



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751
ANTITRUST: 296-3299

September 30, 1986

ATTORNEY GENERAL OPINION NO. 86-138

The Honorable Roy M. Erlich
State Senator
Thirty-Fifth District
Route 1, Box 92
Hoisington, Kansas 67544

Re: Oil and Gas--Oil and Gas Wells;
Regulatory Provisions--Use of Conservation
Fee Funds

Synopsis: Under its police power, a state may reimburse itself for the cost of regulating and supervising a business by assessing the necessary expenses to the business which created the necessity for such regulation and supervision. Use of conservation fee fund monies for the prevention and cleanup of pollution from oil and gas activities regulated by the state corporation commission is sufficiently related to the regulatory function to make its use for such purposes a valid exercise of the police power. The conservation fee fund may be used to fund the study and cleanup of oil and gas pollution pursuant to section 37 of 1986 House Bill No. 3078 (K.S.A. 55-143, as amended by 1986, ch. 201, § 37), to the extent that such study and cleanup are reasonably related to those activities of the oil and gas industry which are regulated by the commission.

Use of the conservation fee fund by the state corporation commission for those oil and

gas activities it does not regulate (as authorized by K.S.A. 55-143, as amended by L. 1986, ch. 201, § 37, which references subsection (a)(2)(A) of K.S.A. 65-171d, as amended by L. 1986, ch. 201, § 22), is contrary to the findings of the Kansas Supreme Court in Panhandle Eastern Pipeline v. Fadeley. Such use exacts revenue from the oil and gas industry under the guise of a regulatory fee in violation of article 11, section 1 of the Kansas Constitution, and the commerce clause and the Fourteenth Amendment of the United State Constitution. Cited herein: Kans. Const., Art. 11, § 1; U. S. Const., Fourteenth Amendment; K.S.A. 55-131; 55-143; 65-171d, as amended by L. 1986, ch. 33, § 10(f); L. 1986, ch. 201, §1, 2, 10, 17, 22, 28, 37, 39 and 40; and K.A.R. 28-41-1.

* * *

Dear Senator Erlich:

You have asked for our opinion regarding the legality of using the conservation fee fund (Fund) of the state corporation commission (commission) for purposes not considered "regulating" the oil and gas industry under Panhandle Eastern Pipeline v. Fadeley, 183 Kan. 803 (1958). In conjunction with that question, the following issues are also raised.

1. Is pollution control sufficiently related to the regulatory function to make it a valid exercise of the police power?
2. Can regulatory fees in the Fund be used to fund the study and clean up of oil and gas pollution?
3. Is the use of the Fund to clean up pollution not regulated by the commission a valid exercise of the police power?

In your request letter you indicate that there have been two major withdrawals or transfers by the legislature from the commission's conservation fee fund for purposes other than "regulating" the oil and gas industry. The first withdrawal was for \$100,000 as authorized by the legislature in 1985 for the first phase of a study of the Dakota aquifer promoted by the Kansas Water Office and undertaken by the

Kansas Geological Survey pursuant to a contract with the commission. The second was pursuant to 1986 House Bill No. 3161, the omnibus bill, which authorized the transfer of \$453,687 from the commission's conservation fee fund to the conservation fee fund of the department of health and environment (department). L. 1986, ch. 33, § 10(f).

The basic question you have presented is whether it is legal to use the Fund for purposes not considered "regulating" the oil and gas industry under the Panhandle Eastern Pipe Line Co. v. Fadeley, id.

