BEFORE THE
NORTH DAKOTA LEGISLATIVE MANAGEMENT
ADMINISTRATIVE RULES COMMITTEE

Tuesday, September 13, 2016
Roughrider Room, State Capitol
Bismarck, North Dakota

TESTIMONY OF
CONTINENTAL RESOURCES, INC.
AND KINDER MORGAN, INC.

BY

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Mr. Chairman and Members of the Administrative Rules Committee,

I am here today on behalf of Continental Resources, Inc. ("Continental"), an oil and gas exploration and production company, and Kinder Morgan, a company specializing in midstream energy infrastructure. My Clients have asked me to speak in opposition to rules now under consideration, which were recently approved by the North Dakota Industrial Commission (the "Commission"). While my Clients are appreciative of the efforts put forth by the Commission and its staff, there are certain aspects of the rules now under consideration that materially impact the industry, potentially conflict with pending federal action, and exceed the intent of the North Dakota Legislature.

Under N.D.C.C. § 28-32-18, the Administrative Rules Committee (the "Committee") has the power to declare a rule or any part thereof void if the Committee specifically finds that there is an absence of statutory authority for the rule, that the rule fails to comply with express legislative intent, or that the rule is an arbitrary or capricious exercise of authority. My Clients believe that certain portions of the newly-approved rules should be invalidated on these grounds. First, my Clients object to N.D.A.C. § 43-02-03-29.1 to the extent that, under subdivision (1) thereof, the Commission purports to regulate underground gathering pipelines transporting natural gas, rather than just crude oil or produced water. Second, my Clients object to N.D.A.C. § 43-02-03-29.1 to the extent that, under subdivision (10) thereof, the Commission purports to

require underground gathering pipeline owners to file leak "detection" plans, rather than just leak protection or monitoring plans. Finally, my Clients object to the new requirement in N.D.A.C. § 43-02-03-49 that a six-inch perimeter berm be constructed around all storage facilities and production sites and to divert drainage away from the site. As I will explain, the requirements imposed by the rules under consideration are in excess of the Commission's statutory authority or are arbitrary or capricious exercises of that authority. Accordingly, the Committee should declare the pertinent portions of the new rules void.

Authority of Administrative Agencies, and the Commission in Particular

The authority of an administrative agency to adopt administrative rules is authority delegated by the Legislature. Since the power to make regulations is administrative in nature, legislation may not be enacted under the guise of its exercise by issuing a "regulation" which is out of harmony with, or which alters, extends, or limits, the statute being administered, or which is inconsistent with the expression of the lawmakers' intent in other statutes. *See Moore v. N.D. Workmen's Comp. Bureau*, 374 N.W.2d 71, 74 (N.D. 1985). If an administrative agency's regulation exceeds or conflicts with an agency's authority under the statute it implements, the regulation is void. *Sloan v. North Dakota Workforce Safety & Ins.*, 804 N.W.2d 184 (N.D. 2011).

The Legislature has delegated authority to the Commission in Section 38-08-04(5) of the North Dakota Century Code which states that the Commission has the authority "[t]o adopt and to enforce rules and orders to effectuate the purposes and the intent of [Chapter 38-08] . . . ." Additionally, House Bill No. 1358, passed in 2015, declared that the Commission should adopt "administrative rules necessary to improve produced water and crude oil pipeline safety and integrity." The Commission must adopt, amend, or repeal such rules in conformity with the Administrative Agencies Practice Act, N.D.C.C. ch. 28-32, as well as the particular statute being implemented, namely N.D.C.C. ch. 38-08, which pertains to the Control of Gas and Oil Resources.

Application of Rules to Natural Gas Pipelines

The proposed new section 43-02-03-29.1 of North Dakota Administrative Code cites N.D.C.C. § 38-08-04 as the general authority and law under which each was implemented. *See*

N.D.C.C. § 38-08-04(5) (permitting the Commission to "adopt and to enforce rules and orders to effectuate the purposes and the intent of [Chapter 38-08]"). N.D.C.C. ch. 38-08, does not contain any general grant of authority to regulate natural gas pipelines. The only express references to "pipelines" in N.D.C.C. § 38-08-04 are in provisions permitting the Commission to require bonds for the operation of oil and produced water pipelines and permitting the Commission to require metering or measuring of oil and gas in pipelines. *See* N.D.C.C. § 38-08-04(1)(d), (h). The only other references to pipelines in N.D.C.C. ch. 38-08 are in N.D.C.C. § 38-08-27, which applies only to crude oil and produced water pipelines, and in N.D.C.C. § 38-08-26, which requires owners and operators of underground gathering pipelines to submit shape files pertaining thereto. Accordingly, beyond the issues of pipeline metering and submission of pipeline shape files, the Commission has no authority to regulate natural gas gathering pipelines under the statutes it cites.

