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April 14, 2017

084205.0101

VIA E-MAIL AND CM/RRR

Mr. John Baumgartner
City Manager, League City
300 W. Walker
League City, TX 77573
john.baumgartner@leaguecitytx.gov
(281) 554-1414

Bill Kroger
TEL +1 713.229.1736
FAX +1 713.229.2836
bill.kroger@bakerbotts.com

RE: League City Ordinance/HB40

Dear Mr. Baumgartner:

Baker Botts has been retained to represent Woodstone Resources, LLC, and Lynn Watkins regarding ongoing efforts to secure a drilling permit for oil and gas development within League City. It is our understanding that the permit application was first submitted on January 29, 2016, and has been pending for more than fourteen months as various discussions regarding compliance with, among other things, (1) the League City Oil and Gas Ordinance; and (2) the League City Special Use Permit Ordinance ("SUP"). We understand that the SUP requirements have since been waived.

As part of those efforts, our firm conducted a preliminary legal analysis regarding the constitutionality of League City's ordinances in light of the enactment of House Bill 40 ("HB-40"), which expressly preempts local oil and gas regulation. We presented findings regarding violations of HB-40 to city officials in an October 2015 meeting.

Despite our conclusion that League City's Oil and Gas Ordinance and SUP violated HB-40 as written, we understand that the City has refused to grant needed variances relating to certain portions of its ordinance requirements. The specific requirements at issue are:

1. Safety and Environmental Management System plan as defined in the City Ordinance (being a city-specific SEMS Plan). This requirement is in spite of the fact that a comprehensive Safety Instruction Manual has been submitted by the proposed driller that covers safety, environmental responsibilities, (*see* Sect. 42-103);

2. Specific well control equipment (see Sect. 42-143) (4-ram blowout preventer with casing shears is in excess of API Standard 53, Fourth Edition which is the RRC standard. Our clients are prepared to comply with API Standard 53)¹ (*see id.*); and
3. A third-party technical advisor to the city—at a cost of over \$11,000 to the Operator to date—to review applications, plans, documentation, and operations associated with the oil and gas drilling and advise the City (*see* Sect. 42.81, SUP Sect. 4). We understand that Applicant has agreed to pay these expenses as long as a permit is issued without having to expend additional review, technical or legal fees.

These ordinances, if enforced, are prohibited in HB-40 because (1) the ordinances attempt to regulate specific oil and gas operations that are already covered by existing Railroad Commission (“RRC”) and Texas Commission on Environmental Quality (“TCEQ”); and (2) the ordinances are commercially unreasonable and prohibit Mr. Watkins from fully and economically exploiting his mineral rights. The city’s attempt to regulate these detail aspects of oil and gas operations encroaches on the exclusive jurisdiction of the RRC and TCEQ.

Our opinion is shared by the Texas Oil and Gas Association (“TXOGA”), which expressed concern in an April 7, 2016 letter that League City’s action would be “in direct conflict with existing state law.” *See* April 7, 2016 Letter, attached as Exhibit 1. Our firm represented TXOGA in litigation challenging attempts by Denton, Texas to regulate oil and gas operations, which resulted in Denton’s repeal of its entire ordinance despite incurring extensive attorneys’ fees in the litigation.

We hope that a similar lawsuit will not be necessary here, as both our clients and League City would benefit by avoiding expensive, protracted litigation. However, if our client is forced to challenge the enforceability of League City’s ordinances because they are impeding legitimate oil and gas development, we intend to seek the recovery of all attorneys’ fees, costs, and expenses related to the enforcement of HB-40.

With those considerations in mind, we respectfully request that League City consider appropriate variances for items 1 and 2 identified above to comply with HB-40. In addition, we would like for the City Manager be empowered to use reasonable business judgment in granting and administering a permit and monitoring the drilling of a well or wells.

¹ The city’s own technical advisor, Robert Taylor, of TEACUPS, raised concerns about the availability of a four-ram BOP with casing shears for land-based drilling given the departure from standard industry practice and regulations promulgated by the Texas Railroad Commission.
Active 35228058.1

BAKER BOTTS LLP

Mr. John Baumgartner

- 3 -

April 14, 2017

If you have any questions, my direct line is 713.229.1736 or you may contact my colleague, Louie Layrisson, at 713.229.1421.

Very truly yours,

A handwritten signature in black ink, appearing to read "Bill Kroger", with a large, stylized loop at the end.

