenditures/ofcu2009.pdf. Accessed: October 19, 2010.

4 Texas Senate Bill 1, *General Appropriations Act*, 81st Legislature (2009), Article VIII, sec. 2, p. VIII-80.

5 Ibid., Article V, rider 7, p. V-9.

6 Ibid., Article VI, rider 3, p. VI-5.

7 Ibid., Article VI, rider 3, p. VI-48; rider 6, p. VI-48; rider 8, p. VI-49; rider 10, p. VI-49; rider 11, p. VI-50; rider 13, p. VI-50; and rider 14, p. VI-51.

8 Ibid., Article V, rider 7, p. V-9.

9 Texas Alcoholic Beverage Code, sec. 5.50.

10 Ibid.

11 Texas Senate Bill 1, *General Appropriations Act*, 81st Legislature (2009), Article VIII, sec. 2, p. VIII-80.

12 Texas Senate Bill 310, 77th Legislature (2001).

13 Texas Natural Resources Code, sec. 91.1135.

14 Oil Field Cleanup Fund Advisory Committee, public hearing (Austin, Texas, July 31, 2009). Online. Available: www.house.state.tx.us/media/additional/81.htm. Accessed: October 12, 2010.

Responses to Issue 2

Overall Agency Response to Issue 2

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. However, the three Commissioners did provide written and oral testimony on Issue 2, as summarized below, representing their individual opinions but not that of the agency as a whole.

Recommendation 2.1

Require the Commission's Oil and Gas program to be self-supporting, and authorize the Commission to levy surcharges on the program's permits, licenses, certificates, or reports to achieve this purpose.

Chairman Williams' Response to 2.1

Chairman Williams states that there is a need for a consistent dependable funding source that does not first rely upon additional dollars from the regulated industry. He says that the Oil Field Cleanup Fund should be continued as it is today. He suggests that maybe another funding mechanism, such as using some severance tax dollars or maybe additional industry funding, could be found. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to 2.1

Commissioner Carrillo generally agrees with this recommendation. However, the Commissioner cautions that the Legislature should not drastically increase dues, fees, penalties, or taxes without a deliberative and well-reasoned rationale. The aim should be to provide a fair and predictable regulatory structure with appropriate environmental protection, but one that does not quash the desire to risk capital in the energy sector for a reasonable return on such investment.

Commissioner Carrillo's Modification

1. Take a small portion of the already existing oil and gas severance tax and redirect such portion into the Railroad Commission's budget, instead of increasing dues, fees, penalties, or taxes to fund vital agency technical personnel and critical services.

(The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

Commissioner Jones' Response to 2.1

Commissioner Jones supports the idea that the Railroad Commission could be self-funded as well as self-leveling, if given the tools to operate more efficiently.

Commissioner Jones' Modification

2. Authorize the Railroad Commission, as a pilot project, to craft a five-year, self-funded budget for the agency overall, with the latitude to adjust as needed. For the Oil and Gas

program, consider the use of some severance tax funds or funds from non-enforcement permit fees to make up additional funds. Require other divisions to be self-funded with funds from the industry they regulate.

(The Honorable Elizabeth Ames Jones, Commissioner – Railroad Commission of Texas)

For 2.1

Michael C. Burgess, M.D. – 26th Congressional District of Texas

Senator Wendy R. Davis, Member – Texas Senate

Calvin Tillman, Mayor, DISH

Betty J. and Clyde W. Collins, Fort Worth

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Ronald Kitchens – CenterPoint Energy, Austin

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Lionel Milberger, Robertson County

Urban “Obie” O’Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Robert J. Vann II, Fort Worth

Andy Wilson, Research Associate – Public Citizen, Austin

Against 2.1

None received.

Modifications

3. Ensure that increased fees are used for their intended purpose of funding the agency and that the fees are not set at levels where they become excess revenue generators or at levels where they act as a disincentive for oil and gas activity in the state. (Urban “Obie” O’Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston)

Staff Comment: Staff recommendations would direct fees to the reconstituted Oil and Gas Fund, set up as a fund dedicated to the Oil and Gas program and not to other uses. Ultimately, the Fund would be self-leveling, with the Legislature determining the level of appropriations from the Fund for the Oil and Gas program, and the agency setting fees to meet that appropriation level.

4. Make the agency self-supporting, but do so in the following manner.

- Use the same funding formula as currently used for the Oil Field Cleanup Fund to allow the Railroad Commission's Oil and Gas program to become completely self-funded, but do not give the Commission the authority to levy surcharges and otherwise develop the funding formula.
- Increase the amount added to the self-supporting funding mechanism by another \$9.2 million annually to provide for additional staff, higher salaries, better technology, and fleet replacement.

(Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin and Douglass Robison, Chief Executive Officer and Chairman – Permian Basin Petroleum Association, Midland)

5. Make the Oil and Gas program self-supporting, but do so in the following manner.

- Modernize Commission operations (particularly related to data entry) and direct the resultant savings to other areas of the agency where staff is lacking, such as field inspectors.
- Direct all taxes collected from industry that currently go to General Revenue and that are specifically designated to fund operations of the Railroad Commission to be credited toward the Commission's budget.
- Place statutory limits on fees levied by the Commission, and then authorize the Commission to levy fees on the Oil and Gas program's permits, licenses, certificates, or reports to aid in achieving the goal of being self-supporting.

(Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

6. Make the Commission's Oil and Gas program self-supporting, but do so in the following manner.

- Follow the formula for setting fees, surcharges, and penalties as set forth in Sunset legislation in 2001 and set these in statute.
- Adjust the Oil Field Cleanup Fund activity level and provide necessary performance standards, and then move excess funds and FTEs out of the Fund and into Commission operations.

(Bill Stevens, Executive Vice President – Texas Alliance of Energy Producers, Austin)

Staff Comment: Sunset legislation in 2001 directed a series of fees to be deposited to the Oil Field Cleanup Fund and established new fees for deposit in the Fund to raise additional revenue. Sunset staff's understanding is that members of the oil and gas industry collectively recommended fee levels to the Legislature that would balance the additional burden and not present an undue hardship to any industry segment.

7. While agreeing that the Commission should be self-funded through a combination of reasonable fees and General Revenue allocation, consider allocating to the Commission a

small fraction of severance tax revenue to be used for the operation of the agency. (T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall)

Recommendation 2.2

Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the direct and indirect costs of administering its Oil and Gas program, including benefits.

For 2.2

Senator Wendy R. Davis, Member – Texas Senate

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Robert J. Vann II, Fort Worth

Against 2.2

None received.

Recommendation 2.3

Reconstitute the Oil Field Cleanup Fund as the Oil and Gas Fund, continued as a dedicated fund in General Revenue established to pay for the entire Oil and Gas program.

Chairman Williams' Response to 2.3

Chairman Williams disagrees with the Sunset staff recommendation and recommends maintaining the Oil Field Cleanup Fund. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

For 2.3

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton; and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Robert J. Vann II, Fort Worth

Against 2.3

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall

Morgan O'Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Modifications

8. Change the name of the proposed Oil and Gas Fund to the Oil and Gas Regulation and Cleanup Fund. (Senator Glenn Hegar, Jr., Chairman – Sunset Advisory Commission)
9. If the funding mechanism for the Oil and Gas program is changed, make certain that the cleanup of abandoned wells is continued. (Morgan O’Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin)

Staff Comment: The intent of the staff recommendation is not to eliminate funding for well plugging or remediation. As now occurs, the level of funding for these two items would be set by the Legislature in the Appropriations Act, which identifies well plugging and remediation as two separate funding strategies in the Railroad Commission’s appropriation.

10. Move the Oil Field Cleanup Fund into the Railroad Commission budget, as long as performance standards are provided so that wells continue to be plugged and sites continue to be remediated. (Douglass Robison, Chief Executive Officer and Chairman – Permian Basin Petroleum Association, Midland)
11. Establish future performance guidelines for the Oil Field Cleanup Fund programs. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin)
12. Create a statutory mechanism for the Oil Field Cleanup Fund, such as minimum performance standards, to ensure the Railroad Commission adequately performs its charge under the cleanup program. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)
13. Although no compelling reason appears to exist for reconstituting the Oil Field Cleanup Fund as the Oil and Gas Fund, if this approach is taken, establish performance standards set by the Legislature, with oversight from the Oil Field Cleanup Fund Advisory Committee. (Bill Stevens, Executive Vice President – Texas Alliance of Energy Producers, Austin)
14. Maintain the Oil Field Cleanup Fund, but reconstitute a portion of the Oil Field Cleanup Fund to assist the Railroad Commission in becoming a self-supporting agency. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

Staff Comment: The Oil Field Cleanup Fund is composed of fees and other revenues primarily directed to the Fund by statute, and the Fund itself is statutorily dedicated to oil field cleanup. Reconstituting a portion of the Oil Field Cleanup Fund to fund aspects of the Oil and Gas program other than those related to cleanup would require statutory changes to clarify broader uses for the Fund or to direct some of its revenue sources to a new dedicated fund.

Recommendation 2.4

Contingent on the transition to the dedicated Oil and Gas Fund, redirect fines previously deposited in the Oil Field Cleanup Fund to General Revenue.

For 2.4

Robert J. Vann II, Fort Worth

Against 2.4

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Bill Stevens, Executive Vice President – Texas Alliance of Energy Producers, Austin

Recommendation 2.5

Abolish the Oil Field Cleanup Fund Advisory Committee.

Chairman Williams' Response to 2.5

Chairman Williams agrees with the staff recommendation that the Oil Field Cleanup Advisory Committee should be abolished. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

For 2.5

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin (subject to the modification below)

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin (subject to Modification 16)

Against 2.5

Bill Stevens, Executive Vice President – Texas Alliance of Energy Producers, Austin

Modifications

15. In addition to abolishing the Oil Field Cleanup Fund Advisory Committee, require in statute that the State appropriations process include, as it does now, two key output measures related to oil field cleanup:

- the number of orphaned wells plugged with the use of state-managed funds; and
- the number of abandoned sites investigated, assessed, or cleaned up with State funds.

Also, modify the Commission's current quarterly statutory reporting requirements related to cleanup and remediation to require that the Commission report to the Legislative Budget Board its performance in meeting projected targets for the two key output measures noted above, with explanation of any variance of more than 5 percent. Further, require that these reports include information related to total funds deposited to the new Oil and Gas Regulation and Cleanup Fund, as well as expenditures from the fund related to cleanup and remediation.

Finally, modify the Commission's current annual statutory reporting requirement related to cleanup and remediation to include its performance in meeting projected targets for the two key output measures noted above, including explanation of any variance of more than 5 percent. As is currently required, the report would be made available to the Legislature and the public. (Senator Glenn Hegar, Jr., Chairman – Sunset Advisory Commission)

16. Abolish the Oil Field Cleanup Fund Advisory Committee only if benchmarks are established in statute for the Oil Field Cleanup Fund programs. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin and Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

Staff Recommended Action

Adopt Recommendations 2.1, 2.2, 2.3 with Modification 8, 2.4, and 2.5 with Modification 15.

Issue 3

Current Enforcement Processes Hinder the Commission's Ability to Prevent Future Threats to the Environment and Public Safety.

Background

To ensure compliance with environmental and safety requirements, the Railroad Commission (Commission) inspects and monitors oil and natural gas production, storage, and delivery. Staff oversee the drilling, operation, and plugging of wells; as well as a variety of other activities such as the disposal and clean-up of waste generated by oil and gas production. Inspections may occur as part of the agency's routine risk-based schedule or in response to a complaint. In fiscal year 2009, the Commission spent nearly \$15.8 million on its inspection and monitoring functions, employing 87 oil and gas field inspectors who work out of nine district offices across the state. Appendix B of this report contains information on the location and staffing of these field offices.

In fiscal year 2009, Commission inspectors performed more than 128,000 inspections, finding more than 80,000 violations. When inspectors uncover violations of statute or Commission rule, they report the violations to the district office for review, and the agency sends a notice of violation to operators. The flowchart on the following page, *Oil and Gas Inspection and Enforcement Process*, depicts the process from initial inspection through final Commission order. To take enforcement action against violators of law or rule, statute gives the Commission a variety of sanctioning options, including penalty authority of up to \$10,000 per day, per violation for violations related to oil and natural gas production. In fiscal year 2009, the Commission issued 379 penalties, assessing more than \$2 million in fines to oil and natural gas operators. The textbox, *Enforcement Tools*, provides a full listing of the Commission's enforcement options.

For situations involving emergency pollution problems, the Commission requires immediate response from operators to address the problem. Depending on the severity of the pollution, the Commission gives operators up to 48 hours to take action before the Commission remedies the problem itself using state funds. In fiscal year 2009, the Commission initiated four emergency pluggings and 54 emergency site remediations. For emergency actions, the Commission refers these cases to the Attorney General's Office to seek reimbursement from the responsible parties. In fiscal year 2009, the Attorney General's Office collected \$95,000 in reimbursements for the Commission.

Enforcement Tools

Statute grants the Commission the following mechanisms to ensure oil and gas producers comply with the law and agency rules.

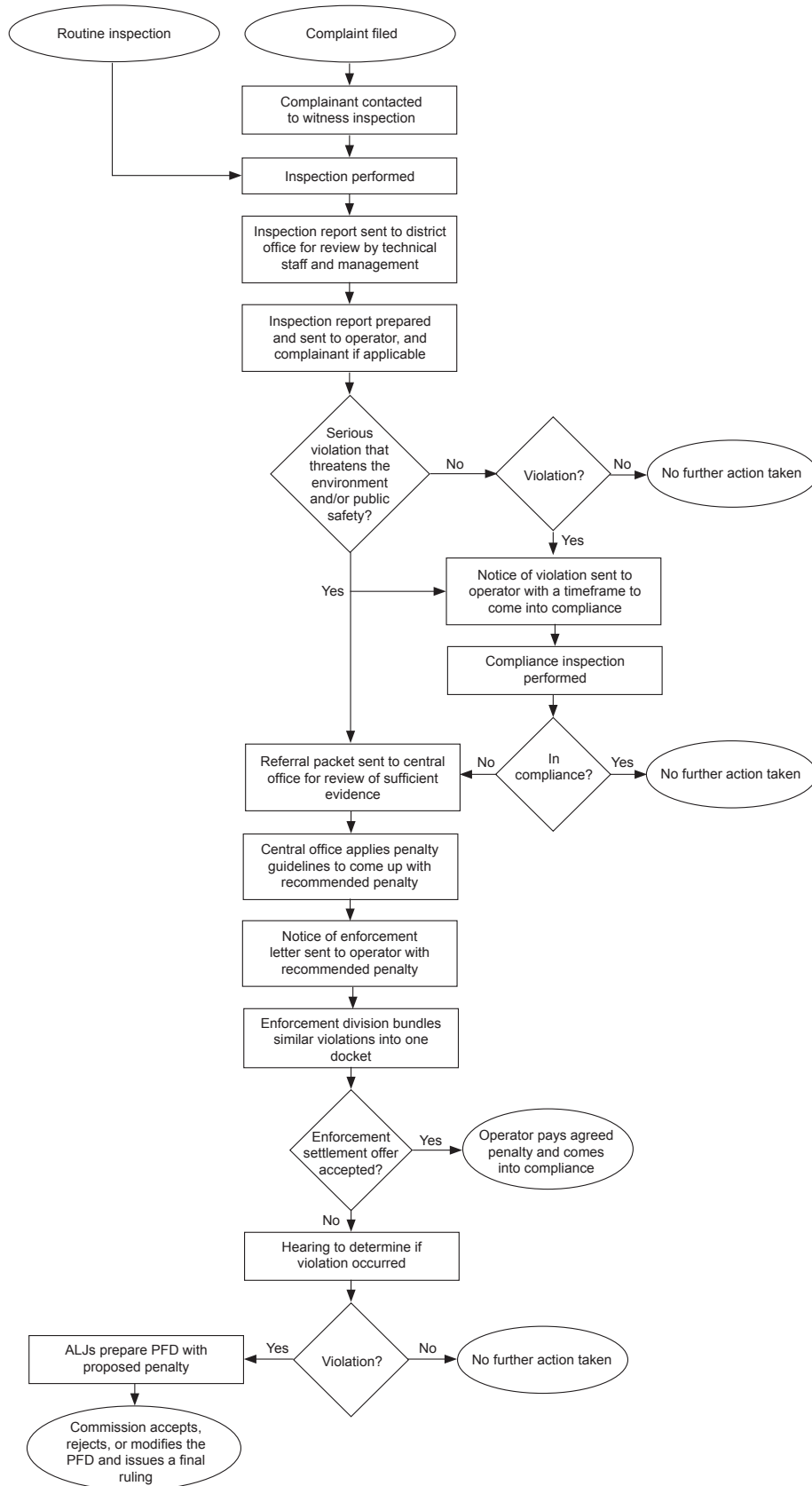
Standard enforcement tools:

- Assessing administrative penalties
- Seeking civil penalties
- Pursuing injunctive relief
- Referring for criminal prosecution

Industry-specific enforcement tools:

- Reducing allowable oil and gas production levels
- Suspending production through severance

Oil and Gas Inspection and Enforcement Process



Findings

The Commission initiates a limited number of enforcement actions against noncompliant oil and gas producers and relies on incomplete data to guide its enforcement process.

An effective enforcement process should balance monitoring, compliance, and penalties. Monitoring is expensive and inspectors cannot reasonably oversee the significant amount of oil and gas activity in a state the size of Texas. The efficient and fair use of penalties plays a key role in deterring and punishing violators, and thus increases compliance. The Commission and its field staff go to great lengths to ensure compliance through monitoring and inspections; however, the Commission takes relatively few enforcement actions, resulting in a lack of deterrence for future noncompliance. While there is no standard for how many violations should result in a monetary sanction, action should be frequent enough to deter future violations. In addition, the agency cannot ensure that monetary penalties are assessed consistently and fairly.

- **Limited Deterrence of Future Violations.** To effectively deter future violations, an agency needs to ensure that its regulated community is aware of its enforcement actions. This means assessing fines frequently enough to send the message to operators that if they commit a violation, a penalty may be assessed, even if the operator comes into compliance.

The Commission ensures that operators who violate law or Commission rule bring their production sites into compliance, but because the Commission views compliance as an end in itself, few violations ultimately result in Commission enforcement actions. Of the more than 80,000 oil and natural gas production-related violations found in fiscal year 2009, field staff forwarded less than 4 percent to the agency's central office for enforcement action. In contrast, the Texas Commission on Environmental Quality forwarded about 20 percent of its more than 11,000 violations for enforcement action.

Even modest fines for less serious, but frequent violations can substantially affect compliance, especially once word spreads that coming into compliance will no longer suffice to avoid a penalty. For example, inspectors reported nearly 24,000 sign violations, more than any other single type of violation. While signs may not seem important on an individual basis, safety and public information reasons exist for these requirements. The numbers suggest some operators do not install required signs unless found in violation by an inspector. If operators had to pay a fine of \$250 for each sign violation, the number of these violations would decrease.

While a large number of the total violations found by the Railroad Commission may be relatively minor, the Commission also finds violations that can pose a serious threat to public safety and the environment, like water pollution. In fiscal year 2009, the Commission found more than

Monetary sanctions should be frequent enough to deter future violations.

Out of 80,000 violations, only 4 percent went to enforcement.

18,000 water protection violations but took enforcement action on less than 1 percent of these violations. Perhaps more importantly, the Commission is unable to say with certainty that there were no serious violations in the roughly 17,900 water pollution violations that did not go for enforcement, since the Commission relies on the discretion of each district office to determine which violations should be forwarded for enforcement action.

Out of 18,000 water protection violations, only 1 percent went to enforcement.

If operators are able to repeatedly commit the same offense and avoid a penalty by coming into compliance, the threat of a penalty loses its deterrent effect. Field staff record all violations, but the Commission does not specifically track repeat violations unless the violation is one of the 4 percent brought forward to enforcement. As a result, the Commission cannot be certain that operators are not committing repeated violations, only to come into compliance before the Commission assesses a penalty. This approach is comparable to police only issuing tickets to 4 percent of speeders. If the police give a driver a warning, the driver may slow down that day, but without a sanction the driver will likely return to speeding in short order. Further, if the police do not track warnings issued, an officer would not know if a speeder was a first-time offender or a recurring violator that places the public in jeopardy.