This lack of authority is confirmed by the comments that Lynn Helms, Director of the Commission's Oil & Gas Division of the Department of Mineral Resources, made to members of the North Dakota legislature during its consideration of House Bill No. 1358. On April 2, 2015, speaking to members of the Senate Appropriations Committee about House Bill No. 1358, Mr. Helms stated,

> There has always been a [regulatory] gap, between the large oil and gas tank . . . battery and the point where those fluids got to a transmission line and left the state. Last session you decided to step into that with a self-certifying system; the company would build the pipeline and certify to the industrial commission that it had followed our construction minimums in terms of the way it built the pipeline and put it into service. That wasn't enough; we had two very large salt water spills, both the same pipe material. The legislature is now recognizing we need to be in that arena as the pipeline is designed and as is constructed with third party inspectors

Senate Appropriations Committee, 2015 Senate Standing Committee Minutes (Job # 25733), p. 3 (April 2, 2015). Later, before members of the same committee, referring to House Bill No. 1358's delegation of authority to the Commission to make rules "to improve produced water and crude oil pipeline safety and integrity," Mr. Helms indicated that the language was intended to facilitate rulemaking regarding the crude oil and produced water pipelines referenced in Section 2 of House Bill No. 1358. Senate Appropriations Committee, 2015 Senate Standing Committee

Minutes (Job # 25913), p. 2 (April 8, 2015). Mr. Helms then stated, "Before this there was never a connection of the rules to any authority or jurisdiction to come back and apply them to the pipelines being built under section 2." *Id.* In other words, the Commission lacked authority to regulate gathering pipelines under N.D.C.C. ch. 38-08 as it existed prior to the passage of House Bill No. 1358.

The passage of House Bill No. 1358 did not alter the Commission's authority as to underground gathering pipelines carrying natural gas. House Bill No. 1358 expressly refers to produced water and crude oil pipelines throughout, and contains no provisions at all specifically adopted or amended to address gas pipelines. In February of 2015, the House Energy and Natural Resources Committee met to consider House Bill No. 1358. During the meeting, when a legislator asked if a bond requirement set forth in the bill would cover "all pipelines necessary," Ron Ness of the North Dakota Petroleum Counsel indicated that it "does not cover gas lines," after which Mr. Helms explained, "The ones people are concerned about are the oil and produced water pipelines." Energy and Natural Resources Committee, 2015 House Standing Committee Minutes (Job # 23151), p. 2 (February 3, 2015); *see also* Senate Appropriations Committee, 2015 Senate Standing Committee Minutes (Job # 25964), p. 1 (April 9, 2015) (indicating that the insertion of "crude" into certain provisions of HB 1358 was "just clarifying that [the I]ndustrial Commission can adopt the administrative rules necessary to improve produced water and crude oil pipeline safety and integrity, so just clarifying that crude oil is also included in there"). Thus, while House Bill No. 1358 may have given the Commission greater authority to regulate crude oil and produced water pipelines, it did not grant any additional authority to regulate natural gas pipelines. Accordingly, the Commission has no general authority to regulate natural gas pipelines under N.D.C.C. ch. 38-08 or under House Bill No. 1358, and N.D.A.C. § 43-02-03-29.1 is void to the extent that it purports to exercise such authority.

Federal Preemption

Beyond the lack of statutory authority to adopt rules regulating natural gas pipelines, the actions of the Commission are in conflict with recent Federal agency action in the same field, and may be considered an unconstitutional interference with Federal regulation under the Federal Pipeline Safety Act and 49 U.S.C. §601. A basic tenant of U.S. law and regulation is that, if Congress evidences an intent to occupy a certain field of law, state laws regulating that same topic

of law are preempted by the Supremacy Clause of the U.S. Constitution. *See Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984). Further, express preemption also exists where the U.S. Congress enacts an explicit statutory demand that state law be displaced. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383 (1992); *See also, Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541 (2001). The Pipeline Safety Act does contain a clear and express preemption provision, establishing that "[a] State authority may not adopt or continue in force safety standards for interstate pipeline facilities or interstate pipeline transportation." *See* 49 U.S.C. § 60104(c). A state may be certified by the U.S. DOT's Pipeline and Hazardous Materials Safety Administration ("PHMSA") and adopt additional or more stringent standards, but only for intrastate pipeline facilities and only if those standards are compatible with the Federal standards. *See* 49 U.S.C. § 60104(c). Last, courts have held that regulations promulgated by Federal agencies have the same preemptive power as statutes where the Congress has delegated the requisite authority to the administrative agency. *See Louisiana Public Serv. Comm'n. v. FCC*, 476 U.S. 355, 368-69 (1986); *see also Taylor v. General Motors Corp.*, 875 F.2d 816, 826 (11th Cir. 1989), superseded on other grounds, *Myrick v. Freuhauf Corp.*, 13 F.3d 1516 (11th Cir. 1994).