Bill Kroger

Attachment

Exhibit 1



TEXAS OIL & GAS ASSOCIATION | SINCE 1919

Jonny Jones
Chairman

D. Todd Staples
President

April 7, 2016

The Honorable Pat Hallisey
Mayor
City of League City
300 W. Walker
League City, Texas 77573

Sent via e-mail: pat.hallisey@leaguecity.com

Dear Mayor Hallisey:

Thank you for your service to the citizens of League City. The Texas Oil and Gas Association is committed to both vibrant cities and a strong Texas. We want to partner with cities to continue to bring jobs and investment to our state, all while protecting and promoting public safety.

We have observed the City is contemplating action under an ordinance that regulates certain oil and gas activity. Please know it is our opinion this action would be in direct conflict with existing state law. The Texas Legislature wisely affirmed that cities should regulate issues like traffic, noise, and lights, but the regulation of oil and gas operations is governed by the State in order to ensure there are consistent safety standards.

The Texas Railroad Commission ("RRC") has been delegated broad authority to address items of safety and has the scientific staff to ensure compliance. We believe the City should work with the RRC to address the oil and gas activity on which the City is focused.

We want to collaborate with League City to make decisions that are within legal bounds and ensure that mineral and property owners are able to exercise their constitutional rights. We do want a successful and positive outcome for all parties.

Please let me know if you would like to discuss this matter further.

Sincerely yours,

A handwritten signature in black ink that reads "Todd Staples". The signature is written in a cursive, flowing style.

Todd Staples
President

cc: The Honorable Dan Becker, City Council Position 1
The Honorable Hank Dugie, City Council Position 2
The Honorable Heidi Hansing, City Council Position 3
The Honorable Todd Kinsey, City Council Position 4
The Honorable Geri Bentley, Mayor Pro Tem, City Council Position 5

The Honorable Pat Hallisey
April 7, 2016
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The Honorable Keith Gross, City Council Position 6
The Honorable Nick Long, City Council Position 7
The Honorable Nghiem Doan, City Attorney
The Honorable Mark Rohr, City Manager

2 May 2017

By Hand Delivery

Paul Menzies
Director of Planning
City of League City
300 West Walker
League City, TX 77573

Re: Tidwell Permit

Mr. Menzies:

We respectfully request that the City move forward expeditiously with the variance request necessary to enable us to drill our well. As noted in our prior letters we are asking that the City accept the safety plans that have been submitted as sufficient to satisfy Section 42-103 of the Drilling Ordinance. In addition we are asking that the City recognize and accept the Well Control equipment requirements that are required by the Texas Railroad Commission per API Standard 53, 4th Edition as referenced by your consultant. Upon notice of an approved permit the state permit will be updated, the Bond and General insurance requirements and the permit fee will be tendered.

Pursuant to our meeting on April 26, 2017, we are in agreement with your request to forward the permit application package that has been submitted to Lloyds Register for review and comment. The agreement to proceed is conditioned on the items listed below to be addressed as a part of the review and evaluation.

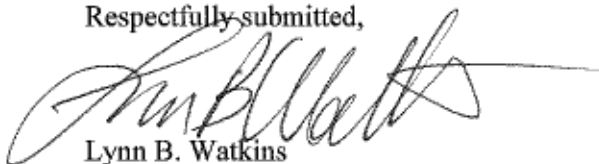
Reviewer is to comment on whether the overall completeness and thoroughness of the Safety Instruction Manual (SIM) submitted appears to be consistent with industry standards for land based drillers in the State of Texas and whether it appears to be sufficient to assure a reasonably safe and environmentally sound drilling process.

Reviewer is to comment if in his opinion the SIM meets or exceeds the conditions that quality drillers utilize in safely drilling land based wells in the State of Texas.

Reviewer is to indicate the number of onshore wells drilled in the State of Texas that reviewer is aware of where a four ram BOP with casing shears was used. In addition the reviewer is to furnish the approximate number of land based wells drilled in the same time period that utilized a BOP consistent with the requirements of API Std. 53, 4th Edition, which is the standard set out by the Texas Railroad Commission.

We ask that the supplemental package be submitted to Lloyd's along with a request that the items listed above be addressed.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Lynn B. Watkins", is written over the typed name.

Lynn B. Watkins

Menzies, Paul

From: Doan, Nghiem <nghiem.doan@leaguecitytx.gov>
Sent: Thursday, May 04, 2017 5:17 PM
To: Menzies, Paul
Cc: Baumgartner, John
Subject: RE: Watkins drilling permit

Paul,

I have reviewed Lynn Watkins' letter dated May 2, 2017 as well as the letter from Baker Botts dated April 14, 2017. As I understand them, the remaining issues with Lynn's drilling permit application are the City's requirement of a SEMS plan and a 4-ram BOP. This discussion occurs against the backdrop of HB 40, codified in Sec. 81.0523 of the Natural Resources Code, below:

Sec. 81.0523. EXCLUSIVE JURISDICTION AND EXPRESS PREEMPTION. (a) In this section:

(1) "Commercially reasonable" means a condition that would allow a reasonably prudent operator to fully, effectively, and economically exploit, develop, produce, process, and transport oil and gas, as determined based on the objective standard of a reasonably prudent operator and not on an individualized assessment of an actual operator's capacity to act.