- **Inadequate Tracking of Enforcement Data.** The agency does not track data on operator violations in a way that allows the Commission to see the effectiveness of its enforcement efforts. When asked how many of the more than 18,000 water protection violations found in fiscal year 2009 resulted in an enforcement action, the agency produced the total, about 150, with difficulty since it does not track how many of each type of violation is forwarded for enforcement action. The Commission required a manual count of each violation in the enforcement dockets when asked for enforcement actions by type. In addition, the Commission could not provide information on how many serious violations were found, without reviewing each inspection file to determine the seriousness of each case. Without data on the types and seriousness of violations being sent for enforcement action, the Commission cannot get an accurate picture of its enforcement efforts.

Commission staff would have to manually review enforcement actions to determine how many were serious.

The Commission tracks violations by the Statewide Rule violated, but does not track additional important information. The chart on the following page, *Ten Rules Most Frequently Violated*, created using information provided by the Commission, depicts the agency's method for grouping information on the 10 most frequently found Statewide Rule violations. While the information provides a general picture of types of violations inspectors find, the data does not indicate whether the violations found are serious or, if they are not serious, represent repeated violations by the same operator. By relying on this limited information the Commission cannot determine or ensure effective and consistent enforcement across the state.

Ten Rules Most Frequently Violated – FY 2009

Statewide Rule Number	Rule	Total Violations
3	Identification of Properties, Wells, and Tanks	23,969
8	Water Protection	18,035
14B2	Plugging Extension	17,124
91	Clean up of Soil Contaminated by a Crude Oil Spill	5,731
13	Casing, Cementing, Drilling, and Completion Requirements	2,808
46	Fluid Injection into Productive Reservoir	2,396
14	Plugging	1,514
9	Disposal Wells	1,174
36	Oil, Gas, or Geothermal Resource Operation in Hydrogen Sulfide Areas	1,048
22	Protection of Birds	1,044

- Poor Public Perception.** A lack of consistent enforcement can contribute to a public perception that the Commission is not willing to take strong enforcement action. This is especially true for violations that arise from complaints. In fiscal year 2009, the Commission received 681 complaints related to oil and gas production and found 1,997 violations based on these complaints. However, these complaints ultimately resulted in enforcement action for only 91, or 4 percent, of these violations. When the public sees so few enforcement actions for violations found from its complaints, the public’s confidence in the Commission’s enforcement process is undermined. In addition, the Commission does not post its enforcement data in a manner that is easily accessible to the public, making it difficult for the public to find information on the Commission’s enforcement efforts.

Other regulatory agencies have formalized processes for ranking violations to ensure that serious or repeat offenses of lower-level violations are referred for enforcement action. For example, the Texas Commission on Environmental Quality uses Enforcement Initiation Criteria to evaluate violations found during inspections. This system ensures that serious violations and certain repeat violations are automatically forwarded for enforcement action.

Limited enforcement action taken by the Commission is not a new concern. The 2001 Sunset review of the Commission found that the agency’s enforcement efforts did not adequately address serious pollution violations and noted that even then, poor enforcement had been a long-standing problem for the Commission. If operators are rarely brought in for enforcement action, a pattern of non-compliance can develop leading to escalating violations, which can eventually result in costly State-managed well plugging or remediation, large environmental impacts, or public safety hazards.

The Commission’s enforcement data is not easily accessible to the public on its website.

Not making full use of enforcement tools wastes the time of agency inspectors.

With the oil and gas industry continuing to expand into suburban areas, as seen in the Barnett Shale region, the Commission is under increasing pressure to conduct more inspections and hire more field staff. However, increasing spending is very difficult in a poor economy, especially in light of the upcoming budget shortfall. Failing to maximize the use of its existing tools, like monetary penalties, to increase compliance wastes agency resources, forcing inspectors to have to check and recheck to ensure violations come into compliance.

Once referred for enforcement action, the Commission’s informal penalty guidelines inhibit the amount of penalties assessed and don’t allow for public input.

Commission staff use an informal penalty guideline to calculate proposed penalty recommendations. The Commission makes settlement offers to operators based on the proposed penalty, and if the operator chooses not to settle the violation, the matter proceeds to hearing. Although the Commission’s hearing examiners are not bound by this recommended penalty amount, the hearing examiner generally follows these guidelines when determining the proposed penalty amount for a case and the Commission rarely deviates from the staff-proposed penalty amount.

Public input on the agency’s enforcement approach is critical as drilling expands into urban and suburban areas.

By not having a formally adopted penalty schedule, the Commission also lacks a process to gather public input on what penalty levels should be for violations – from both industry members and the general public. As the oil and gas industry continues to expand into urban and suburban areas such as the Barnett Shale, the public has an increasing interest in the Commission’s enforcement activities.

In comparison, statute requires the Railroad Commission to have formally adopted penalty guidelines in rule for its Pipeline Safety division, and to consider a pipeline operator’s compliance history, good faith efforts, and the seriousness of the violation when developing the penalty.¹ Also, other regulatory agencies, such as the Public Utility Commission, have formally adopted penalty guidelines in rule to help ensure fair and consistent penalties. The Public Utility Commission’s guidelines provide a system establishing a class for each type of violation, based on the seriousness of the violation, and the maximum penalty for each class of violation.²

The Commission’s hearing process for contested enforcement cases lacks the independence that the State Office of Administrative Hearings could provide.

The Railroad Commission conducts all of its enforcement hearings with in-house staff. In fiscal year 2009, the Commission conducted 55 default and 18 contested enforcement hearings. The majority of participants – the administrative law judge, the attorneys who bring the charges, and the staff who investigate the violations – are all Commission employees. The relationship between the judges, attorneys, and staff provides the opportunity

for inadvertent ex-parte communication and may create the perception that the Commission's staff, as a party to the case, could exert an unfair amount of influence over the administrative law judge's decisions.

The State Office of Administrative Hearings (SOAH) offers an independent and objective forum for agencies to adjudicate contested matters. The Legislature created SOAH in 1991 to conduct hearings for other state agencies. The agency has 58 administrative law judges who hear cases across the state.

If a SOAH judge conducted the hearings for Railroad Commission contested enforcement cases, the agency's role as a party in the hearings would be clearly separated from the responsibility of conducting the hearing itself. Since SOAH's creation, the Sunset Commission has routinely reviewed administrative hearings conducted by agencies to determine whether this function should be performed by SOAH. In fiscal year 2009, SOAH conducted 33,415 hearings for 50 agencies. Also, SOAH routinely hears complex enforcement cases that involve highly technical matters, such as cases heard for the Texas Commission on Environmental Quality and Public Utility Commission. While complex, Sunset staff found no reason that SOAH could not effectively handle the Railroad Commission's enforcement cases.

SOAH routinely hears complex enforcement cases for other agencies, like TCEQ and PUC.

Recommendations

Change in Statute

3.1 Require the Commission to develop, in rule, an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.

This recommendation would require the Commission to develop an overall enforcement policy in rule that includes specific processes for classifying violations based on the risk to public safety or the risk of pollution. The Commission would adopt standards providing guidance to field staff on which type of violations to appropriately dismiss based on compliance, versus violations that should be forwarded to the central office for enforcement action. In addition, the Commission should develop standards that take into account an operator's previous violations and compliance history when determining whether to forward a violation.

3.2 Require the Commission to formally adopt penalty guidelines in rule.

This recommendation would require the Commission to adopt its penalty guidelines in rule, using public input to update current penalty amounts. The guidelines should assign penalties to different violations based on their risk and severity, making full use of higher penalties for more serious and repeat violations. By formally adopting penalty guidelines in rule for oil- and natural gas-related violations, the Commission would be aligning these enforcement procedures with its Pipeline Safety division's enforcement procedures.

3.3 Transfer the Commission's enforcement hearings to the State Office of Administrative Hearings.

Under this recommendation, the Commission would enter into an interagency contract with SOAH to conduct the Commission's enforcement hearings – not just oil- and natural gas-related violations. In conducting hearings, SOAH would consider the Commission's applicable substantive rules and policies. Like other agencies that have hearings conducted at SOAH, the Commission would maintain final authority to accept, reverse, or modify a proposal for decision made by a SOAH judge. The Commission may reverse or modify a decision only if the judge did not properly apply or interpret applicable law, Commission rules, written policies, or prior administrative decisions; the judge relied on a prior administrative decision that is incorrect or should be changed; or the Commission finds a technical error in a finding of fact that should be changed.

Management Action

3.4 Direct the Commission to revamp its tracking of violations and related enforcement actions tied to oil and natural gas production, and to develop a clear and consistent method for analyzing violation data and trends.

This recommendation would direct Commission staff to compile more useful statistical information on violations to identify regulatory problem areas, and report on this data to the Commission at least annually. At a minimum, the Commission should collect information on the number of complaints received and how the complaints were resolved, the number and severity of violations sent for enforcement action, the number of violations sent for enforcement action for each Commission rule, and the number of repeat violations found for each operator.

3.5 The Commission should publish additional complaint and enforcement data on its website.

This recommendation would direct the Commission to increase the public's access to complaint and enforcement data online, and provide a more user-friendly format. Enforcement-related information displayed on the Commission's website should include all inspection and enforcement activity, designating whether the inspection was Commission-initiated or complaint-based. Data should include the disposition of violations and the amount of final enforcement penalties assessed to the operator. The Commission should also make available trend data and analysis online from the information collected as part of Recommendation 3.4. The Commission should update this data at least quarterly.

Fiscal Implication Summary

These recommendations would likely generate additional revenue from penalties for the General Revenue Fund. Recommendation 3.1 should increase the number of violations forwarded for enforcement and updating the penalty guidelines would likely bring in more revenue. However, because penalty amounts generated would depend on the number and seriousness of future violations, the potential fiscal impact could not be estimated. Under current law, any additional penalty amounts would be directed to the Oil Field Cleanup Fund; however, Issue 2 of this report would redirect such penalties to the General Revenue Fund.

Transferring the Commission's enforcement hearings to SOAH would have no significant fiscal impact to the State. The savings to the agency would be offset by the cost of conducting the hearings at SOAH.

Directing the Commission to track more enforcement data and to publish that information on its website would have little fiscal impact, as the agency can accomplish these website improvements as time and money allow.

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1 Texas Natural Resources Code, sec. 81.0531(d).

2 Texas Administrative Code, Title 16, part 2, rule 25.8.

Responses to Issue 3

Overall Agency Response to Issue 3

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. Chairman Williams and Commissioner Carrillo did provide written and oral testimony on aspects of Issue 3, as summarized below, representing their individual opinions but not that of the agency as a whole.

Recommendation 3.1

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

Chairman William's Response to 3.1

Chairman Williams states that lease severances provide a valuable enforcement tool without the delay and cost of enforcement hearings. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to 3.1

Commissioner Carrillo generally agrees that the agency can and should strive to improve enforcement efforts by developing an enforcement policy to guide staff in rule. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

For 3.1

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Rita Beving, North Texas resident – Farmers Branch

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Morgan O'Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin

Robert J. Vann II, Fort Worth

Against 3.1

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Modification

1. Require the Railroad Commission to develop, but to not adopt in rule, an enforcement guidance document or policy statement that would offer more adaptability to the Commission for changing circumstances. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

Recommendation 3.2

Require the Commission to formally adopt penalty guidelines in rule.

Commissioner Carrillo's Response to 3.2

Commissioner Carrillo generally agrees that the agency can and should strive to improve enforcement efforts by adopting penalty guidelines in rule. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

For 3.2

Calvin Tillman, Mayor, DISH

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Rita Beving, North Texas resident – Farmers Branch

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Morgan O'Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Robert J. Vann II, Fort Worth

Against 3.2

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Modification

2. Require the Commission to develop, but to not adopt in rule, penalty guidelines that would offer more adaptability to the Commission for changing circumstances. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

Staff Comment: The Commission already has informally adopted penalty guidelines to assist staff in making penalty recommendations.

Recommendation 3.3

Transfer the Commission's enforcement hearings to the State Office of Administrative Hearings.

Chairman Williams' Response to 3.3

Chairman Williams opposes transfer of any contested case hearings, including natural gas ratemaking, to the State Office of Administrative Hearings. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to 3.3

Commissioner Carrillo strongly disagrees with the recommendation to transfer enforcement hearings to the State Office of Administrative Hearings. The Railroad Commission has enormous in-house expertise among its technical staff, attorneys, and hearing examiners that is absolutely critical to the effective and efficient administration of its various regulatory programs. Commissioner Carrillo also states that the recommendation limits the Railroad Commission's ability to reverse or modify a SOAH decision beyond what is available to other agencies, such as TCEQ and PUC. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

Staff Comment: The Public Utility Commission and Texas Commission on Environmental Quality do have broader authority than that given in the Administrative Procedure Act to modify a finding of fact or conclusion of law made by an Administrative Law Judge of the State Office of Administrative Hearings. Both commissions have the ability to change findings determined to not be supported by a preponderance of evidence, an option not included in the APA. Sunset staff made no recommendation to extend this authority to the Railroad Commission under the proposed transfer; however, this change could be easily made.

Affected Agency Response to 3.3

The State Office of Administrative Hearings (SOAH) states that if the Legislature decides to transfer enforcement cases from the Railroad Commission, SOAH is firm in its belief that it could do an excellent and efficient job. Staff would draw on its extensive experience and knowledge in enforcement work to learn the Railroad Commission's subject matter without difficulty and to be proficient in it quickly. (Cathleen Parsley, Chief Administrative Law Judge – State Office of Administrative Hearings)

For 3.3

Senator Wendy R. Davis, Member – Texas Senate

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton; and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Urban “Obie” O’Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Morgan O’Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Robert J. Vann II, Fort Worth

Andy Wilson, Research Associate – Public Citizen, Austin

Against 3.3

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Ronald Kitchens – CenterPoint Energy, Austin

Patrick Nugent, Executive Director – Texas Pipeline Association, Austin

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Bob Thompson, Austin

Recommendation 3.4

Direct the Commission to revamp its tracking of violations and related enforcement actions tied to oil and natural gas production, and to develop a clear and consistent method for analyzing violation data and trends.

Chairman William's Response to 3.4

Chairman Williams agrees that, given the resources, the Commission can improve the tracking and analysis of violations and related enforcement actions. He points out that the agency's ongoing capital project to expand its tracking system, the District Field Operations and Management System, will allow for better reporting and tracking of violations and trends. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to 3.4

Commissioner Carrillo generally agrees that the agency can and should strive to improve enforcement efforts by revamping violation and enforcement tracking systems. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

For 3.4

Calvin Tillman, Mayor, DISH

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Rita Beving, North Texas resident – Farmers Branch

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Morgan O'Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Robert J. Vann II, Fort Worth

Against 3.4

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Recommendation 3.5

The Commission should publish additional complaint and enforcement data on its website.

Commissioner Carrillo's Response to 3.5

Commissioner Carrillo generally agrees that the agency can and should strive to improve enforcement efforts by publishing additional complaint and enforcement data on the agency's website. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

For 3.5

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston

Morgan O'Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin

Robert J. Vann II, Fort Worth

Against 3.5

Tricia Davis, National Director – American Royalty Council, Dripping Springs

Modification

3. Require the Commission to publish only confirmed, investigated violations that have gone through the enforcement process. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin; Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin; and Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)

Staff Comment: This modification reflects Sunset staff's intent.

Staff Recommended Action

Adopt Recommendations 3.1 through 3.4 and 3.5 with Modification 3.

Issue 4

The Commission's Marketing of Propane Is No Longer Necessary.

Background

In 1991, the Legislature established the Alternative Fuels Research and Education Division (AFRED), giving the Railroad Commission (Commission) the authority to promote propane and other environmentally beneficial alternative fuels.¹ While authorized to promote other fuels, the Commission has always focused solely on propane as this industry alone contributes funds to support this purpose. The Commission employs 24 staff who administer the AFRED program, 10 of whom work to increase the public's awareness of propane as an alternative fuel.

The Commission funds its propane marketing function using a statutorily authorized delivery fee paid by the propane industry on the sale of odorized gas, collecting more than \$1.8 million in fiscal year 2009. Such fees fund the Commission's primary marketing activity, a rebate program.² The Commission's rebate program encourages the consumption of propane by providing financial incentives to purchasers of propane water heaters and other propane appliances. In fiscal year 2009, the Commission issued about 4,000 rebates to purchasers of propane appliances, totaling more than \$1 million. In addition, Commission staff issue a monthly propane newsletter, provide educational programs on propane appliances for homebuilders, organize and conduct seminars on propane vehicles for fleet operators, and research new ways in which to use propane as an alternative fuel.

The Commission also employs three staff who distribute grant money from other state agencies and the federal government to promote the use of propane as an alternative fuel. The grants, as described in the chart, *Propane-Related Grants*, provide funding to local governments and fleet operators who replace old forklifts, school buses, and other medium-duty trucks with new, low-emissions propane vehicles. In fiscal year 2009, the Commission awarded more than 500 grants to local governments and fleet operators, totaling more than \$17 million.

Propane-Related Grants

Awarding Agency	Description	Timeframe	Amount Awarded
Texas Commission on Environmental Quality	Provides funding for the purchase of propane school buses and for retro-fitting old forklifts and medium-duty trucks that run on propane.	September 1, 2009 – August 31, 2011	\$10,000,000
State Energy Conservation Office	Provides funding for purchasing new propane fueled vehicles.	February 10, 2010 – August 31, 2011	\$3,092,080
U.S. Department of Energy	A one-time stimulus grant that provides funding for 882 propane vehicles and 35 propane refueling stations.	February 2, 2010 – January 31, 2014	\$12,633,080

In addition to its propane promotion activities, the Commission also licenses all businesses and individuals that supply, transport, or distribute propane. The Commission employs 11 staff in its propane training and licensing program, housed within the same division as its propane marketing program. The Commission also regulates the safe use of propane. In addition to other funding, the

agency uses about \$55,000 from the \$1.8 million in delivery fees referenced above to supplement its propane safety function.

Established in statute, the Propane Alternative Fuels Advisory Committee oversees the AFRED program and advises the Commission on opportunities to expand the use of propane. The Advisory Committee also helps the Commission develop ideas for training and testing, as part of the propane licensing function.

Findings

The Commission's role in marketing propane poses a potential conflict with its regulation of the industry.

The Commission's primary responsibility is to ensure the safe handling and distribution of propane and to prevent the risk of injury or property loss to workers in the industry or the public. Involvement in promoting propane can give the appearance of conflicting with this task, which at times could necessitate taking enforcement action that could place the industry in a negative light. In fact, Sunset staff could find no other state agency that promotes a product it also regulates. The Texas General Land Office (GLO), for example, encourages the consumption of natural gas, but does not regulate the production, transportation, and distribution of natural gas. Similarly, the Texas Department of Agriculture (TDA) encourages Texans to buy products grown in the state as well as regulates many of the state's agricultural industries. However, TDA does not promote the products that it also regulates. Rather, TDA regulates the processes and facilities where products are grown and stored, but does not regulate the products themselves.

No other state agency promotes a product that it also regulates.

Marketing only propane inappropriately places the State in the position of appearing to favor one alternative fuel over all others.

In general, the State's standard is not to promote a specific product because it can give the impression that the State is partial to one industry or product over another. For example, the Department of Agriculture does not limit what producers or products are eligible to be promoted by the State. Rather, TDA's goal is to increase consumption of Texas grown products as a whole without giving one product or industry an advantage over another. Although GLO promotes the use of natural gas, GLO has a vested interest in the sale of natural gas because the State receives royalties from gas produced on its lands. However, the State has no direct benefit in promoting propane over all other alternative fuels.

The State's role in marketing and researching propane is no longer needed as other state and national propane organizations now perform these same functions.