With regard to regulation of gathering pipelines, the Pipeline Safety Act broadly defines transportation of hazardous liquid to include gathering lines. *See* 49 U.S.C. § 60101 (22). To that end, PHMSA has very recently released an inclusive, 550-page Notice of Proposed Rulemaking where PHMSA has expressed its specific intent to comprehensively expand regulation and information collection activities over certain unregulated liquid and gas gathering lines. When finalized, the rules proposed by PHMSA will preempt any existing state rules that regulate the same liquid and gas gathering lines. Adding further to this complication is that many of the Commission's rules regarding gas gathering lines are in potential conflict with the PHMSA Proposed Rulemaking. Accordingly, the authority of the Commission and the North Dakota Legislature are preempted, in whole or in part, by express Congressional directive and by forthcoming federal regulation of certain liquid and gas gathering lines.

Submission of Leak Detection Plans

As noted above, N.D.A.C. § 43-02-03-29.1 cites N.D.C.C. § 38-08-04 as the general authority and law under which each was implemented. Section 43-02-03-29.1(10) also

specifically cites N.D.C.C. § 38-08-27 as the authority for requiring underground gathering pipeline owners to file a "leak protection, detection, and monitoring plan" with the Commission. Section 38-08-27 was recently added to Chapter 38-08 of the North Dakota Century Code by way of House Bill No. 1358, and it reads in part as follows:

> Upon request, the operator shall provide the commission the underground gathering pipeline engineering construction design drawings and specifications, list of independent inspectors, <u>and a plan for leak protection and monitoring for the underground gathering pipeline</u>. (emphasis added)

The Committee will note that the text of N.D.C.C. § 38-08-27 refers only to plans "for leak protection and monitoring," and makes no mention of "detection."

A review of the legislative history for House Bill No. 1358 reveals that that Senate Standing Committee voted unanimously to approve certain amendments to the bill on April 9, 2015. Among the amendments approved was the deletion of "leak detection and monitoring technologies be installed by the operator of these pipelines." *See* Senate Appropriations Committee, Report of Standing Committee (April 10, 2015). The following language was added in the same amendment:

> Upon request, the operator shall provide the commission the underground gathering pipeline engineering construction design drawing and specification, list of independent inspectors, and a *plan for leak protection and monitoring* for the underground gathering pipeline. (emphasis added)

Id. This language is reflected in N.D.C.C. § 38-08-27 as currently enacted and cited above. This amendment to House Bill No. 1358 indicates that the Legislature intended to include "leak protection" plans and to exclude "leak detection" plans from the scope of N.D.C.C. § 38-08-27. Accordingly, to the extent that the Commission now seeks to require submission of leak detection plans under N.D.A.C. § 43-02-03-29.1(10), it has exceeded the authority granted to it under N.D.C.C. ch. 38-08, and the new regulation must to that extent be declared void.

<u>Arbitrary and Capricious Exercise of Authority by Administrative Agencies</u>

The "arbitrary or capricious" standard is commonly used to review the validity of administrative agency decisions. For example, N.D.C.C. § 28-32-47 states that a court shall

uphold an agency's rulemaking action unless the language of the rule, on its face, is an arbitrary or capricious application of authority granted by statute. The North Dakota Supreme Court attempted to clarify the "arbitrary or capricious" standard of review in *Sloan v. North Dakota Workforce Safety & Ins.*, stating:

> On appeal in a case challenging validity of a rule promulgated by an administrative agency, for which Supreme Court is directed by statute to apply an "arbitrary or capricious application of authority" standard of review, the record is adequate if it enables the Supreme Court to discern the rationale for the decision, and a decision is arbitrary, capricious, or unreasonable if it is not the product of a rational mental process.

804 N.W.2d 184 (N.D. 2011). An agency decision may be deemed arbitrary, capricious, or unreasonable if it is apparent to the reviewing body there is an absence of supporting evidence or reason. *Trollwood Vill. Ltd. P'ship v. Cass Cty. Bd. of Cty. Comm'rs*, 557 N.W.2d 732, 734 (N.D. 1996). As noted earlier, the Committee utilizes this "arbitrary and capricious" standard in its review of proposed and existing rules. *See* N.D.C.C. § 28-32-18(1). Though the Committee should consider the entire record of the Commission's rulemaking decision, the "written consideration" of comments prepared by the Commission is particularly important to determining the rationale for the proposed regulations and to determine whether those regulations are the product of a rational mental process. *See Little v. Traynor*, 1997 ND 128, ¶¶ 19-26, 565 N.W.2d 766, 773-75.