(2) "Oil and gas operation" means an activity associated with the exploration, development, production, processing, and transportation of oil and gas, including drilling, hydraulic fracture stimulation, completion, maintenance, reworking, recompletion, disposal, plugging and abandonment, secondary and tertiary recovery, and remediation activities.

(b) An oil and gas operation is subject to the exclusive jurisdiction of this state. Except as provided by Subsection (c), a municipality or other political subdivision may not enact or enforce an ordinance or other measure, or an amendment or revision of an ordinance or other measure, that bans, limits, or otherwise regulates an oil and gas operation within the boundaries or extraterritorial jurisdiction of the municipality or political subdivision.

(c) The authority of a municipality or other political subdivision to regulate an oil and gas operation is expressly preempted, except that a municipality may enact, amend, or enforce an ordinance or other measure that:

(1) regulates only aboveground activity related to an oil and gas operation that occurs at or above the surface of the ground, including a regulation governing fire and emergency response, traffic, lights, or noise, or imposing notice or reasonable setback requirements;

(2) is commercially reasonable;

(3) does not effectively prohibit an oil and gas operation conducted by a reasonably prudent operator; and

(4) is not otherwise preempted by state or federal law.

(d) An ordinance or other measure is considered prima facie to be commercially reasonable if the ordinance or other measure has been in effect for at least five years and has allowed the oil and gas operations at issue to continue during that period.

As you can see, our regulations pass muster if they can meet the four elements of (c). The crux is element (2) commercially reasonable, defined as "means a condition that would allow a reasonably prudent operator to fully,

effectively, and economically exploit, develop, produce, process, and transport oil and gas, as determined based on the objective standard of a reasonably prudent operator and not on an individualized assessment of an actual operator's capacity to act." Despite what Lynn and his lawyer might assert, "commercially reasonable" means not what a reasonably prudent operator would CHOOSE to do voluntarily, but rather that which would still ALLOW a reasonably prudent operator drill and extract oil/gas. This test also expressly disallows an individualized assessment of the actual operator's capacity (or willingness) to meet the requirements, such that Orion's refusal to provide a SEMS is irrelevant to this discussion.

Applied to our facts, while a reasonably prudent operator might not choose to provide a SEMS or a 4-ram BOP, the question is whether those requirements would effectively PREVENT a reasonably prudent operator from drilling and extracting oil/gas. In my opinion, I do not believe that these requirements pose such a hurdle. For example, Lynn readily admits that the Bureau of Land Management (BLM) requires 4-ram BOPs for operations on BLM land. That is very strong proof that such a requirement does NOT prevent oil/gas operations. Even if Lynn's assertion that there is no BLM land in Texas were true, that does not render said requirement commercially unreasonable.

I would also point to the presumption provided by Sec. 81.0523 (d): An ordinance or other measure is considered prima facie to be commercially reasonable if the ordinance or other measure has been in effect for at least five years and has allowed the oil and gas operations at issue to continue during that period. The City's requirements of a SEMS plan and 4-ram BOP have been in effect since 2011, and during that time a similar oil/gas operation was able to be carried out (Langley) in the city. Therefore, I believe that these requirements are prima facie commercially reasonable.

Regarding the questions to submit to Lloyds, Lynn's proposed questions do not help the "commercially reasonable" analysis. If we were to ask Lloyds about our requirements, I would ask:

- 1) Are SEMS plans ever prepared for land oil/gas operations?
- 2) If so, what percentage of land oil/gas operations provide a SEMS?
- 3) What jurisdictions, if any, require a SEMS for land oil/gas operations?
- 4) Do land oil/gas operations take place in said jurisdictions?
- 5) Are 4-ram BOPs ever provided for land oil/gas operations?
- 6) If so, what percentage of land oil/gas operations provide 4-ram BOPs?
- 7) What jurisdictions, if any, require 4-ram BOPs for land oil/gas operations?
- 8) Do land oil/gas operations take place in said jurisdictions?

Nghiem V. Doan
City Attorney
City Attorney's Office
City of League City
300 W. Walker St.
League City, Texas 77573
Phone: 281-554-1003