Although the Commission once stood alone as the only entity that promoted propane statewide in Texas, almost 20 years later other state and national propane organizations exist that serve the same purposes. In 1996, the U.S.

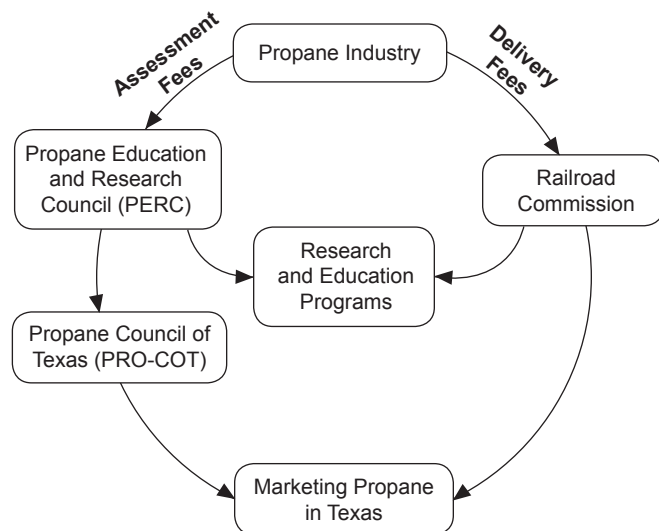
Congress created the Propane Education and Research Council (PERC) to market propane as an alternative fuel at the national level. Two years later, the Texas Propane Gas Association created the Propane Council of Texas (PRO-COT), a non-profit 501(c)3 organization, to promote propane use as an alternative fuel in Texas.

On the state level, PRO-COT now performs many of the same functions as the Commission, including advertising on public radio; providing financial incentives for business fleets, such as taxis and delivery vehicles, to purchase new propane vehicles; publishing brochures and magazines; and providing educational programs for homebuilders and fleet operators. On the national level, PERC funds similar research programs as the Commission. For example, both PERC and the Commission are developing a propane-fueled combined heat and power generator and are participating in numerous studies involving propane fuel quality.

A key criteria of the Sunset process is to question the ongoing need for a function. If other public or private entities provide the same services, then no ongoing need exists for the State to do so. In this case, other entities focused on promoting the use of propane have developed over the years that provide a more appropriate mechanism for marketing and research than the Commission. In addition, the industry no longer needs to be paying 50 percent of all delivery fees in Texas to support AFRED's marketing program, when it is also paying fees to PERC for many of the same marketing and research programs. The propane industry pays an assessment fee to PERC for education and research. In turn, PERC then distributes some of the collected fees to fund PRO-COT's marketing programs at the state level. The flowchart, *Duplicative Funding for Propane Marketing*, illustrates the industry's funding of marketing and research programs at both the national and state level. In the end, these extra costs to the industry impact the cost of propane to the customer.

The propane industry, and ultimately the consumer, pays twice for the same function.

Duplicative Funding for Propane Marketing



Industry fees dedicated to marketing propane fail to cover program costs.

Although funded mainly by industry fees, the Commission's propane marketing expenses have exceeded revenue collected in recent years. In fiscal year 2009, the Commission received \$1,801,973 in revenue from industry fees. However, the Commission's expenditures, which includes the costs of rebates issued and the salaries and benefits of the staff who administer the program, totaled \$2,181,669, resulting in a \$379,696 shortfall, which is supplemented by General Revenue funds. Furthermore, this shortfall does

not include the \$272,824 of indirect costs associated with administering the Commission's propane promotion programs. Thus, the Commission spent \$652,520 in taxpayer dollars to cover costs associated with marketing and promoting the propane industry.

Recommendation

Change In Statute

4.1 Eliminate the Commission's statutory authority to promote the use of propane.

This recommendation would remove the Commission's statutory authority to promote propane, including its marketing, research, and education functions. As part of this recommendation, the Commission's statutory authority to assess a delivery fee on the propane industry for the purpose of funding AFRED should also be removed. These changes would also do away with the need for the AFRED General Revenue-dedicated account, which should be dissolved.

Under this recommendation, the Commission would continue to administer, until completed, its current propane-related grants. In the future, nothing would prohibit the Commission from continuing to apply for such grants; however, the Commission should do so with an alternative fuel-neutral approach.

As part of this recommendation, the Propane Alternative Fuels Advisory Committee's statutory authority to advise the Commission on opportunities to expand the use of propane in Texas would also be eliminated. The Advisory Committee, however, would continue to help the Commission develop ideas for training and testing of propane licensees as these changes would not impact the Commission's ongoing role in licensing businesses and individuals who work with propane.

Fiscal Implication Summary

The recommendation to eliminate the Commission's propane marketing, research, and education functions would have a net savings of \$596,775 to the General Revenue Fund and an associated reduction of 10 full-time equivalents (FTEs).

The Commission would no longer collect or expend fees assessed to the propane industry for the purpose of marketing propane, representing more than \$1.8 million in fiscal year 2009. Because industry fees dedicated to marketing propane fail to cover these program costs, eliminating this function would result in a savings of \$652,520. However, because delivery fees would no longer be collected, the Commission would need to account for the loss of \$55,745 used to supplement the Commission's propane safety duties, reducing the savings to \$596,775.

Continuing to monitor grants would have no fiscal impact; as such functions would continue to be paid for using existing funds associated with the grants. In addition, this recommendation would not affect the staff that performs the Commission's licensing and regulatory activities, which are funded through licensing fees.

Railroad Commission of Texas

Fiscal Year	Savings to the General Revenue Fund	Change in the Number of FTEs From FY 2009
2012	\$596,775	-10
2013	\$596,775	-10
2014	\$596,775	-10
2015	\$596,775	-10
2016	\$596,775	-10

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¹ Texas Natural Resources Code, sec. 241.

² Texas Natural Resources Code, sec. 2435.

Responses to Issue 4

Overall Agency Response to Issue 4

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. Neither Commissioners nor agency staff commented on this issue.

Recommendation 4.1

Eliminate the Commission's statutory authority to promote the use of propane.

For 4.1

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Betty J. and Clyde W. Collins, Fort Worth

Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Andy Wilson, Research Associate – Public Citizen, Austin

Against 4.1

Curtis Donaldson, CEO – Clean Fuel USA, Georgetown

Modifications

1. If the Railroad Commission continues to market propane, this role should be expanded to include the marketing and promotion of natural gas. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin)
2. Continue the Commission's authority to promote propane and allow the Commission to promote natural gas, compressed natural gas, and natural gas products as alternative fuels. (Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)

Staff Recommended Action

Adopt Recommendation 4.1.

Issue 5

Texas' Interstate Pipelines Lack Needed Damage Prevention Oversight to Ensure Public Protection.

Background

Texas has more than 214,000 miles of regulated pipeline transporting gas, oil and other hazardous liquids, and carbon dioxide. As described in the chart below, *Pipeline Regulation in Texas*, the Railroad Commission (Commission) oversees intrastate pipelines in Texas – pipelines that operate within the State's borders and typically link production sources to distribution systems. The federal Pipeline and Hazardous Materials Safety Administration (PHMSA) in the U.S. Department of Transportation oversees Texas' interstate pipelines that transport natural gas and other products to other states. Both agencies focus on protecting the public against risks to life and property posed by pipeline transportation.

Pipeline Regulation in Texas

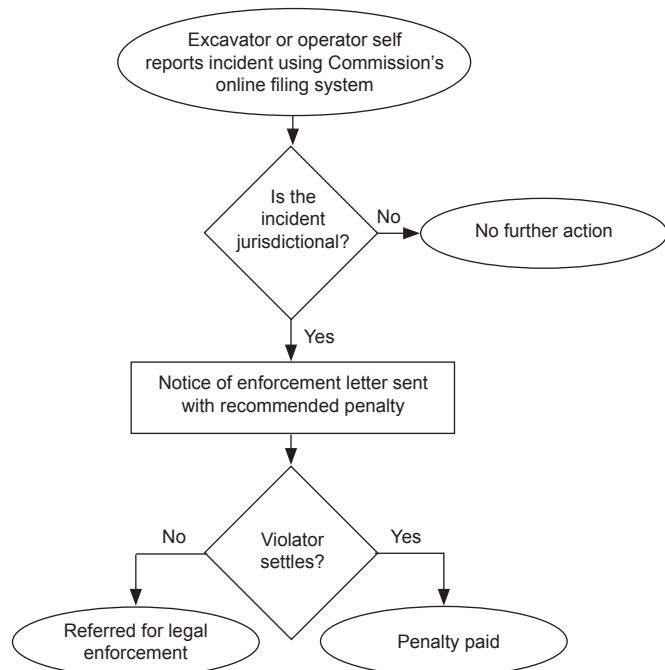
Regulatory Entity	Type of Pipeline	Description of Pipelines	Miles of Pipeline
Railroad Commission	Intrastate	Pipelines operating within Texas' borders*	170,000
Federal PHMSA	Interstate	Pipelines that connect with pipelines in other states	44,000

* Excludes lines leaving production sites.

To prevent damage to the nation's pipelines, the federal government created the 811 – Call Before You Dig – program, a national program that coordinates location services for all underground utilities, including electric, telephone, cable, gas, sewer, and water lines. The 811 program works in conjunction with the Commission's program to prevent damage and potential pipeline explosions caused by excavators. In addition to its damage prevention program, the Commission's pipeline safety program performs physical inspections and audits operator records.

Excavators must call 811 before beginning a project to have all underground utilities marked at the excavation site. The Commission can assess penalties for failing to call 811 or for violations of its damage prevention rules, which set out best practices for excavators and pipeline operators. The Commission's enforcement process is detailed by the accompanying flowchart, *Damage Prevention Enforcement Process*. Commission rule requires excavators to notify 811 within two hours of any damage to a pipeline, and both the operator and excavator to notify the Commission within 10 working days.

Damage Prevention Enforcement Process



For intrastate pipelines under its jurisdiction, the Commission helps enforce compliance with the 811 process by assessing administrative penalties against both excavators that fail to call and pipeline operators that fail to correctly mark underground pipelines. Since 2007, when the Commission began enforcing its damage prevention rules for intrastate pipelines, the Commission has taken more than 9,500 enforcement actions for damage prevention violations, collecting about \$2 million in fines. Nearly all reported incidents that were within the Commission’s jurisdiction resulted in an enforcement action.

The Commission’s damage prevention program currently has 14.5 full-time equivalent positions and operates on an annual budget of about \$930,000. The Commission funds this program with General Revenue that the Commission covers with fees assessed on distribution pipelines and matching federal funds.

Findings

No regulatory entity enforces damage prevention laws for Texas’ interstate pipelines.

Neither the federal government nor the Railroad Commission enforces damage prevention for interstate pipelines. While the federal government has oversight responsibility for interstate pipelines, no federal program exists to enforce damage prevention. In contrast, Texas has a fully operational system for enforcing damage prevention, but only has authority under state law to oversee intrastate pipelines.¹ The chart, *Pipeline Safety Jurisdiction in Texas*, details various pipeline safety activities and whether Texas or the federal government has jurisdiction to perform the activity.

Pipeline Safety Jurisdiction in Texas

Regulatory Activity	Intrastate	Interstate
Inspection of Pipeline Facilities	TX	Federal
Pipeline Accident Investigation	TX	Federal
Damage Prevention Enforcement	TX	None

Twenty-one other states enforce damage prevention rules for interstate pipelines.

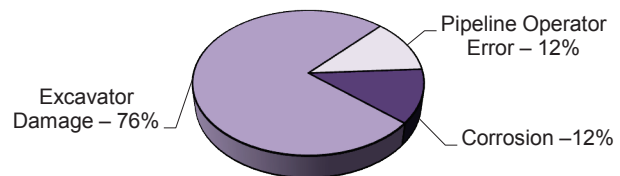
The Pipeline and Hazardous Materials Safety Administration views damage prevention as a state issue that is best handled by a state’s regulatory oversight body and encourages states to enforce damage prevention regulations for violations that affect interstate pipelines. The Pipeline Safety Improvement Act of 2002 allows states to enforce their damage prevention laws for damage to interstate pipelines, and currently, 21 states enforce their pipeline damage prevention rules for violations that affect interstate pipelines within the state.² However, without a change in state law, Texas statute does not provide the Commission with any enforcement authority over interstate pipelines, preventing the Commission from enforcing damage prevention rules for violations that affect these pipelines.

Without enforcement authority, Texas lacks a key tool for responding to, and deterring, excavator damage to its interstate pipelines that can pose a serious threat to public safety.

Incidents involving pipelines can result in serious damage to the pipeline system and can, as was seen in recent months, even result in fatalities. In June 2010, a contractor for an electric utility in Johnson County, Texas drilled into an intrastate gas pipeline using heavy-duty augering equipment, causing an explosion that resulted in the worker's death and injury to eight people. According to the Commission, the incident also resulted in an estimated \$279,000 in property damage and \$750,000 in lost natural gas. In this case, the Commission is pursuing an administrative penalty enforcement action against the pipeline operator for failure to comply with the Commission's damage prevention rules. However, if this incident had involved an interstate pipeline, the Commission would have been unable to take enforcement action, even though damage to interstate pipelines poses the same risks as damage to intrastate lines.

Although the 811 program has helped raise awareness of the need to call before digging, excavator damage to pipelines continues to be the leading cause of damage to pipelines. In fiscal year 2009, excavators caused nearly 80 percent of the more than 12,000 reports of damage to intrastate pipelines in Texas, as shown in the pie chart, *Causes of Intrastate Pipeline Damage*. In fiscal year 2009, the Commission completed more than 1,800 enforcement actions against excavators, collecting nearly \$460,000 in penalties. The Commission also completed 1,300 enforcement actions against operators, collecting more than \$500,000 in penalties. While the Commission has taken an aggressive stance to penalize violations involving pipelines under its jurisdiction, damage to interstate pipelines results in no enforcement. Unfortunately, the Commission cannot even provide an accurate picture of how large a problem damage to interstate pipelines is because the Commission currently has no authority over damage to these pipelines and thus receives no information about such events.

**Causes of Intrastate Pipeline Damage
FY 2009**



Recommendation

Change in Statute

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

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 these rules for violations that affect both types of pipelines. Under this recommendation, the Commission could assess administrative

penalties against operators and excavators that violate damage prevention rules on interstate lines. The Commission would deposit these penalties in the General Revenue Fund, as it does with penalties collected from its intrastate pipeline damage prevention program.

Fiscal Implication Summary

This recommendation would not result in a significant fiscal impact to the State. The Commission states that its staff could oversee damage prevention for interstate pipelines as part of its already established intrastate damage prevention program. Also, should workload expand beyond this capacity, the Commission would be eligible to apply for federal grants to cover additional costs.

As part of this expanded authority, the Commission would assess and collect administrative penalties, which would result in a gain to the General Revenue Fund. However, because amounts generated would depend on the number and seriousness of future violations, a fiscal impact could not be estimated at this time.

¹ Texas Natural Resources Code, sec. 117.012 (a); Texas Health and Safety Code, sec. 756.126.

² Pipeline Safety Improvement Act of 2002, 49 U.S.C. § 60134 (2006).

Responses to Issue 5

Overall Agency Response to Issue 5

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. However, John Tintera, Executive Director for the agency, testified at the hearing on behalf of the agency in support of Issue 5.

Recommendation 5.1

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

Agency Response to 5.1

Mr. Tintera indicates that the agency supports this recommendation. (John Tintera, Executive Director – Railroad Commission of Texas)

For 5.1

Senator Wendy R. Davis, Member – Texas Senate

Calvin Tillman, Mayor, DISH

Al Armendariz, Regional Administrator – Environmental Protection Agency, Dallas

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Betty J. and Clyde W. Collins, Fort Worth

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Ronald Kitchens – CenterPoint Energy, Austin

Mike Mahoney, General Manager – Evergreen Underground Water Conservation District, Pleasanton and Vice President and Legislative Chair – Texas Alliance of Groundwater Conservation Districts

Patrick Nugent, Executive Director – Texas Pipeline Association, Austin

Morgan O’Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Robert J. Vann II, Fort Worth

Against 5.1

None received.

Modifications

1. Require the Railroad Commission to increase its oversight of all pipelines, and develop a database to determine a more exact location of the pipelines to ensure public protection and safety, especially in developing areas. (Calvin Tillman, Mayor, DISH)
2. Require the interstate pipelines whose facilities will be subject to this enhanced program to cover the cost of new damage prevention regulations or ensure that the U.S. Department of Transportation will provide additional funding for such efforts. (Patrick Nugent, Executive Director – Texas Pipeline Association, Austin and Ronald Kitchens – CenterPoint Energy, Austin)
3. To fund the new aspects of the program, explore the use of matching funds from the U.S. Department of Transportation or the assessment of fees on the interstate pipelines that will be subject to the program. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin).

Staff Recommended Action

Adopt Recommendation 5.1.

Issue 6

Impending Retirements of Key Staff Could Leave the Commission Vulnerable to a Significant Loss of Institutional Knowledge.

Background

The Railroad Commission (Commission) employs 662 staff, 279 of whom operate out of the Commission's 13 field offices. Most field staff perform inspections of oil, natural gas, and pipeline facilities. The Commission's staff includes experienced and highly technical employees who possess educational backgrounds in engineering, geology, economics, finance, and law. The average age of the Commission's workforce is slightly over 50 years old with more than 76 percent of the Commission's workforce over the age of 40. The chart, *Railroad Commission Staff by Age*, provides a breakdown of the Commission's staff by age group.

In addition to its aging workforce, more than 48 percent of staff has worked for the Commission for 10 years or more. Currently, 118 employees are already eligible to retire and 334 employees, or close to half the staff, will be eligible to retire by the end of fiscal year 2015. Many of the employees eligible to retire perform highly technical tasks. The chart, *Projected Retirement Eligibility by Job Category*, shows the percent of employees, by job category, who will be eligible to retire by fiscal year 2015.

Railroad Commission Staff by Age*

Age Group	Percent
Under 30 Years	9.5%
30 – 39 Years	13.7%
40 – 49 Years	22.6%
50 – 59 Years	38.5%
60 Years and Over	15.7%

* As of February 28, 2010.

Projected Retirement Eligibility by Job Category*
(By Fiscal Year 2015)

Job Category	Percent
Officials, Administration	70.7%
Technical	49.0%
Professional	46.9%
Para-Professional	40.0%
Administrative Support	38.8%

* As of February 28, 2010.

Findings

The Railroad Commission has and will likely continue to lose top-level management employees to retirement in the near future.

Impending retirements will cause the Commission to experience a significant loss of experienced staff in key management and technical areas in the near future. In fact, of the Commission's 33 top-level managers who act as program directors in the Commission's central office and who oversee the Commission's extensive inspection process in the field, 16 are already eligible to retire, 10 are eligible to retire within the next five years, and two of the positions are already vacant. In other words, most employees in critical management positions are eligible to retire within the next five years. Directors of some of the

Within the next five years, most key agency staff will be eligible to retire.

Commission's largest divisions and field offices, including the director of the Oil and Gas division, the director of the Pipeline Safety division, and the director of the Midland field office, have already retired from the Commission within the last year.

In addition to the key staff that have already left the Commission, four of the Commission's top-level management employees have retired from the State and been rehired. While addressing the problem for now, these employees are still likely to leave their positions and the Commission in the next few years. Key staff nearing retirement, combined with employees who have retired and been rehired, creates the potential for the Commission to lose a significant amount of experienced staff and institutional knowledge in a short time frame.

The Railroad Commission lacks a succession plan to deal with impending retirements and workforce changes.

Although the Commission has developed a Work Force Plan that identifies positions at risk of becoming vacant, the Commission has not implemented a succession plan that trains and develops employees to move into positions vacated by retirements. The purpose of succession planning is to ensure that there are experienced and capable employees who are prepared to assume strategic organizational roles as they become open. However, the Commission has not formally documented what skill sets are critical to meeting agency objectives, identified experienced and capable staff to fill vacancies, or prepared staff to assume top-level management roles by providing additional training and development opportunities.

The Railroad Commission faces numerous obstacles in trying to retain experienced employees and recruit new employees.