Berm Construction Requirements

In its Full Notice of Intent to Adopt and Amend Administrative Rules, the Commission indicated that the purpose of the amendments to N.D.A.C. § 43-02-03-49 is, among other things, "to increase environmental protection around oil tanks." In its 2016 Rule Changes FAQ, the Commission elaborated on the purpose of its new berm requirements:

> The Oil and Gas Division tracks performance measures, such as spill statistics to understand if rules that are in place are adequate. Data show that the percentage of spills that are contained to a well pad has decreased since 2013. Further analysis reveals that the types of spills that should be contained to a well pad, are escaping. In order to prevent these spills from leaving the well pad, which are designed to minimize the impact on the environment, the berm rule was proposed.

Several persons who commented on the new rules, including Continental, noted that, based on the types of leaks and spills that occur during oil and gas operations, use of berms on all sites would be effective at containing leaks and spills in only a small fraction of cases, but would be costly to construct and maintain. Others that commented noted that there are other negative consequences to berm construction, including a larger well-site footprint, problems with trapped water (which permits mosquitoes and other insects to breed in the summer and creates an ice hazard in the winter), and diversion of water from nearby crop lands. Several commenters also stated that they believed the Commission's current approach, which is to require berms on a case-by-case basis, according to the sensitivity of the surrounding environment, is more appropriate.

In its written consideration of comments, the Commission did not specifically address the cost-benefit arguments offered by members of the industry. The Commission's general response to the berm comments was in line with its statement in the 2016 Rule Changes FAQ, namely that "[s]ome leaks in the past have flowed off location, therefore [the berm construction requirement] should apply to existing sites [as well as newly constructed sites]." The Commission also responded to the written comments by amending the proposed rules to permit modification of the berm construction requirements and extensions of time for compliance "in certain circumstances," as allowed by the Director of the Commission's Department of Mineral Resources. The Commission did not clarify why its previous policy of requiring berms on a case-by-case basis was inadequate. In response to one comment, the Commission actually conceded that "perimeter berms are probably unnecessary in most cases around producing oil well pads."

The Commission's written consideration of comments shows that its decision to impose the new berm requirements is arbitrary or capricious. Though the Commission does offer a justification for the new requirements, namely that some unspecified number of spills or leaks have flowed off location in the past, this justification does not indicate that the Commission has taken all relevant facts into consideration. First, this justification fails to take into account the environmental and other hazards posed by berm construction, despite being a measure intended to *lessen* the environmental impact of oil and gas operations. Second, in light of the analysis of spill and leak types presented in the written comments, the Commission's justification fails to indicate whether the spills and leaks that prompted the berm requirement were actually of a type

that could be contained by berms. And third, considering the Commission's admission that perimeter berms are "unnecessary in most cases," its justification fails to explain why the previous case-by-case approach was insufficient, nor does the Commission explain why the burden of costly berm construction, or the burden of obtaining a waiver from the Director of the Oil & Gas Division of the Department of Mineral Resources, should be shifted to oil and gas companies. Accordingly, the Commission's conclusory reasoning and inadequate consideration of the written comments show that its decision to implement the new berm requirements in N.D.A.C. § 43-02-03-49 is not the product of a rational mental process, that its exercise of authority is therefore arbitrary and capricious, and that the new berm requirements in N.D.A.C. § 43-02-03-49 should accordingly be declared void.

Conclusion

In conclusion, the Commission has exceeded the express delegations of regulatory authority contained in N.D.C.C. ch. 38-08 and House Bill No. 1358. Neither of these sources gives the Commission authority to impose the currently-approved underground gas gathering pipeline regulations or to require submission of leak detection plans for underground gathering pipelines. Also, the Commission's new regulations extend into an area that is or will soon be partially or completely regulated by federal agencies. To the extent that the Commission has therefore exceeded the scope of its statutory authority, the rules now under consideration by the Committee must be declared void. In addition, the currently approved berm requirements in N.D.A.C. § 43-02-03-49 are an arbitrary or capricious exercise of the Commission's rulemaking authority. The perfunctory reasoning provided both in support of the requirements and in response to written comments on the requirements fail to show that the Commission engaged in a rational decision-making process in approving its new berm requirements, and such requirements should thus be declared void.

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