With the increase in production of natural gas in the Barnett and Eagle Ford Shale regions, the Commission faces a clear need for a strong and highly skilled staff to effectively oversee a changing and evolving industry. The Commission will need to retain its experienced employees, especially top-level managers, and recruit new employees to effectively perform its regulatory functions. However, developing a pool of experienced staff from within the agency is hampered by the Commission's high turnover among its employees under the age of 40. In fact, one of the highest rates of turnover (42.6 percent) at the Commission occurs among employees under 40 years of age.

The chart, *Commission Turnover by Age*, shows the percentage of employees who leave the Commission by age group. Inadequate pay and lack of career advancement resulted in 26 employees under the age of 40 leaving

Commission Turnover by Age*

Age Group	Percent
Under 30 Years	18.03%
30 – 39 Years	24.59%
40 – 49 Years	11.48%
50 – 59 Years	27.87%
60 Years and Over	18.03%

* As of February 28, 2010.

Without a succession plan, the agency cannot ensure consistent regulation.

Retaining and developing younger experienced staff is critical to the Commission's future.

the Commission in fiscal year 2009.¹ Having to compete with higher paying private sector jobs also creates barriers to recruiting employees external to the agency. All of these factors combine to make it difficult for the Commission to retain, train, and develop employees to fill vacancies left by retiring top-level managers.

A review of the Railroad Commission's equal employment opportunity performance, as required by the Sunset Act, reveals significant deficiencies.

The Sunset Act requires Sunset staff, in conducting reviews of State agencies, to consider agencies' compliance with applicable State requirements regarding equal employment opportunities (EEO) for minorities and women. Of the Commission's staff, 57 percent are male and 43 percent are female. Additionally, 7.7 percent of the Commission's workforce is African-American and 21.5 percent is Hispanic. The Railroad Commission maintains and reports EEO information under guidelines established by the Texas Workforce Commission. Appendix F shows the Railroad Commission's EEO performance in each job category for fiscal years 2007 to 2009.

While agency performance regarding EEO requirements is routinely evaluated in the course of each Sunset Review, staff only report significant deficiencies, as is the case for the Railroad Commission. With the one exception of administrative support, the Commission fell below the EEO statewide civilian workforce percentages for minorities and women for all job categories during the past three fiscal years. In the administrative support category, however, the Commission far exceeds the statewide average by employing 90 percent women. The Commission indicates that it was unable to meet civilian workforce percentages because the pool of applicants for open positions was predominately Caucasian men, as is reflective of the greater workforce pool in the oil and gas industry.

The Commission does not meet most EEO goals.

Recommendation

Management Action

6.1 The Railroad Commission should develop and implement a succession plan to prepare for impending retirements and workforce changes.

With the expected increase in staff turnover of top-level management positions, the Commission should implement a succession plan by no later than September 2011, before anticipated retirement-eligibility dates of key staff. As part of the succession planning process, the Commission should identify positions at risk of becoming vacant; identify the skills needed to fill these vacancies; identify experienced and capable staff to fill vacancies; and prepare staff to assume top-level management roles by providing additional training and development opportunities.

For example, Commission managers could document day-to-day activities and use those to prepare prospective management staff, require managers to identify and educate future managers, and develop a job shadowing program that prepares staff to assume top-level management positions. The Commission could also access the experience of other state agencies, such as the Texas Department of Insurance and

the Texas Workforce Commission, in developing and implementing effective succession plans. In addition, the agency could consider seeking legislative appropriation support to reclassify or increase salaries for certain hard to fill management positions. In conjunction with the fee recommendation in Issue 2, the increased salary costs would be recovered through Commission fees.

Also, in an effort to better meet statewide EEO civilian workforce percentages, the Commission should place greater emphasis on recruiting and training minorities and women to fill all vacancies at the agency including top-level management positions.

Fiscal Implication Summary

These recommendations would not have a fiscal impact to the State. Preparing for future staff needs is an essential agency function and should be handled with existing resources. Providing internal training for positions at-risk of becoming vacant can be accomplished within the Commission's existing budget.

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¹ Railroad Commission of Texas, *Strategic Plan for the Fiscal Years 2011 – 2015* (Austin, TX. 2010), p. 175.

Responses to Issue 6

Overall Agency Response to Issue 6

The agency as a whole did not provide a formal, written response to the Sunset staff report that reflected a consolidated agency opinion. However, John Tintera, Executive Director for the agency, testified at the hearing on behalf of the agency on Issue 6.

Recommendation 6.1

The Railroad Commission should develop and implement a succession plan to prepare for impending retirements and workforce changes.

Agency Response to 6.1

Mr. Tintera states that the Railroad Commission has addressed succession planning in its strategic plan. Mr. Tintera indicates that the agency is very active in trying to retain its tenured employees. Also, the Railroad Commission has the same problem as industry in that there is a gap in employees between the ages of 30 and 45 with geology and engineering degrees, stemming from decreases in education enrollment in those areas. The agency has taken some steps to address the issue. For example, the agency has implemented a technical ladder culminating in the Chief Geologist position. (John Tintera, Executive Director – Railroad Commission of Texas)

For 6.1

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Against 6.1

None received.

Modifications

1. Suggest that the Legislature consider revising the pay scale for Railroad Commission employees in order to retain and attract new employees. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin)
2. Provide the Railroad Commission with the money and structure necessary to maintain a professional, experienced staff. (Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)

Staff Recommended Action

Adopt Recommendation 6.1.

Gas Utility Regulation Transfer

*Supplement to the Sunset Staff Report
on the Public Utility Commission*

The State Could Benefit From Combining Regulatory Functions Related to Gas and Water Utilities in the Public Utility Commission.

Background

The Public Utility Commission (PUC), the Railroad Commission of Texas, and the Texas Commission on Environmental Quality (TCEQ) each carry out utility regulation. One of the statutory charges to the Sunset Commission is to review the extent of overlapping programs and their potential for consolidation.¹ The concurrent Sunset reviews of these three agencies this biennium present a rare opportunity to evaluate the utility regulations at PUC, the Railroad Commission, and TCEQ for their consolidation potential. Adding further reason to review this potential, Texas is unusual in separating utility regulatory functions in three agencies. As pointed out in the PUC Sunset staff report, nearly all states have only one agency that regulates electric, telecommunications, natural gas, and water utilities.²

Public Utility Commission. PUC regulates the rates and services of electric and telecommunications companies in Texas as a substitute for competition where it does not exist or lacks robustness. Although recent legislative changes have restructured and deregulated major portions of the electric and telecommunications markets, PUC continues to have significant ratemaking and other responsibilities in areas where competition is lacking. Within the large part of the state that is open to electric competition, PUC still oversees rates of transmission and distribution utilities that operate as monopolies in the deregulated market. Outside these competitive areas, PUC is fully responsible for rates of investor-owned electric utilities that continue to generate, transport, and sell electricity to the public. PUC also has varying degrees of regulatory responsibility over local telephone service.

In setting rates for utilities under its regulations, PUC's basic mission is to determine the utility's reasonable revenue requirement for operation and how that requirement can be turned into rates paid by different customer classes. The typical course for contested rate cases is for PUC staff to prepare its case, which, along with the utility's original request and information from parties intervening in the case, goes to the State Office of Administrative Hearings (SOAH) for a neutral determination of findings and conclusions that are proposed to the PUC Commission for final decision. In addition to these rate responsibilities, PUC approves Certificates of Convenience and Necessity (CCNs), defining areas these utilities must serve; monitors service quality for rate-regulated utilities; and addresses consumer complaints about their utility service.

In fiscal year 2009, the agency operated with 189 authorized staff and a budget of \$14.2 million. Its rate responsibility covers four investor-owned electric utilities, eight transmission and distribution utilities, and 63 local telephone companies. For these utilities, PUC conducted 41 electric and 12 telephone rate proceedings. Details of PUC's operations, as well as the Sunset Commission's recommendations on its operations, can be found in the July 2010 Sunset report on the agency.³

A separate agency, the Office of Public Utility Counsel (OPUC), represents the interests of residential and small commercial consumers in rate and other matters before PUC. OPUC often intervenes as a party in PUC proceedings, and is authorized to intervene on behalf of residential consumers in appeals of gas utility rates to the Railroad Commission when asked to do so by a municipality.⁴ OPUC reports that it has participated in proceedings before the Railroad Commission twice, once in 1985 and once in 2000.

Railroad Commission of Texas. Gas utility regulation has a long history at the Railroad Commission dating to the 1920s. Today, the agency carries out rate-related regulation of about 200 investor-owned natural gas utilities to help ensure fair and equitable gas rates in the monopolistic gas utility industry. An investor-owned utility often serves customers within a city, as well as in the “environs” surrounding a city. Texas also has 84 municipally owned natural gas utilities, but the Railroad Commission does not have rate jurisdiction over them.

The Railroad Commission has original jurisdiction over investor-owned gas utility rates outside a municipality as well as rates a company can charge for transporting gas to the city limit. Cities have rate jurisdiction over investor-owned gas utilities within their boundaries, but utilities may appeal city decisions to the Railroad Commission.⁵

The Railroad Commission typically holds hearings for major contested cases in which it has original jurisdiction or cases on appeal from a city rate decision. Generally, the Railroad Commission staff presents its case before a Railroad Commission hearing examiner and technical examiner, who preside together over hearings and develop a proposal for decision for Commissioners’ consideration and ruling. In fiscal year 2009, the Railroad Commission received nine filings for full ratemaking review. Five of these cases came to the agency under its original jurisdiction, and the remaining four cases came to the Railroad Commission on appeal.

Statute allows adjustments for gas utility rates through other procedures without requiring an administrative hearing. Utilities may apply to make interim rate adjustments for designated infrastructure investments between full rate cases, subject to filing a full rate case within five years. The Railroad Commission staff may authorize a utility to make cost-of-service adjustments in tariffs that are approved by Commission order as part of a full rate case and specified in the underlying tariff. A gas utility may also apply to recover unreimbursed costs of relocating facilities to accommodate public construction projects, such as roads. Gas utilities took advantage of these adjustments 13 times in fiscal year 2009.

Among other aspects of the regulation of gas utilities, the Railroad Commission conducts audits of intrastate gas utilities to verify that utilities are billing residential and small commercial customers according to authorized rates, and that utilities are remitting the proper amount of gas utility tax. The Railroad Commission also handles utility-related consumer complaints and inquiries from residential and small commercial consumers, and business-to-businesses complaints involving negotiated rates between businesses.

The Railroad Commission’s Gas Services Division, with about 24 employees, is primarily responsible for gas utility rate-related regulation and operated with expenditures of about \$1.39 million in fiscal year 2009, not counting indirect support from administrative functions throughout the agency. Attorneys from the Office of General Counsel, totaling about two full-time equivalent employees, also participate directly in the Railroad Commission rate-related regulation.

Texas Commission on Environmental Quality. Water and wastewater rate regulations in Texas date back to 1913. In 1975, when the Legislature established the Public Utility Commission to regulate utilities, it included authority to oversee retail public utilities for water and wastewater service. In 1986, the Legislature transferred this authority to the Texas Water Commission, now part of TCEQ. At that time, the Legislature considered the Water Commission a better fit for water utility regulation because of its familiarity with the special issues of small water systems prevalent in the water industry compared to PUC’s orientation toward complex ratemaking for huge electric and telecommunications utilities.

In fiscal year 2009, TCEQ regulated a total of 3,938 water and wastewater utilities. TCEQ is responsible for ensuring that retail public utilities' rates, operations, and services; and wholesale and submetering rates are just and reasonable. It also has the authority to grant CCNs and ensure that utilities have the financial, managerial, and technical capability to provide adequate and continuous service within their certificated areas. TCEQ has original jurisdiction for rates of investor-owned water and wastewater utilities (IOUs) outside cities and within cities that have surrendered their rate jurisdiction to the agency. TCEQ has appellate jurisdiction over rates of districts, water supply corporations, cities providing service outside their city limits, IOUs operating inside a city, and utilities owned by counties within 50 miles of the Mexico border. TCEQ also has appellate jurisdiction over the wholesale rates of potable water and wastewater service providers. TCEQ basically does not have either original or appellate jurisdiction for municipally owned water and wastewater utilities operating *inside* cities.

In a case of original jurisdiction, an IOU filing a rate change application must give notice to its customers at least 60 days before the effective date of the increase. TCEQ reviews the application and the required notice, checking for deficiencies and ensuring the utility has a CCN. If the application and the notice are sufficient, the utility is allowed to begin charging the proposed rates while the application is pending. TCEQ staff evaluates the proposed rate change, performing an audit and site visit, and reviewing complaints and compliance history. Rate evaluation staff also work with other TCEQ staff to check the utility's compliance with water and wastewater environmental requirements.

This process includes a protest mechanism by which customers may have the case referred to SOAH for a hearing and provisions for establishing interim rates if a proposed increase results in an unreasonable economic hardship on the utility's customers. Cases not protested or settled through mediation may be approved administratively by the Executive Director. Otherwise, if a case goes to a contested hearing, SOAH makes a proposal for the Commission's final decision.

Appellate cases, generally for districts, water supply corporations, and city customers outside city limits, work similarly to the protest provision for original jurisdiction cases. Customers must file a petition with TCEQ within 90 days of the effective date of a rate change to protest that change and have the case referred to SOAH for hearing. TCEQ staff then conducts cost-of-service and quality-of-service reviews, which generally require the same level of review as for cases under original jurisdiction.

At SOAH, the process for hearing the protest is the same as that described above for IOUs. In original and appellate rate cases, both TCEQ's Executive Director and the Office of Public Interest Counsel are always parties to rate cases at SOAH and before the Commission. TCEQ assists consumers and utilities with inquiries and complaints regarding customer service and protection rules, and has recently added staff to oversee the assistance function.

TCEQ has about 21 employees that conduct water and wastewater utility rate and CCN regulation and assist customers. Funding for these functions totaled about \$1.5 million in fiscal year 2009. In that year, TCEQ conducted 125 rate reviews, of which 76 were contested; of these, seven had evidentiary hearings. TCEQ also processed 287 CCN applications, referred 30 CCN cases to SOAH, and made three final Commission decisions.

Findings

With its core mission of utility oversight, PUC’s expertise and structure are focused on handling rate-related regulation efficiently and fairly.

- **Focus on Utility Ratemaking.** The Legislature established PUC in 1975 to regulate utilities, and although its operations have changed over its 35-year history, PUC still carries out ratemaking functions as one of its primary focuses. Even after the restructuring of the telecommunications and electric markets in most of Texas to encourage competition, PUC continues to have major rate-related regulatory functions, particularly in the electric industry, but also with local telephone service. PUC’s staff and its Commission are geared toward overseeing utilities and ensuring that regulated utility rates are just and reasonable.
- **Development of Expert Staff.** PUC ratemaking staff has expertise in economic regulation and is large enough to specialize on specific areas of responsibility. Rate regulation staff are largely Certified Public Accountants and other financial analysts who evaluate a utility’s cost of service and other revenue requirements, and translate that amount into a reasonable rate of return and a schedule of rates to be charged to different customer classes. Infrastructure staff, often engineers, help evaluate facilities-related questions, such as depreciation, for use in determining a utility’s revenue needs. Personnel advising PUC Commissioners have no connection with other PUC offices on ratemaking matters, developing their own separate expertise. As a separate agency, SOAH has its own expert staff of administrative law judges dealing with utility issues in its Utility Division.
- **Organizational Structure for Fair Ratemaking.** PUC’s organizational structure has evolved in large part to promote fairness in decision making. State law prohibits agency personnel involved in rendering decisions or making findings of fact and conclusions of law from communicating with parties to a case without the opportunity for all parties to participate.⁶ This requirement is aimed at ensuring that all parties have an equal, and therefore fair, opportunity to hear and persuade decision makers.

PUC is well structured for utility oversight and ratemaking.

Separation of Ratemaking Duties at PUC

Staff Acting as Party to Case	Entities Involved in Neutral Hearing and Decision Making
Legal	PUC Commissioners
Rate Regulation	State Office of Administrative Hearings
Infrastructure and Reliability	Staff Advising Commissioners

PUC’s separation of staff with party status and staff involved in decision making into physically distinct offices, as summarized in the chart, *Separation of Ratemaking Duties at PUC*, significantly reduces the possibility of inadvertent, improper communication between them. SOAH’s involvement as a separate agency, apart from PUC, further insulates the decision-making process from improper influence. Finally, PUC actively trains its entire staff on their proper role and the lines of communication they should not cross.

- **Attention to Consumer Complaints.** In response to the State’s transition toward competitive telecommunications and electric markets, PUC now gives much stronger attention than in its early days to complaint resolution. PUC has its own division of about 21 employees to manage complaints, including those involving rates, for the entire agency, helping to ensure agency-wide consistency and focus on customer protection issues. Receiving complaints at its call center and from other sources, these employees respond to all complaints, including rate-related matters; investigate jurisdictional complaints; and provide information to address inquiries.⁷
- **Extensive and Accessible Online Records.** PUC keeps all filings in docketed cases, as well as other information, available to the public online. This resource is significant, given the immense volume of records developed through PUC’s various proceedings. The online document management system contributes to the transparency of PUC operations.

PUC’s online document system makes its records easily accessible to the public.

Although ratemaking functions at the Railroad Commission and TCEQ are working, transferring these duties to PUC offers potential benefits from aligning the State’s utility regulation within one agency.

- **Gas Utility Rate Regulation.** Gas utility regulation has worked over its long history at the Railroad Commission and benefits from interconnections between rate regulation and other programs within the Railroad Commission. One important tie is the connection between pipeline safety and ratemaking. For example, the Railroad Commission staff can help inform utility staff about a utility’s degrading and dangerous pipelines and the utility’s revenue needs to fix the problem.

Despite these beneficial aspects of regulating gas utilities at the Railroad Commission, several opportunities for improving regulation by aligning it at PUC also exist, as outlined below.

More focused expertise in ratemaking at PUC. PUC has about 22 full-time equivalent employees directly involved in ratemaking, whereas the Railroad Commission has a staff of about five performing these functions. The Railroad Commission’s technical staff must multi-task in performing several ratemaking functions such as financial analysis, calculation of fair rates of return, and calculation of plant depreciation. At PUC, these functions tend to be exercised by staff specialized in each area. Consolidating duties, especially of this specialized nature, would provide a greater opportunity to develop and maintain focused expertise that is essential in ratemaking.

PUC’s larger ratemaking staff offers additional ratemaking expertise.

Beneficial separation of roles in PUC’s organizational structure. PUC’s larger ratemaking staff and more defined approach to ratemaking allows it to separate staff involved in different phases of the rate case in a way that is not possible at the Railroad Commission. Specifically, PUC’s

process clearly separates those who provide testimony and technical expertise in advocating the staff case; those who preside over hearings and develop findings of fact and conclusions of law; and those who advise Commissioners on the case. This structure improves impartial decision making by limiting opportunities for inadvertent or improper communication between advocating staff and staff involved directly in assisting the decision making process.

Greater independence in hearings through use of SOAH. Different from PUC's process for hearing utility rate cases, the Railroad Commission is authorized, but not required to contract with SOAH for carrying out administrative hearings in contested cases.⁸ The Railroad Commission relies on its own staff attorneys to preside as hearings examiners over contested rate cases. Use of SOAH for administrative hearings is now typical for most agencies unless good reasons exist to hold hearings in-house. SOAH specializes in hearings, and in fact, has a division devoted to hearing utility cases. External hearings promote independence from any potential pressures that might come from inside or outside an agency. SOAH also has the capability to conduct hearings throughout much of the state, as well as Austin.

While challenges would arise from separating interrelated functions between the Railroad Commission and PUC, the two agencies could still communicate and share information on these issues. The agencies could look to the federal government for a model on coordinating issues between pipeline safety and ratemaking. The federal government separates these two functions, with the Federal Energy Regulatory Commission regulating interstate gas rates and the U.S. Department of Transportation regulating pipeline safety. Also, in Texas, the Railroad Commission is responsible for safety of intrastate pipelines throughout the state, but cities set rates for their own municipal gas systems and, frequently, for investor-owned utilities operating within their boundaries.

- **Water and Wastewater Utility Rate Regulation.** TCEQ conducts the economic regulation of these utilities' rates and services. As with the Railroad Commission, this regulation has worked and also has benefitted from the environmental regulation of other TCEQ programs. For example, programs for ensuring public drinking water standards and protecting the environment from sewage discharges can identify problems that these water utilities need to address.

Although these strengths exist at TCEQ, oversight of water and wastewater utilities could benefit from an overall realignment and consolidation of utility regulation, as outlined below.

Improved focus on TCEQ's core mission. Measured against TCEQ's huge environmental mission, the economic regulation of utilities is a smaller function, but its effects on Texas ratepayers can be significant. Transferring the functions would allow TCEQ to better focus on its core

Gas utility ratemaking and pipeline safety functions are separated at the federal and local level.

Transferring utility functions would better focus TCEQ on its core environmental quality mission.

mission under its umbrella of ensuring environmental quality and take advantage of PUC's focus and processes, making PUC an umbrella utility regulatory agency. Much the same expertise regarding financial analysis and calculating fair rates of return already exists at PUC, where it can be further focused and enhanced. In addition, PUC's more established ratemaking and CCN processes offer benefits in regulating the increasingly larger, more sophisticated water corporations that TCEQ currently deals with.

Improved consumer assistance at PUC. In permitting and rate cases, utilities may hire consultants and lawyers who are reimbursable through rates. Consumers, however, have limited resources to pay for representation, making the need for their interest to be represented more important. PUC's consumer protection staff effectively focuses on utility consumer complaints and outreach. In addition, the Office of Public Utility Counsel (OPUC) represents residential and small commercial utility consumers in areas of PUC's jurisdiction. While TCEQ's Office of Public Interest Counsel (OPIC) represents the public interest in utility cases, and has been directed by TCEQ's Commission to assist utility customers in understanding the contested case and mediation process, it has no statutory authority to represent consumers the way OPUC does. In addition, OPIC does not employ or contract with economists or other technical specialists to provide needed expertise in rates cases, as OPUC does.

Improved funding opportunities. TCEQ funds water and wastewater utility rate and CCN regulations through a combination of statutory fees. Three statutory fees collected by TCEQ relate to applications for a CCN; application for the sale, transfer, or merger of a CCN; or application to change rates.⁹ The three fees raised only about \$28,000 in fiscal year 2009, a small fraction of the costs of rate and CCN regulation. Because these fees would have to be set at prohibitively high levels to raise the revenue needed, they are not well-suited to support the costs of water and wastewater utility regulation.

TCEQ also receives revenue from the Water Utility Regulatory Assessment to pay for costs associated with utility and district regulation. Customers of public water and wastewater utilities pay an assessment of 1 percent of their total utility charge, while customers of water supply or sewer service corporations and utility districts are assessed at 0.5 percent.¹⁰ Although TCEQ regulates the utility rates of these three categories differently, the former being original jurisdiction and two latter being appellate jurisdiction, the assessment covers TCEQ's utility regulatory costs of more than just rate regulation, including CCN regulation. In addition, since TCEQ experiences no significant difference in the amount of workload and resources needed for the rate regulation of these two categories, the inequity is not justified.

OPIC has no statutory authority to represent consumers the way OPUC does.

TCEQ's utility regulation depends on a customer fee set at different levels depending on the type of utility.

As with the Railroad Commission, TCEQ and PUC could work together to address challenges caused by separating environmental and economic regulation of water and wastewater utilities. TCEQ could easily coordinate with PUC to ensure the flow of needed information to effectively regulate these utilities. Much as TCEQ utility staff work with water quality staff in separate divisions of the agency to ensure that utilities are in compliance with environmental and drinking water requirements, a similar process could be established with PUC to ensure effective regulation, if a transfer were to occur. In addition, such a transfer would not affect either agency's ability to take enforcement against one of these entities, as each regulatory program has its own enforcement provisions.

Recommendations

Change in Statute

S 1.1 Continue the Public Utility Commission for 12 years.

The Sunset staff report on PUC, published in July 2010, concluded in Issue 3 that Texas has a continuing need to regulate the electric and telecommunications industries and oversee evolving competition in the industries. The report left pending the question of whether these regulatory functions should be continued at PUC or in other agencies until completion of the Sunset staff reports on TCEQ and the Railroad Commission. Now that these other reviews have been completed, staff recommends that PUC be continued for 12 years, with additional functions as indicated in the recommendations below.

S 1.2 Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.

This recommendation would transfer the responsibility that resides at the Railroad Commission for gas utilities to PUC. Under the recommendation, PUC would administer these regulations under the same original and appellate jurisdiction over rates as currently exists at the Railroad Commission. The transfer would include the Railroad Commission's existing efforts regarding utility rates and services, consumer complaints, reports, and audits. Generally, the same regulatory approaches that exist now in gas utilities statutes would continue to apply at PUC, including provisions for interim rate adjustments, cost-of-service adjustments, and cost-recovery surcharges. Collection of the Gas Utility Tax would also transfer to PUC.

The recommendation would provide for the transfer to be completed by March 1, 2012, and would provide for planning and coordination to occur between the Railroad Commission and PUC to implement the transfer. A transition team would be established with high-level employees of both agencies to develop plans regarding the transfer to PUC of obligations, property, personnel, powers, and duties for gas utility functions and sharing of records and information. The team would develop ways to coordinate on areas of interrelated responsibilities, such as the impact of the Railroad Commission's pipeline safety requirements on the rates of gas utilities. The recommendation would also require the agencies to develop memoranda of understanding, as needed, to implement the plans developed by the transition team. Statute would require the memoranda to be completed by February 1, 2012.

S 1.3 Require the use of the State Office of Administrative Hearings in contested gas utility cases.

This recommendation would remove the option in law to have contested gas utility cases heard at SOAH, and instead require them to be heard at SOAH, the same as all other utility cases. This recommendation would apply regardless of whether gas utility regulation is ultimately transferred to PUC. As with other agencies using SOAH, the responsible agency would maintain final authority to accept, reverse, or modify a proposal for decision made by a SOAH judge.

S 1.4 Transfer responsibility for regulating water and wastewater rates and services from TCEQ to PUC.

This recommendation would transfer TCEQ's existing authority for water and wastewater utilities regarding retail, wholesale, and submetering rates; Certificates of Convenience and Necessity; reporting requirements; and consumer assistance and complaints to PUC. TCEQ would continue to have responsibility for ensuring that utilities meet drinking water standards, sewage treatment requirements, and review of IOU Drought Contingency Plans.

Regarding rates, PUC would assume the same original and appellate jurisdiction as it currently exists at TCEQ to ensure that retail public utility rates, operations, and services are just and reasonable. To administer these regulations, PUC would have the same reporting requirements as TCEQ for these utilities, including annual service and financial reports and tariff filings, as well as information about affiliate interests. PUC would have responsibility for providing consumer assistance and resolving complaints regarding regulated water and wastewater services.

This recommendation, like for gas utilities above, would provide for the transfer to be completed by March 1, 2012, and for planning and coordination to occur between TCEQ and PUC to implement the transfer. A transition team would be established with high-level employees of both agencies to develop plans regarding the transfer to PUC of obligations, property, personnel, powers, and duties for water and wastewater utility functions and sharing of records and information. The recommendation would also require the agencies to develop memoranda of understanding, as needed, to implement the plans developed by the transition team. Statute would require the memoranda to be completed by February 1, 2012.

The transition team would develop ways to coordinate on areas of interrelated responsibilities between the two agencies, especially regarding meeting federal drinking water standards and maintaining adequate supplies of water; meeting established design criteria for wastewater treatment plants; demonstrating the economical feasibility of regionalization; and serving the needs of economically distressed areas. Ongoing efforts would also be needed to coordinate responsibilities for service standards and the sharing of information and utility data between the two agencies.

PUC would have responsibility for ensuring accuracy of meters, instruments, and equipment for measuring the utility service. TCEQ would need to maintain responsibility for quantity, quality, pressure and other conditions relating to the supply of the service. TCEQ should also continue to have the authority to appoint temporary managers for abandoned water and wastewater utilities under its responsibility to ensure adequate capacity of public water systems, but should coordinate with PUC regarding the financial aspects of these appointments. Emergency operations would need to be shared by both PUC and TCEQ to ensure adequate utility oversight and maintenance of drinking water and wastewater discharge requirements, and emergency and temporary rates for nonfunctioning systems.

S 1.5 Eliminate the existing water and wastewater utility application fees and adjust the Water Utility Regulatory Assessment Fee to pay for utility regulation at PUC.

Under this recommendation, filing fees that currently reside at TCEQ for applications for rate changes, CCNs, and the sale, transfer, or merger of a CCN would be repealed. These fees cannot adequately cover the costs associated with these regulatory actions, and statute provides that the Utility Regulatory Assessment Fee cover regulatory costs associated with utilities and districts. To ensure the fee covers all regulatory costs, the recommendation would equalize the 0.5 percent customer assessment for non-profit utilities and utility districts at 1.0 percent – the same level as for public utilities. The increased revenue would cover the cost of utility rate regulation at PUC while also paying TCEQ's ongoing costs associated with its water resource management responsibilities.

The recommendation would provide for the Legislature to appropriate revenues from the Utility Regulatory Assessment Fee collections to PUC to cover its costs for the transferred utility regulations. The Legislature would make these appropriations from the Water Resource Management Account, but only from the amounts collected from the utility regulatory assessment. Statute would continue to require TCEQ to collect the fee from water utilities. Under this recommendation, TCEQ would be required to remit funding for utility regulation to PUC, based on the level of the legislative appropriation. The transfer of funds could occur by interagency contract, and TCEQ would not be responsible for PUC's use of the funds.

This recommendation would pay for utility regulation through the Utility Regulatory Assessment Fee that was established for this purpose. The recommendation would not change the existing mechanism for TCEQ to collect the fee from water and wastewater utilities, providing an administrative efficiency that could be jeopardized if another fee or collection process were established. Having TCEQ transfer funds to PUC for utility regulation as envisioned under this recommendation may present some challenges as the agencies coordinate, but comes closest to the State's current approach to paying for water and wastewater utility regulation.

S 1.6 Require OPUC to represent residential and small commercial interests relating to water and wastewater utilities, contingent on the transfer to PUC.

This recommendation would expand the role of OPUC to represent the interests of residential and small commercial consumers in water and wastewater utilities matters, but only if regulatory oversight is transferred to PUC, as specified in Recommendation S 1.4. Under this recommendation, OPIC would not be involved in water and wastewater utility matters at PUC. If the realignment of utility regulations at PUC does not occur, OPIC would retain its existing authority to represent the public interest in water and wastewater utility matters that remain at TCEQ.

S 1.7 Require PUC to make a comparative analysis of statutory ratemaking provisions under its authority, contingent on any transfers, to determine opportunities for standardization.

This recommendation would require PUC to make a comparative analysis of its own authority and any new ratemaking or other authority transferred to PUC. PUC would report to the Legislature any recommendations about opportunities to standardize these ratemaking requirements in time for consideration in the 2013 legislative session.

S 1.8 Require PUC to analyze the staffing requirements, contingent on any transfers, and report potential changes in staffing needs to the Legislative Budget Board and the Governor’s budget office.

This recommendation would require a report to the Legislative Budget Board and the Governor’s budget office at the same time PUC submits its Legislative Appropriations Request for the 2014-2015 biennium. The report should detail any staffing changes, including reductions that the agency recommends related to savings from consolidated functions. This recommendation gives PUC the opportunity to gain first-hand knowledge about the programs transferred and the staffing required to meet program needs.

Fiscal Implication Summary

Overall, the recommendations to continue the Public Utility Commission and add to its current responsibilities the regulation of gas utilities and water and wastewater utilities would not immediately result in savings to the State. The recommendations to realign utility regulation would require the transfer of about \$3.1 million and 47.5 employees from the Railroad Commission and TCEQ. Additionally, opportunities to adjust fees and assessments for paying the costs of regulating water and wastewater utilities at PUC and other water resource management needs at TCEQ could raise an additional \$5.6 million annually.

Public Utility Commission

The recommendation to continue PUC with its current functions and existing organizational structure would continue to require the agency’s annual appropriation of about \$118.3 million. This funding includes about \$14.2 million for support operations, and about \$104.1 million in pass-through funding to electric companies to provide discounts to low-income electric customers in areas of the state open to electric competition.

The other recommendations requiring PUC to conduct a comparative analysis of ratemaking provisions and to analyze staffing requirements of any transferred functions could be performed with current resources.

Railroad Commission

Based on fiscal year 2009 expenditures, the recommendation to move gas utility regulation from the Railroad Commission to PUC would require the transfer of about \$1.39 million and 24.4 full-time equivalent employees directly associated with the Commission’s Gas Services Division. All but about \$151,000 in appropriated receipts and dedicated funds would transfer from General Revenue. Additionally, one-half an FTE directly involved in ratemaking in the Railroad Commission’s Office of General Counsel would move to PUC along with about \$36,000 in General Revenue.

The recommendation to require the use of the State Office of Administrative Hearings to conduct gas utility contested rate hearings would result in increasing SOAH’s budget and staff by about \$101,000 in General Revenue and 1.5 FTEs, with corresponding reductions from the Railroad Commission’s Office of General Counsel.

An amount for indirect support from the Railroad Commission’s administrative operations would need to be added to amounts transferred to PUC and SOAH, but that amount could not be estimated.

Texas Commission on Environmental Quality

The recommendation transferring regulation of water and wastewater utilities from TCEQ to PUC would require the transfer of about \$1.5 million and 20 employees from TCEQ to PUC to conduct rate and CCN regulation and to provide needed consumer assistance. The recommendation could also require an adjustment in PUC’s contract with SOAH to pay the cost of contested case hearings related to water and wastewater utility cases, but the amount of that adjustment could not be determined.

To cover these costs at PUC without relying on General Revenue funding, a separate recommendation provides for equalizing the utility regulatory assessment for water supply corporations and districts at 1 percent. Beyond covering the costs of utility regulation at both TCEQ and PUC, ensuring all water and wastewater utilities pay the same assessment rate would increase revenue by about \$5.6 million annually.

The recommendation to transfer responsibility for representing consumer interests in water and wastewater utility matters from OPIC to OPUC would require the transfer of one employee and approximately \$81,000.

Texas Commission on Environmental Quality

Fiscal Year	Gain to General Revenue Dedicated – Water Resource Management Account No. 153
2012	\$5.6 million
2013	\$5.6 million
2014	\$5.6 million
2015	\$5.6 million
2016	\$5.6 million

1 Texas Government Code, sec. 325.011(6).

2 Sunset Advisory Commission, *Commission Decisions – Public Utility Commission, Electric Reliability Council of Texas, and Office of Public Utility Counsel* (Austin, Texas, July 2010), p. 28. Online. Available: www.sunset.state.tx.us/82ndreports/puc/puc_dec.pdf. Accessed: October 25, 2010.

3 Ibid.

4 Texas Utilities Code, sec. 101.052.

5 Texas Utilities Code, sec. 102.001.

6 Texas Government Code, sec. 2001.061.

7 Public Utility Commission, *Self-Evaluation Report*, (Austin, Texas, September 2009), p. 185. Online. Available: www.sunset.state.tx.us/82ndreports/puc/ser.pdf. Accessed: October 24, 2010.

8 Texas Utilities Code, sec. 102.006. The Legislature first made the Railroad Commission’s use of SOAH mandatory in 2001, but changed the provision to be permissive in 2003.

9 Texas Water Code, sec. 13.4521 and 13.4522.

10 Texas Water Code, sec. 5.701(n)(1).

Responses

Recommendation S 1.1

Continue the Public Utility Commission for 12 years.

Public Utility Commission Response to S 1.1

PUC supports this recommendation. (Paula Mueller, Interim Executive Director – Public Utility Commission)

For S 1.1

Carol Biedrzycki – Texas Ratepayers’ Organization to Save Energy, Austin

Lanetta Cooper, Staff Attorney – Texas Legal Services Center, Austin

Randall Chapman – Texas Legal Services Center, Austin

John W. Fainter, Jr. – Association of Electric Companies of Texas, Inc., Austin

Stephen Minick, Vice President of Governmental Affairs – Texas Association of Business, Austin

Glenn Morris – Fort Worth

Staff Comment: All these individuals expressed support for continuing PUC for 12 years, either when responding to the full Sunset staff report on PUC earlier this year or in later responses after the Sunset hearing on the Railroad Commission and TCEQ.

Against S 1.1

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

Modification

1. Continue the Public Utility Commission for six years. (Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin; Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin)

Recommendation S 1.2

Transfer gas utility regulation from the Railroad Commission to the Public Utility Commission.

Public Utility Commission Response to S 1.2

The Public Utility Commission appreciates the Sunset Staff’s confidence in PUC’s ability to take on additional duties, and is prepared to undertake responsibility for regulation of gas utilities, should these recommendations ultimately be adopted by the Legislature. (Paula Mueller, Interim Executive Director – Public Utility Commission)

Railroad Commission Response to S 1.2

The agency as a whole did not provide a formal, written response to the Supplement to the Sunset Staff Report on the Public Utility Commission. Chairman Williams and Commissioner Carrillo provided oral and written feedback on the transfer of gas utility regulation to PUC; however, these comments were not represented as the agency's formal position but as personal positions.

Chairman Williams' Response to S 1.2

As stated in oral and written testimony, Chairman Williams opposes the transfer of gas utility regulation from the Railroad Commission to the Public Utility Commission. He says that the transfer had an allure to him at one time. Now, when he thinks of his last four or five years at the Commission, he can think of nothing worse to do. Chairman Williams points out that Texas already has a bifurcated system, with cities having the right to set rates first with appeals to the Railroad Commission. The transfer to PUC would divorce ratemaking from safety, issues of reliability, and the general welfare of the company. While at the federal level the Office of Pipeline Safety handles some matters and FERC handles others, Chairman Williams notes that the pipelines they regulate do not go to homes and small businesses, which makes a difference.

In written comments, Chairman Williams indicates that the Commissioners' cost of service decisions have properly balanced the interests of consumers and the utilities. He indicates that, since 2005, Commissioners have approved the hearing examiners' cost of service and revenue recommendations over 93 percent of the time. In one case, GUD 9670, the Commissioners reached different conclusions than the hearing examiners, but the decisions involved major and novel public policy issues. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo's Response to S 1.2

Commissioner Carrillo opposes the transfer of gas utility regulation from the Railroad Commission to the Public Utility Commission. Commissioner Carrillo states that transferring gas utility rate setting could result in the re-litigation of well-established precedents at tremendous expense to all parties, and offers questionable and comparatively insignificant savings.

Also, Commissioner Carrillo notes that the Railroad Commission is responsible for assuring the safe transportation and delivery of natural gas, and safety regulations imposed by the Railroad Commission, which represent a substantial piece of the cost of natural gas delivery, could undermine the approved gas utility rates. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

For S 1.2

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

Joel Foy, Atmos Energy residential customer, Dallas

T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall

For S 1.2 (continued)

Urban “Obie” O’Brien, Vice President for Governmental and Regulatory Affairs - Apache Corporation, Houston

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Robert J. Vann II, Fort Worth

Against S 1.2

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Ronald Kitchens – CenterPoint Energy, Austin; and Scott E. Rozzell, Executive Vice President and General Counsel – CenterPoint Energy, Austin

Patrick Nugent, Executive Director and James Mann, Attorney – Texas Pipeline Association, Austin

David J. Park, Vice President, Rates and Regulatory Affairs – Atmos Energy, Mid-Tex Division, Dallas

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Ben Seabee, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin

Modification

2. If there is any effort to move any part of the regulation of gas utilities to PUC, it should exclude any regulation of pipelines. (Patrick Nugent, Executive Director – Texas Pipeline Association, Austin)

Recommendation S 1.3 _____

Require the use of the State Office of Administrative Hearings in contested gas utility cases.

Public Utility Commission Response to S 1.3

If Recommendation S 1.2 is adopted, PUC supports this recommendation, with the following modification.

PUC Modification

3. Modify the recommendation to clarify that PUC Commissioners themselves can conduct hearings on gas utility matters without using SOAH, just as they can now in areas of regulation currently under PUC. This authority is granted to PUC Commissioners in Government Code, Section 2003.049. Usually PUC Commissioners conduct hearings only when important policy questions or issues of first impression are involved, so PUC

does not anticipate that Commissioners would ordinarily conduct gas utility rate hearings. However, the ability to conduct hearings when appropriate would provide useful flexibility.

(Paula Mueller, Interim Executive Director – Public Utility Commission)

Staff Comment: PUC’s modification captures the intent of the recommendation. PUC Commissioners should maintain the same authority to hear gas utility cases that they now have for other areas of PUC regulation.

Railroad Commission Response to S 1.3

Neither the agency staff nor the Commission as a whole provided a formal, written response to the Supplement to the Sunset Staff Report on the Public Utility Commission. Commissioner Carrillo and Chairman Williams provided oral or written feedback on the use of SOAH in contested gas utility cases; however, they indicated such comments were personal and did not necessarily reflect the sentiment of other Commission members.

Chairman Williams’ Response to S 1.3

In written comments, Chairman Williams recommends maintaining all contested case hearings, including natural gas ratemaking, at the Commission. (The Honorable Michael Williams, Chairman – Railroad Commission of Texas)

Commissioner Carrillo’s Response to S 1.3

Commissioner Carrillo strongly disagrees with the recommendation to transfer contested gas utility cases to the State Office of Administrative Hearings. Commissioner Carrillo says that the Railroad Commission has enormous in-house expertise among its technical staff, attorneys, and hearing examiners that is absolutely critical to the effective and efficient administration of its various regulatory programs. Commissioner Carrillo also states that the recommendation limits the Railroad Commission’s ability to reverse or modify a SOAH decision beyond what is available to other agencies, such as TCEQ and PUC. (The Honorable Victor Carrillo, Commissioner – Railroad Commission of Texas)

Staff Comment: The Public Utility Commission and Texas Commission on Environmental Quality do have broader authority than that given in the Administrative Procedure Act to modify a finding of fact or conclusion of law made by an Administrative Law Judge of the State Office of Administrative Hearings. Both commissions have the authority to change findings that they determine are not supported by a preponderance of the evidence, a grant not included in the APA.

Affected Agency Response to S 1.3

The State Office of Administrative Hearings (SOAH) states that if the Legislature decides to transfer contested gas utility cases from the Railroad Commission to PUC, SOAH could draw on its extensive experience and knowledge in utility work to learn the Railroad Commission’s subject matter without difficulty and to be proficient in it quickly.

State Office of Administrative Hearings Modification

4. If gas utility regulation does not transfer to PUC, use one funding mechanism to fund SOAH for the Railroad Commission's enforcement hearings as well as the Railroad Commission's gas utility hearings.

(Cathleen Parsley, Chief Administrative Law Judge – State Office of Administrative Hearings)

Staff Comment: If gas utility hearings were transferred to PUC, Sunset staff has recommended for SOAH's General Revenue appropriation to pay for PUC's gas utility hearings, consistent with SOAH's funding for other PUC cases. However, if gas utility regulation stays at the Railroad Commission, it would be appropriate for the Railroad Commission to contract for SOAH to hear gas utility cases, just as Sunset staff recommended for enforcement cases, so that the Railroad Commission has one consistent method of paying for SOAH services.

For S 1.3

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington

T.D. and Steve Howell – Howell Oil & Gas, Inc., Marshall

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.3

Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin

Patrick Nugent, Executive Director and James Mann, Attorney – Texas Pipeline Association, Austin

Mark Sutton, Executive Director and Robert Dunn, Past President – Gas Producers Association, Tulsa, Oklahoma

Bob Thompson, Austin

Modification

5. Require the use of the State Office of Administrative Hearings for enforcement cases from the Railroad Commission as well. (Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin)

Staff Comment: The Sunset Staff Report on the Railroad Commission of Texas recommends transferring enforcement hearings from the Railroad Commission to the State Office of Administrative Hearings in Issue 3 of that report.

Recommendation S 1.4

Transfer responsibility for regulating water and wastewater rates and services from TCEQ to PUC.

Public Utility Commission Response to S 1.4

The Public Utility Commission appreciates the Sunset Staff's confidence in PUC's ability to take on additional duties, and is prepared to undertake responsibility for regulation of water and wastewater utility rates and services, should these recommendations ultimately be adopted by the Legislature. (Paula Mueller, Interim Executive Director – Public Utility Commission)

Texas Commission on Environmental Quality Response to S 1.4

TCEQ agrees with the recommendation to transfer responsibilities for regulating water and wastewater rates and services from TCEQ to the Public Utility Commission. If this recommendation is adopted TCEQ states it will work with PUC to assure an efficient and transparent transition, including the development of a Memoranda of Understanding. (Mark R. Vickery, P.G., Executive Director – Texas Commission on Environmental Quality)

Affected Agency Response to S 1.4

State Office of Administrative Hearings Modification

6. The State Office of Administrative Hearings (SOAH) suggests that, if water and wastewater utility cases transfer from TCEQ to PUC, SOAH's General Revenue appropriation should be increased to pay for its services to PUC, consistent with how other PUC hearings at SOAH are handled. TCEQ's current contract with SOAH for hearing services would be reduced by an appropriate amount since TCEQ would not be paying for water and wastewater hearings at SOAH.

(Cathleen Parsley, Chief Administrative Law Judge – State Office of Administrative Hearings)

Staff Comment: To fund the cost of contested case hearings for water and wastewater utilities at SOAH, the staff recommendations intend for SOAH to pay for these cases from its General Revenue appropriation, consistent with SOAH's funding for other PUC cases.

For S 1.4

Orville R. Bevel, Jr., Chairman – Texans Against Monopolies Excessive Rates (TAMER), Chandler

Gina Brown, Montgomery

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

C.A. Cockrell, Vice President – Texans Against Monopolies Excessive Rates (TAMER), Chandler

David Frederick – Texans Against Monopolies Excessive Rates (TAMER), Austin

Roger Lampman, Comfort

For S 1.4 (continued)

Kathy Nielsen, Roanoke

David W. Schumaker – Coalition for Equitable Water Rates

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.4

Terry Franks – Aqua Texas, Southwest Water Company, and San Jose Water

Michael R. Farrell, Vice President and General Manager – Southern Utilities Company

Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin

Mark H. Zeppa, Executive Director – Independent Water and Sewer Companies of Texas, Austin

Modifications

7. If water utility ratemaking is transferred to PUC, establish either a universal interim rate or a rate hold-off period until final water rates have been approved by PUC. (C.A. Cockrell, Vice President – Texans Against Monopolies Excessive Rates (TAMER), Chandler)
8. Continue all water utility cases at TCEQ and provide the Office of Public Utility Counsel with jurisdiction to intervene in TCEQ water cases. (Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin)

Recommendation S 1.5

Eliminate the existing water and wastewater utility application fees and adjust the Water Utility Regulatory Assessment Fee to pay for utility regulation at PUC.

Public Utility Commission Response to S 1.5

If Recommendation S 1.4 is adopted, PUC supports this recommendation. (Paula Mueller, Interim Executive Director – Public Utility Commission)

Texas Commission on Environmental Quality Response to S 1.5

TCEQ agrees with the recommendation, with modification.

TCEQ Modification

9. Transfer a portion of the Utility Regulatory Assessment Fee to PUC from the Water Resource Management Account and require that the fee payers remit to each agency a percentage of the Utility Regulatory Assessment Fee in proportion to the amounts appropriated to each agency by the Legislature.

(Mark R. Vickery, P.G., Executive Director – Texas Commission on Environmental Quality)

For S 1.5

Orville R. Bevel, Jr., Chairman – Texans Against Monopolies Excessive Rates (TAMER), Chandler

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

C.A. Cockrell, Vice President – Texans Against Monopolies Excessive Rates (TAMER), Chandler

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.5

Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin

Mark H. Zeppa, Executive Director – Independent Water and Sewer Companies of Texas, Austin

Modifications

10. Deposit revenues to an account solely controlled by PUC and, if new information supports a uniform assessment for all regulated water utilities, set the Water Utility Regulatory Assessment to be revenue neutral, or at the level only required to support the current program. (Stephen Minick, Vice President of Governmental Affairs – Texas Association of Business, Austin)
11. Leave the Water Utility Regulatory Assessment Fee the same, and instead raise application fees to pay for water utility regulation. (Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin)
12. Require cities to pay the Water Utility Regulatory Assessment Fee for areas where the State has appellate jurisdiction. (Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin)

Recommendation S 1.6

Require OPUC to represent residential and small commercial interests relating to water and wastewater utilities, contingent on the transfer to PUC.

Public Utility Commission Response to S 1.6

If Recommendation S 1.4 is adopted, PUC supports this recommendation. (Paula Mueller, Interim Executive Director – Public Utility Commission)

Texas Commission on Environmental Quality Response to S 1.6

TCEQ supports the transfer to OPUC of responsibilities related to representation of residential and small commercial consumers in water and wastewater utility matters, if PUC is given regulatory oversight of water and wastewater utility activities. (Mark R. Vickery, P.G., Executive Director – Texas Commission on Environmental Quality)

Affected Agency Response to S 1.6

The Office of Public Utility Counsel supports this recommendation. (Sheri Givens, Public Counsel – Office of Public Utility Counsel)

For S 1.6

Orville R. Bevel, Jr., Chairman – Texans Against Monopolies Excessive Rates (TAMER), Chandler

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

C.A. Cockrell, Vice President – Texans Against Monopolies Excessive Rates (TAMER), Chandler

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.6

Kent Watson, Legislative Chairman – Texas Rural Water Association, Austin

Mark H. Zeppa, Executive Director – Independent Water and Sewer Companies of Texas, Austin

Modification

13. Provide that a fee be assessed on consumers of gas and water utilities, similar to the fee collected to fund the Office of Public Utility Counsel, to support additional funding for OPUC. (Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin; Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin)

Recommendation S 1.7

Require PUC to make a comparative analysis of statutory ratemaking provisions under its authority, contingent on any transfers, to determine opportunities for standardization.

Public Utility Commission Response to S 1.7

If Recommendations S 1.2 and S 1.4 are adopted, PUC supports this recommendation. (Paula Mueller, Interim Executive Director – Public Utility Commission)

For S 1.7

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.7

None received.

Recommendation S 1.8

Require PUC to analyze the staffing requirements, contingent on any transfers, and report potential changes in staffing needs to the Legislative Budget Board and the Governor's budget office.

Public Utility Commission Response to S 1.8

If Recommendations S 1.2 and S 1.4 are adopted, PUC supports this recommendation. (Paula Mueller, Interim Executive Director – Public Utility Commission)

For S 1.8

Lize Burr, Coalition Coordinator – Alliance for a Clean Texas, Austin

Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin

Against S 1.8

None received.

Modification

14. Require OPUC, as well as PUC, to report similar staffing information to the Legislative Budget Board and the Governor's budget office. (Tom “Smitty” Smith – Public Citizen, Austin; and Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin)

Staff Recommended Action

Adopt Recommendations S 1.1, S 1.2, S 1.3 with Modification 3, and S 1.4 through S 1.8.

New Issues

Railroad Commission of Texas

The following issues were raised in addition to the issues in the staff report. These issues are numbered sequentially to follow the staff's recommendations.

Commissioner and Staff Conflicts of Interest

7. Require Railroad Commissioners to resign from the Commission should they decide to run for another office. (Ben Sebree, Vice President for Governmental Affairs – Texas Oil and Gas Association, Austin; Douglass Robison, Chief Executive Officer and Chairman – Permian Basin Petroleum Association, Midland; and Bob Thompson, Austin)
8. Require Railroad Commissioners to resign from the Commission should they decide to run for another office with appropriate safeguards to ensure proper transition intervals and to not act as a disincentive to the election or appointment of meritorious candidates. (Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)
9. Prohibit Railroad Commissioners from accepting campaign contributions from the industry groups that they regulate. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup, Fairfield)
10. Adopt recusal criteria for Railroad Commissioners to ensure greater transparency in the voting process. (Bill Stevens, Executive Vice-President – Texas Alliance of Energy Producers, Austin)
11. Require Railroad Commissioners to resign or to stay out of politics for two to three years before running for another office. (Ann Ewing, President – South Texas Opposes Pollution, Corpus Christi)
12. If the Commissioners continue to be elected, enact campaign finance rules similar to those for state legislators by limiting contributions to a 30-day window before filing and after election, prohibiting contributions from those with business before the Commission, placing caps on how much individuals can donate, and moving to a system of public financing. (Andy Wilson, Research Associate – Public Citizen, Austin and Molly Rooke, Dallas)
13. Make it illegal for Railroad Commission employees to accept gifts from the industry they regulate; place a very low limit on such gifts; or at the very least require public disclosure of all such gifts. (Robert J. Vann II, Fort Worth)
14. Require a statutory time limit on when Railroad Commission staff can take a position in the industry that they have been responsible for regulating. (Robert J. Vann II, Fort Worth)

Agency Jurisdiction and Coordination

15. Transfer regulatory authority over exploratory in situ uranium mining from the Railroad Commission to the Texas Commission on Environmental Quality. (Senator Glenn Hegar, Jr., Chairman – Sunset Advisory Commission)

16. Realign the relationships between the Railroad Commission and the Texas Commission on Environmental Quality (TCEQ), so that TCEQ would have broader authority over the environmental issues relating to natural gas drilling. (Senator Wendy R. Davis, Member – Texas Senate)
17. Transfer the Railroad Commission’s authority over water quality to TCEQ. (Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin; Tom “Smitty” Smith – Public Citizen, Austin and Molly Rooke, Dallas)
18. Clarify the regulatory authority over hydro-fracking gas drilling between the Railroad Commission and TCEQ. (Dewayne Quertermous, Conservation Chair – Fort Worth Sierra Club, Arlington)
19. Transfer all environmental regulatory functions from the Railroad Commission to the Texas Commission on Environmental Quality. (Rita Beving, North Texas resident – Farmers Branch)
20. Transfer uranium exploration prior to in situ mining to TCEQ. (Mina Williams, Vice-Chair – Sierra Club, Costal Bend Chapter, Corpus Christi and Tom “Smitty” Smith – Public Citizen, Austin)
21. Transfer all coal combustion waste regulation to TCEQ. (Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin; Tom “Smitty” Smith – Public Citizen, Austin; and Molly Rooke, Dallas)
22. Require the Railroad Commission to provide TCEQ the following information regarding Underground Injection Control Class I applications: a letter of approval or acknowledgement from the mineral owners; a letter of approval from the mineral lease holders; a letter of approval from the mineral lease producers; a Railroad Commission letter certifying that the Class I application has been reviewed in regard to protection of mineral interest, including a summary statement of findings; and a letter from the Railroad Commissioners certifying that the proposed Class I injection well is approved or disapproved, including attachments of the previously discussed documents. (Karen Darcy-Pawlak – Citizens/Residents Oppose Wells (CROW))
23. Require every company drilling in Texas to provide local fire departments, the Railroad Commission, TCEQ, and the Environmental Protection Agency with a list of all chemicals they plan to use at each drill site. (Doreen Geiger, Fort Worth)
24. Require the Railroad Commission to forward information that indicates a licensed individual or entity may have committed a violation to the Board of Professional Geoscientists and other appropriate licensing boards. (Barbara Roeling, P.G., Chair – Texas Board of Professional Geoscientists, Austin)
25. Create a Texas Gas and Energy Efficiency Coordinating Council to look at gas and electricity conservation that would meet quarterly to report to the Electric Reliability Council of Texas (ERCOT) on energy efficiency gains from the Texas Department of Housing and Community Affairs, Public Utility Commission, State Energy Conservation Office, Texas Commission on Environmental Quality (TCEQ), Railroad Commission of Texas, and other programs, allowing ERCOT’s long-term planning process to account for these gains. Require reports to

be standardized to capture gains in natural gas and electricity. Require the Council to report pollution gains by these entities to the Texas A&M Energy Systems Laboratory and TCEQ. (Tom “Smitty” Smith – Public Citizen, Austin; Cyrus Reed, Conservation Director – Sierra Club, Lone Star Chapter, Austin; and Molly Rooke, Dallas)

26. Transfer the regulation of the electrical industry, including ratemaking, to the Railroad Commission and rename the Railroad Commission the Texas Energy Commission. (Charles Erwin, Hico)

Public Information and Notice

27. Establish a liaison or ombudsman office to assist citizens in traversing the complicated division of responsibilities between the Railroad Commission and the Texas Commission on Environmental Quality. Require the Ombudsman to have a comprehensive understanding of each agency’s role and to immediately direct citizens to the proper office in either agency to assist with their specific cases, with follow-up until the situation is resolved. (Michael C. Burgess, M.D. – 26th Congressional District of Texas)
28. Enhance transparency and provide the public with information about new drilling rules and regulations by requiring regularly scheduled town hall meetings and forums by both elected officials and regulators. (Michael C. Burgess, M.D. – 26th Congressional District of Texas)
29. For public meetings and administrative hearings, provide better access for public citizens affected by the decisions that will be made by the agency. Hearings should be conducted, or at least considered, in areas outside of Austin where those affected live or operate (for example, in agency offices in Fort Worth). This will encourage meaningful participation in these quasi-legal processes. (Senator Wendy R. Davis, Member – Texas Senate)
30. Require the Railroad Commission to do much more to address the public’s concerns or orient itself to better address the complexities of large scale production in dense urban areas. (Senator Wendy R. Davis, Member – Texas Senate)
31. Require the Railroad Commission to provide greater public notice of hearings that amend field rules for oil and gas wells, including publishing notices in local newspapers and posting notices on the agency’s website, not just on a bulletin board at the agency’s Austin office. (Morgan O’Conner, Vice-Chair – Texas Land and Mineral Owners Association, Austin and Molly Rooke, Dallas)
32. Require the Railroad Commission to provide public notice of meetings, including publishing notices in local newspapers and posting notices on the agency’s website. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup)
33. Allow the public to more easily access well and pipeline maps. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup)
34. Require that legal notices provide the street address that borders a property as well as the legal description. (Doreen Geiger, Fort Worth and Charles Morgan, Executive Director – Citizens for Environmental Cleanup)

35. Re-train or educate all Railroad Commission employees to be responsive and willing to help and prevent problems for homeowners instead of just being loyal to the oil and gas companies. (Betty J. and Clyde W. Collins, Fort Worth)
36. Require the Railroad Commission to provide city and county maps of all gas lines. (Darlia Hobbs, Fort Worth)
37. Require the Railroad Commission to provide maps of proposed and existing oil and gas wells and natural gas compressor stations. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup)

Funding

38. As the Legislature considers potential budget cuts, urge the Legislature to resist aggressive cuts to fee-based agencies, like TCEQ and the Railroad Commission, that protect citizens' health and safety; and consider finding funding for these agencies from stronger penalties assessed to industry bad actors. (Michael C. Burgess, M.D. – 26th Congressional District of Texas)
39. Require the Railroad Commission to set fees for the disposal of well water from well sites outside of the state of Texas. (Senator Wendy R. Davis, Member – Texas Senate)
40. Put the Oilfield Cleanup Fund into an account similar to Social Security. (Robert Hobbs, Jr., Fort Worth)
41. Provide the Railroad Commission more money and inspectors. (Gary Hogan, Fort Worth)
42. Continue funding the Railroad Commission's publicly available mapping system for surface locations of oil and gas wells. (Lionel Milberger, Robertson County)

Permitting, Inspection, and Enforcement

43. Require that drilling companies and pipeline companies that are out of compliance to completely shut down their operations at that site until they achieve compliance. (Doreen Geiger, Fort Worth)
44. Prevent the Railroad Commission from issuing new drilling permits in the Dallas and Fort Worth area until Atmos has verified that all compression couplings in that area have been replaced. (Kim Feil, President – Old Town Neighborhood Association, Arlington)
45. Give the Railroad Commission authority to deny a permit if the proposed site is risky to safety or health, or puts ground water at risk of contamination from shale gas drilling and fracking, and uranium mining. (Molly Rooke, Dallas with the comments on public interest and health made by Public Citizen and Sierra Club)
46. Require the Railroad Commission to consider the effects of oil and gas operations on property valuations and public health when permitting. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup, Fairfield)
47. Require the Railroad Commission to increase its enforcement efforts, number of inspections, and number of employees in the field. (Rita Beving, North Texas resident – Farmers Branch and Dalia Hobbs, Fort Worth)

48. Mandate the Railroad Commission to require pipeline operators to provide more precise maps of their pipelines, since the Commission currently allows a 500 foot variance. (Jerry Lobdill, Fort Worth; Mary Kelleher, Fort Worth; and Esther McElfish, President – North Central Texas Communities Alliance, Fort Worth)

Staff Comment: Pipeline operators provide maps of proposed locations of pipelines to the Commission. The actual location may vary from the proposed map and maps are supposed to be updated. However, the Railroad Commission notes on its maps that the maps are not intended to be used for locating lines and that anyone who needs to locate a line should call 811.

49. Authorize the Railroad Commission to regulate interstate pipelines for safety. (Jerry Lobdill, Fort Worth)

Staff Comment: The regulation of interstate pipelines for safety falls under federal jurisdiction and would require a delegation of authority from the federal government to allow the Railroad Commission to enforce safety regulations on interstate pipelines.

50. Require the Railroad Commission to license land men. (Gary Hogan, Fort Worth)

51. Require the Railroad Commission to fine violators who fail to come into compliance within 48 hours. (Gary Hogan, Fort Worth)

52. Authorize the Railroad Commission to deny a permit to an operator who fails to comply with the law. (Rita Beving, North Texas resident – Farmers Branch)

Staff Comment: The Commission can deny or revoke the operating permit of non-compliant operators.

53. Amend statute to give a person who holds or has held a position of “ownership or control” with any organization defined in §91.114(c) (1) (A) (E), (2), 2 Nat. Res. Code Ann., a legitimate defense to the seven-year sanction imposed by §91.114(b) on that person if they hold or held a position of ownership or control in an organization at the time that organization violated a statute or Commission rule, order, license, permit or certificate that relates to safety or the prevention or control of pollution.

The defenses suggested are:

- The person resigned from, or ceased, being a person in a position of ownership or control before a final judgment or final administrative order finding the violation has been entered against the organization, and appeals have been exhausted.
- The person found to be in a position of ownership or control was unaware of or did not authorize the violation entered against the organization.
- The person in a position of ownership or control was removed from, or removed him or herself from, the organization report required by §91.142 prior to a final judgment or final

administrative order finding a violation being entered against the organization, and all appeals have been exhausted.

(Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

54. Change the law regarding severing a lease in any one of the three following ways.

- Prohibit severance of a lease except where all the wells on a lease are violating or have violated Title 3, §26.131, Tex. Water Code Ann., or Subchapter C, Chapter 27, Tex. Water Code Ann., or any rule, license, or permit issued by the Commission.
- Expressly provide that the Railroad Commission may only sever the certificate of compliance for a well and is expressly prohibited from severing a lease unless every well on the lease is in violation of the statute, rules, license, or permits issued for each well; and allow the operator to continue to operate while the license permit or certificate is under judicial review.
- Require that the certificate may be canceled only as to the specific well that is in violation. The Railroad Commission has no authority to sever a lease unless every well on the lease is in violation, or the operator ceases to have a valid organization report under §91.142, 2 Nat. Res. Code Ann., or the operator ceases to maintain adequate financial assurance required by §91.104, 2 Nat. Res. Code Ann.

(Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

55. Authorize a person in ownership or control of an organization under §91.114(c), 2 Nat. Res. Code Ann., that is identified on an organization report to cause his or her name to be removed from the organization report required under §91.142, 2 Nat. Res. Code Ann., by notice to the Railroad Commission by certified mail, return receipt requested, within sixty (60) days of resignation from the position of ownership or control in the organization. (Teddy Carter, Director of Public Affairs – Texas Independent Producers and Royalty Owners Association, Austin)

Oil and Gas Field Regulations

56. As a management action, direct the agency to revise its notice of hearing provided to parties affected by forced pooling, providing an easily understood description of forced pooling and the hearing process. Also, authorize, by statute, a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled. Finally, authorize the Commission, by statute, to develop a fee schedule, by rule, for increased charges associated with re-filing permits previously withdrawn. (Senator Glenn Hegar, Jr., Chairman – Sunset Advisory Commission)

57. Stop “Forced Pooling” that would compel non-leased interests in neighborhoods. (Senator Wendy R. Davis, Member – Texas Senate)

58. Mandate more Railroad Commission inspections of well sites and related equipment, including pipelines. (Senator Wendy R. Davis, Member – Texas Senate)

59. Mandate the Railroad Commission to create setbacks and rules that are individual to a shale and its operations. This would provide flexibility where needed for separate local governments and rural areas. (Senator Wendy R. Davis, Member – Texas Senate)
60. In the absence of meaningful rulemaking by the Railroad Commission in regards to gas drilling oversight, statutory authority should be developed to require green completion. (Senator Wendy R. Davis, Member – Texas Senate)
61. Require the Railroad Commission to create rules to protect the quality of life of residents living in counties outside municipal jurisdictions, including, but not limited to, drilling setbacks, hours of operation, lighting, noise, and truck traffic. (Senator Wendy R. Davis, Member – Texas Senate)
62. Create a new law that limits noise relating to the production of oil and gas for rural areas. (Charles Morgan, Executive Director – Citizens for Environmental Cleanup)
63. Update and design all Railroad Commission rules to be more applicable to urban settings. (Esther McElfish, President – North Central Texas Communities Alliance)

Hydraulic Fracturing

64. Require the Railroad Commission by law to provide a report for both the Barnett Shale and the Eagle Ford Shale addressing water usage and reviewing the hydraulic fracture process. (Senator Wendy R. Davis, Member – Texas Senate)
65. Require the Railroad Commission to work with the industry to develop a fluid marker substance that would be mixed in every hydraulic fracture job to verify whether or not such fracking fluids are introduced into the water supply. (Senator Wendy R. Davis, Member – Texas Senate)
66. Require the oil and gas industry to disclose the fracture chemicals that are currently being used, and require the Railroad Commission to research the possibility of using nontoxic materials. (Senator Wendy R. Davis, Member – Texas Senate)
67. Require the Railroad Commission to reveal the chemicals used in fracking fluids and publish a list of chemicals used in a fracking operation. (Donna Hoffman – The Alliance of Texans for Uranium Research & Action, San Antonio and Communications Coordinator – Sierra Club, Lone Star Chapter, Austin)
68. Require that hydro-fracking be effectively regulated to ensure public safety, environmental protection, and economic competitiveness in the Barnett Shale. (Dewayne Quertermous, Conservation Chair – Fort Worth Sierra Club, Arlington)

Water Contamination and Waste Disposal

69. Increase the Railroad Commission's focus on wastewater disposal, namely, the development of technology regarding recycling or treatment of wastewater instead of disposal. This includes a closer analysis of the geology in the vicinity of disposal wells, including the development of maximum volumes per well, as well as maximum volumes for local areas. (Senator Wendy R. Davis, Member – Texas Senate)

70. Require the Railroad Commission to conduct enhanced investigations into alleged contamination, especially groundwater and well water contamination. (Senator Wendy R. Davis, Member – Texas Senate)
71. Task the Railroad Commission with the responsibility for the inspections of saltwater injection well transmission lines. (Senator Wendy R. Davis, Member – Texas Senate)
72. Require the Railroad Commission to play an enhanced role in the evaluation and permitting of salt water disposal wells. (Senator Wendy R. Davis, Member – Texas Senate)
73. Mandate the Railroad Commission to require the oil and gas industry to reuse their water. (Darlia Hobbs, Fort Worth and Gary Hogan, Fort Worth)

Air Quality

74. Require the Railroad Commission to take into account the cumulative effect of wells on air quality, among other things, in the permitting and regulation of individual wells. (Dewayne Quertermous, Conservation Chair – Fort Worth Sierra Club, Arlington)
75. Mandate that the Railroad Commission require all drilling companies to capture emissions at every well. (Doreen Geiger, Fort Worth)
76. Locate air monitors at drill site locations. (Kim Feil, President – Old Town Neighborhood Association, Arlington)
77. Grant the Railroad Commission authority to regulate air pollution related to the oil and gas industry. (Darlia Hobbs, Fort Worth)
78. Require vapor recovery and green completion in non-attainment zones. (Gary Hogan, Fort Worth)

Staff Comment: For each of the new issues raised in this subsection, it should be noted that the Texas Commission on Environmental Quality, not the Railroad Commission, currently has jurisdiction over matters relating to air quality.

Uranium Mining and Exploration

79. Require applicants to assess baseline groundwater quality using valid scientific methodology before drilling of uranium exploration boreholes begins. (Mina Williams, Vice-Chair – Sierra Club, Coastal Bend Chapter, Corpus Christi)
80. Require the Railroad Commission to institute a moratorium on uranium exploration and mining in the State until the Commission adopts rules that require producers to conduct baseline testing in advance of uranium exploratory mining. (Donna Hoffman – The Alliance of Texans for Uranium Research & Action, San Antonio and Communications Coordinator – Sierra Club, Lone Star Chapter, Austin)
81. Require the Railroad Commission to require uranium exploration boreholes to be drilled no less than 500 feet from an existing water well without the written consent of the well owner. (Mina Williams, Vice-Chair – Sierra Club, Coastal Bend Chapter, Corpus Christi)

82. Require the Railroad Commission to require mandatory and unannounced inspections of uranium exploration sites to be conducted to assure that exploration boreholes are properly plugged within the time stipulated by the regulations. (Mina Williams, Vice-Chair – Sierra Club, Coastal Bend Chapter, Corpus Christi)
83. Require the Railroad Commission to assess significant penalties for infractions of uranium exploration regulations. (Mina Williams, Vice-Chair – Sierra Club, Coastal Bend Chapter, Corpus Christi)

Gas Utility Regulation

84. Refocus the agency's mission in the Gas Utility Regulatory Act, if ratemaking authority remains vested with the Railroad Commission, to include a heightened focus on gas utility customers. (Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington)
85. Create a process, outside the context of a general rate case, to review the prudence of natural gas acquisition, whether at the Railroad Commission or PUC. (Jay Doegey and Odis Dolton, Co-Chairs – Atmos Cities Steering Committee, Arlington)
86. Repeal the Railroad Commission's informal complaint process. (Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston)
87. Amend the Common Carrier statutes to reflect that, if a common carrier refuses to transport natural gas, the carrier loses their right of eminent domain. (Urban O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston)
88. Give the Railroad Commission the authority to investigate natural gas price manipulation. (Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston)
89. Require all gas pipelines to report volumes and prices to the Railroad Commission. (Urban "Obie" O'Brien, Vice President for Governmental and Regulatory Affairs – Apache Corporation, Houston)
90. Establish depreciation rates for gas utilities without the expense of litigation through an amendment that adopts an approach followed by other states and requires depreciation rates to be set periodically pursuant to a Commission rule. (Ronald Kitchens and Scott E. Rozzell, Executive Vice President and General Counsel – CenterPoint Energy, Austin)
91. Adopt Public Utility Regulatory Act language for rate treatment of post-retirement benefits for gas utilities as currently handled for electric utilities. (Ronald Kitchens and Scott E. Rozzell, Executive Vice President and General Counsel – CenterPoint Energy, Austin)
92. Encourage regulatory authorities to establish tariffs that adjust gas rates for changes in revenues, expenses, or investment. (Ronald Kitchens and Scott E. Rozzell, Executive Vice President and General Counsel – CenterPoint Energy, Austin)
93. Create an annual assessment on gas utilities of up to one dollar per year per customer to fund the Railroad Commission's activities relating to gas utility rates. (Ronald Kitchens and Scott E. Rozzell, Executive Vice President and General Counsel – CenterPoint Energy, Austin)

94. If gas utility ratemaking authority remains with the Railroad Commission, require the agency to collect and post data in an easy-to-read format on its website regarding natural gas base rates and fuel charges paid by home consumer, by region and utility. (Jay Doegey, Co-Chairman – Atmos Cities Steering Committee, Arlington)
95. Require the Railroad Commission to provide historical pricing data as well as additional complaint and enforcement data. (Jay Doegey, Co-Chairman – Atmos Cities Steering Committee, Arlington)

Staff Recommended Action

Staff makes no recommendations on the new issues.

New Issues

Supplement to the Sunset Staff Report on the Public Utility Commission

New issues previously contained in the Supplement dealt only with gas utilities. Those issues have been moved to the New Issues section of the Decision Material for the Railroad Commission of Texas and appear under the heading of “Gas Utility Regulation.”

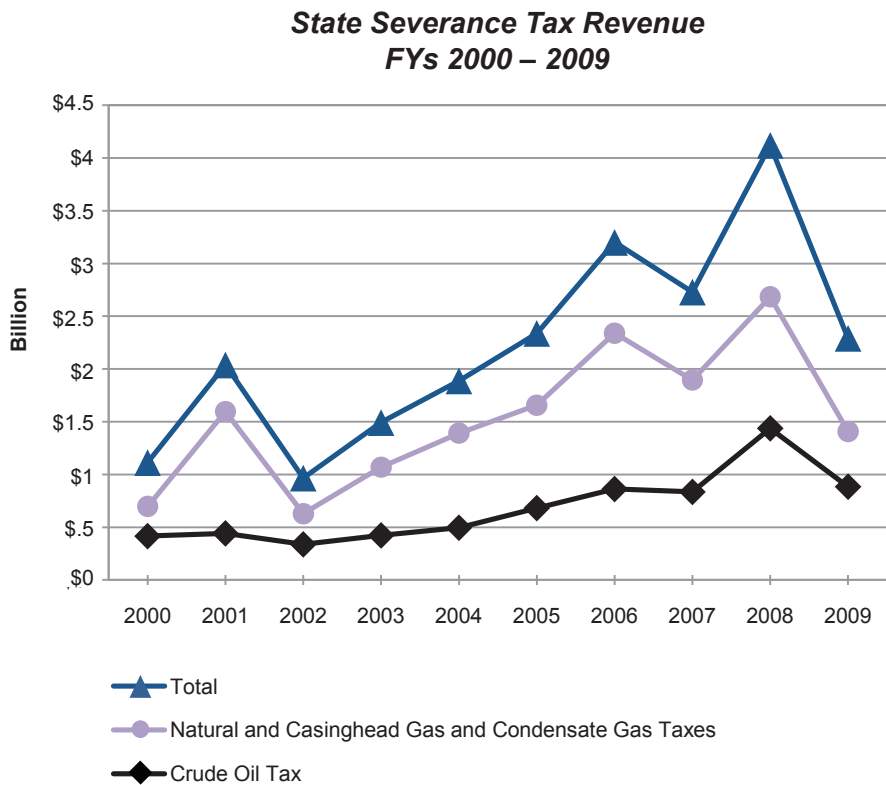
Appendices

Appendix A

Severance Tax Revenue

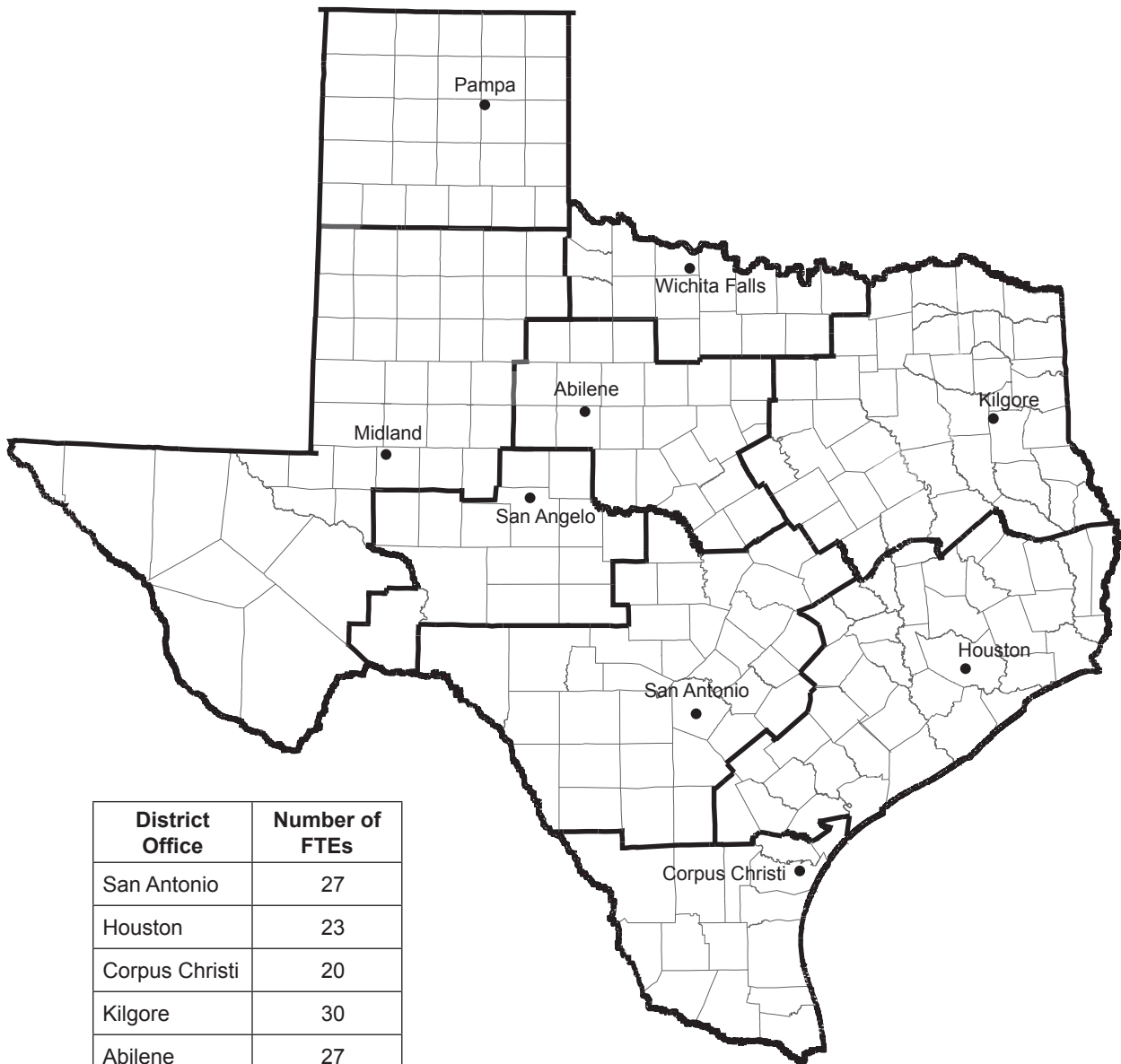
The production of oil and natural gas generates revenue for the State through a severance tax paid by producers to the Comptroller. A severance tax is a tax imposed by a state on the removal of non-renewable natural resources. The severance tax rate is based on the market value of extracted oil and natural gas, and the accompanying textbox, *Severance Tax Rates*, details the State's current severance tax schedule. In fiscal year 2009, severance taxes contributed \$1.13 billion to the General Revenue Fund, \$870 million to the Economic Stability Fund, and \$250 million to the Permanent School Fund. Over the past 10 fiscal years, the State collected annual severance taxes ranging from just under \$1 billion in fiscal year 2002 to as high as \$4.1 billion dollars in fiscal year 2008, as shown in the graph, *State Severance Tax Revenue*.

Natural and Casinghead Gas....	7.5%
Crude Oil.....	4.6%
Condensate Gas.....	4.6%



Appendix B

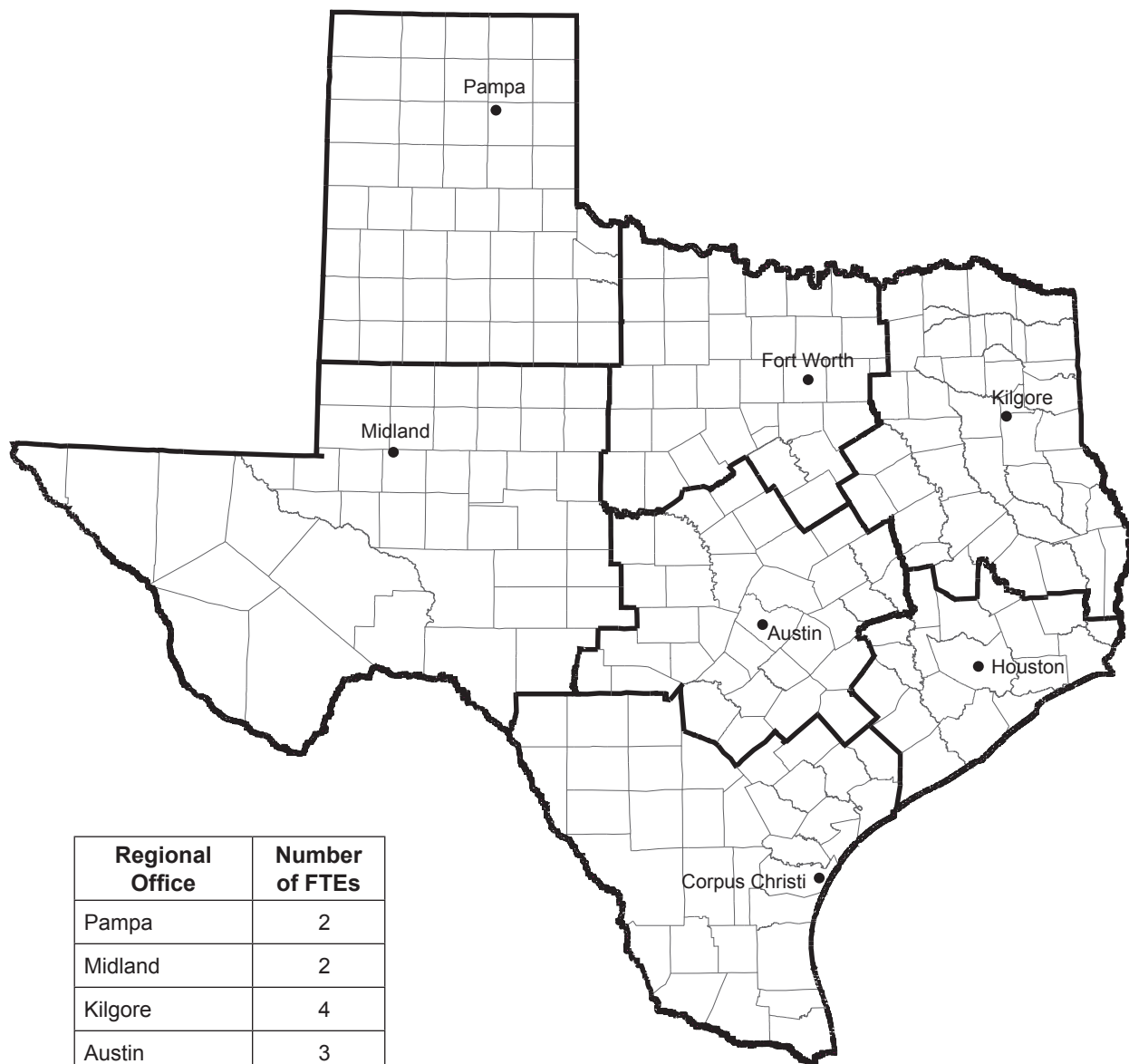
Oil and Gas Division Districts, Office Locations, and FTEs



District Office	Number of FTEs
San Antonio	27
Houston	23
Corpus Christi	20
Kilgore	30
Abilene	27
San Angelo	14
Midland	37
Wichita Falls	27
Pampa	15
Total	220

Appendix C

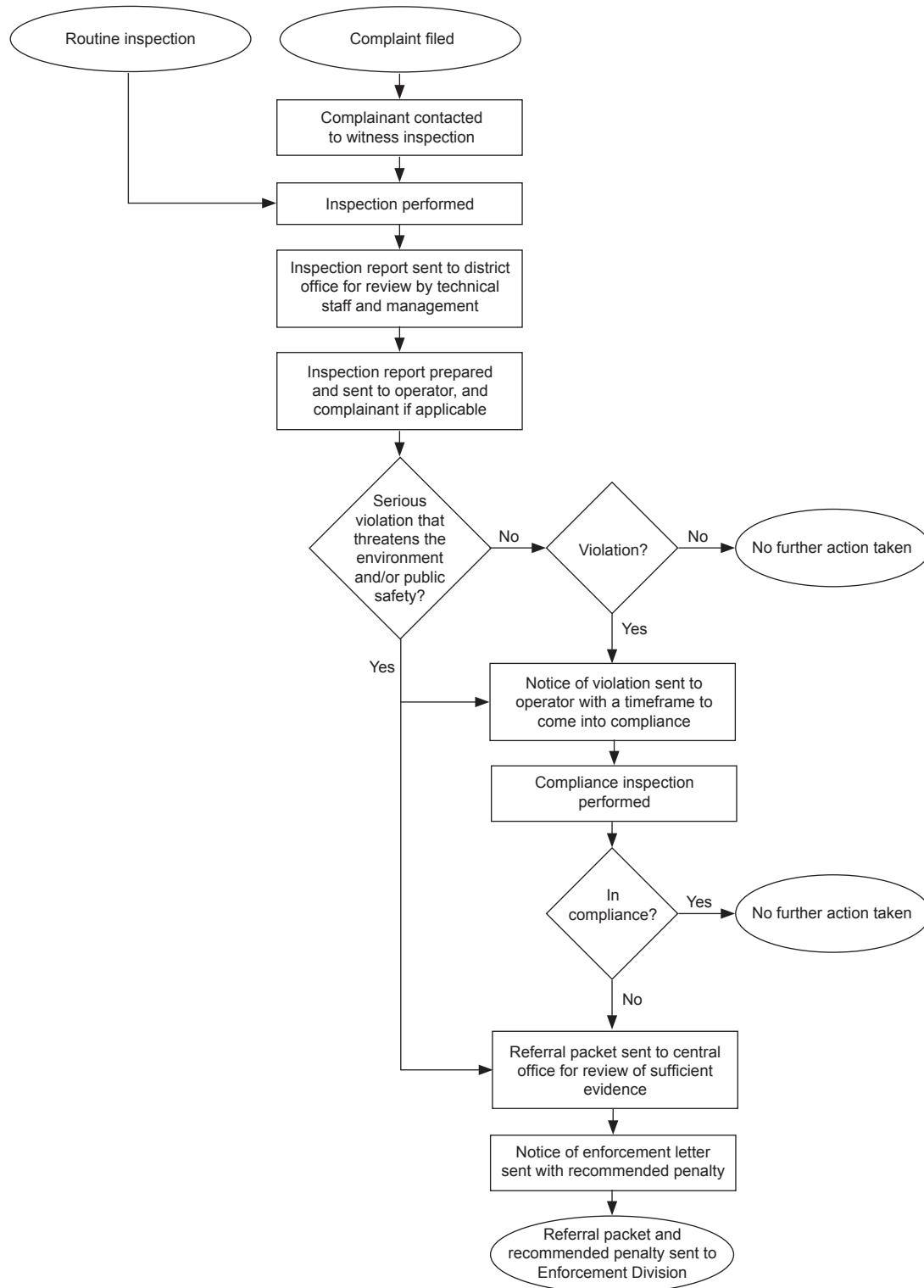
Pipeline Safety Regions, Office Locations, and FTEs



Regional Office	Number of FTEs
Pampa	2
Midland	2
Kilgore	4
Austin	3
Houston	11
Forth Worth	9
Corpus Christi	5
Total	36

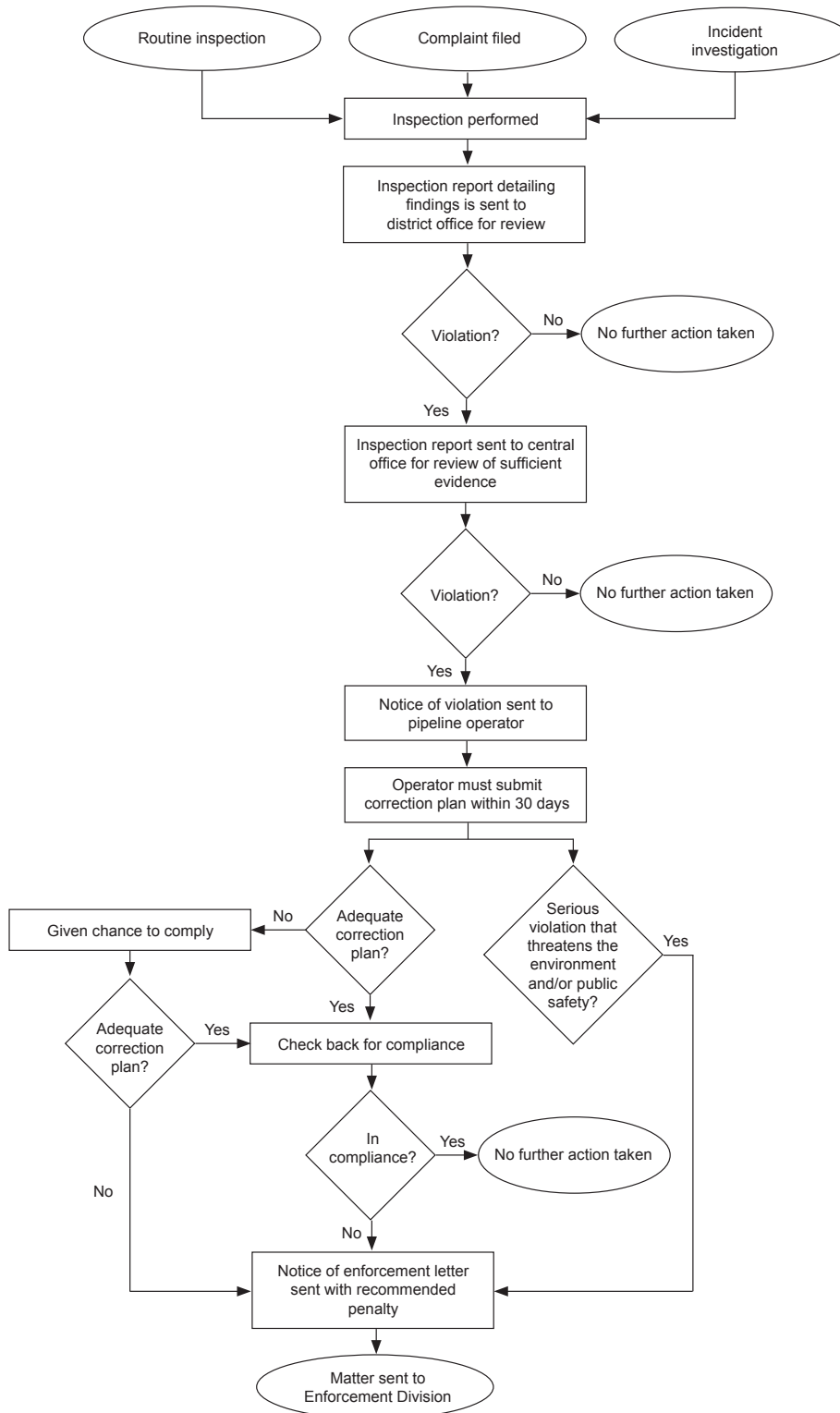
Appendix D

Oil and Gas Inspection Process



Appendix E

Pipeline Safety Inspection Process

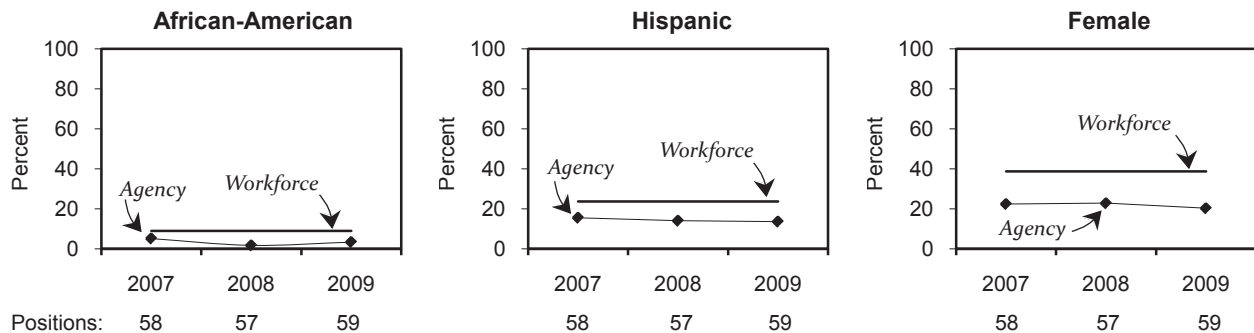


Appendix F

Equal Employment Opportunity Statistics 2007 to 2009

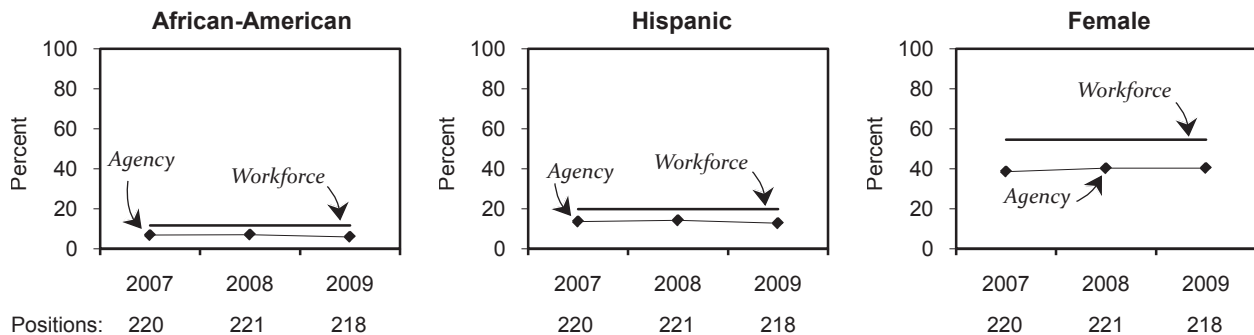
In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Railroad Commission of Texas.¹ The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.² In the charts, the flat lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the agency's actual employment percentages in each job category from 2007 to 2009. The Commission fell below the civilian workforce percentages in every category, except for African-American and female administrative support. The Commission indicates that it was unable to meet civilian workforce percentages because their pool of applicants was predominately Caucasian males.

Administration



The Commission fell below the civilian workforce percentages in all three categories in the last three fiscal years.

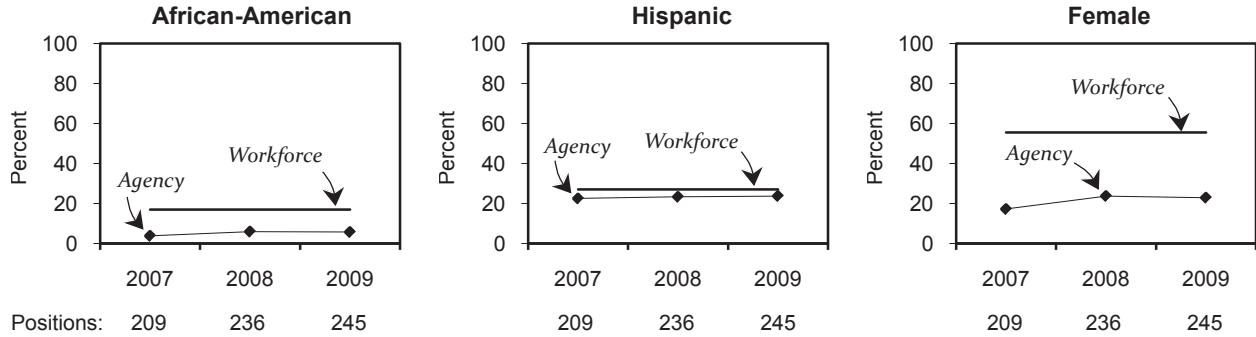
Professional



In an area of the agency with significant staff, the Commission fell below civilian workforce percentages in all three categories in the last three fiscal years, particularly for females.

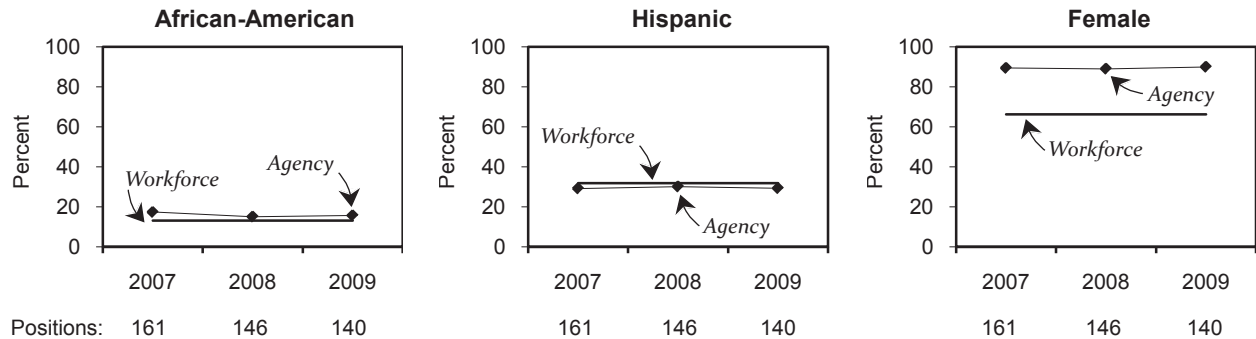
Appendix F

Technical



In the area of the agency with the most employees, the Commission fell below the statewide average for all three categories in each of the last three fiscal years, particularly for females.

Administrative Support



In the administrative support category, the Commission far exceeded the statewide average by employing 90 percent women in the past three fiscal years. Additionally, the Commission exceeded the civilian work force percentage for African-Americans in administrative support in the past three fiscal years. However, the Commission fell below the statewide percentage for Hispanic employees for this category in the past three fiscal years.

¹ Texas Government Code, sec. 325.011(9)(A).

² Texas Labor Code, sec. 21.501.

Appendix G

Staff Review Activities

During the review of the Railroad Commission of Texas, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; met with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes and rules, federal statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research using the Internet.

In addition, Sunset staff also performed the following activities unique to this agency.

- Met with each Railroad Commissioner.
- Accompanied Railroad Commission and Texas Commission on Environmental Quality staff on a tour of natural gas drilling, hydraulic fracturing, and production sites, and a natural gas compressor station.
- Met with local government officials in the Barnett Shale region.
- Met with pipeline safety field inspectors and observed a steel natural gas distribution line replacement effort in Dallas.
- Toured a surface coal mining operation and reclaimed land project at various stages of completion.
- Toured a uranium mining operation under development in South Texas, including the mining site and processing plant.
- Accompanied Railroad Commission staff on a residential propane distribution facility inspection and interviewed Railroad Commission licensees and agency field inspectors.
- Observed a gas utility audit finding presentation conducted by Railroad Commission staff.
- Observed a contested case enforcement hearing and a gas utility rate case proceeding.
- Attended a pipeline safety damage prevention rule-revision workshop.
- Interviewed staff from the Comptroller of Public Accounts' State Energy Conservation Office, Texas General Land Office, Texas Commission on Environmental Quality, Propane Council of Texas, State Office of Administrative Hearings, Public Utility Commission of Texas, Texas Department of Insurance, Texas Alcoholic Beverage Commission, U.S. Department of Transportation, and U.S. Environmental Protection Agency.

SUNSET STAFF REVIEW OF THE RAILROAD COMMISSION OF TEXAS

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