Under 1986 House Bill No. 3078 (L. 1986, ch. 201), the fund must be used to regulate oil and gas activities, including (1) exploration for and gathering of oil and gas and the drilling, production, lease storage, treatment, abandonment and post-abandonment of oil and gas wells, except refining, treating or storing of oil and gas after transportation; and (2) prevention and cleanup of pollution of oil and gas activities, which jurisdiction shall be exercised in cooperation with the department. L. 1986, ch. 201, § 1(a). Subsection 1(b) provides that the department shall have jurisdiction and authority relating to the cleanup of pollution from oil and gas activities to be exercised in cooperation with the commission pursuant to a memorandum of understanding entered into between the two agencies (See L. 1986, ch. 201, § 38). The transfer of certain powers to the commission are presented in section 1(c) which provides:

"The state corporation commission shall be the successor in every way to the powers, duties and functions of the bureau of oil field and environmental geology of the Kansas department of health and environment relating to the authority to regulate oil and gas activities, which activities shall include all practices involved in the exploration for and gathering of oil and gas and the drilling, production, lease storage, treatment, abandonment and postabandonment of oil and gas wells. Every act performed in the exercise of such powers, duties and functions by or under authority of the state corporation commission shall be deemed to have the same force and effect as if performed by the department of health and environment."

The transfer of funds from the department to the commission is address in L. 1986, ch. 201, § 2. It states in part:

"On the effective date of this act, the balance of all funds appropriated and reappropriated to the department of health and environment for the activities of the bureau of oil-field and environmental geology of the department of health and environment relating to the protection of surface water and groundwater from pollution by oil and gas activities, which activities shall include all practices involved in the exploration for oil and gas and the drilling, production, lease storage, treatment, abandonment and postabandonment of oil and gas wells and salt water disposal or injunction wells are hereby transferred to the state corporation commission and shall be used only for the purpose for which the appropriation was originally made."

The use of the conservation fee fund is statutorily detailed in K.S.A. 55-143, as amended by L. 1986, ch. 201, § 37, which provides in pertinent part:

"There is hereby created in the state treasury the conservation fee fund. All deposits credited to the conservation fee fund shall be for the use of the state corporation commission in administering the provisions of K.S.A. 55-128 to 55-142, inclusive, 55-601 to 55-613, inclusive, 55-701 to 55-713, inclusive, 55901, 55-902 and 55-1201 to 55-1206, inclusive, and subsection (a)(1) and subsection (a)(2)(A) of K.S.A. 66-171d, and amendments thereto, and sections 24 to 36, inclusive, of this Act. All expenditures from the conservation fee fund shall be made in accordance with appropriation acts upon warrants of the director of accounts and reports issued pursuant to vouchers approved by the chairperson of the state corporation commission or by a person or persons designated by the chairperson. The corporation commission, with the approval of the director of accounts and reports, shall formulate a system of accounting procedures to account for the money credited to the conservation fee fund pursuant to this section." (Emphasis added, new provisions.)

Although 1986 House Bill No. 3078, among other things, deleted the concurrent regulatory jurisdiction previously granted to the department pursuant to chapter 55 of the Kansas Statutes Annotated, it authorized the commission to utilize the Fund to pay for cleanup of pollution resulting

from oil and gas activities by the department whether or not it resulted from oil and gas activities regulated by the commission.

In the Panhandle case, it was the company's contention that the legislature's transfer of \$100,000 from the unexpended balance of the natural gas conservation fund of the state corporation commission to the general fund, and its decision to transfer twenty percent of all future funds to the general fund, constituted an attempt to raise revenue under the guise of police power. It was further argued that this constituted a discriminatory burden on interstate commerce, deprived the company of its property without due process of law and denied it equal protection in contravention of the Fourteenth Amendment of the United States Constitution and article 11, section 1 of the Kansas constitution. In declaring the act invalid, the court held:

"Under its police power, the state may reimburse itself for the cost of regulating and supervising a business or commodity by assessing the necessary expenses to such business or commodity which created the necessity for such regulation and supervision." Syl. ¶ 1.

"Where a statute which purports to assess expenses of regulation and supervision shows on its face that some part of the exaction is to be used for other purposes, the police power is exceeded and the statute is void." Syl. ¶ 2.

The statutes involved in Panhandle directed that \$100,000 from the unexpended balance of the commission's natural gas conservation fund and twenty percent of all costs collected by the commission pursuant to the natural gas conservation act be transferred to the state general fund. These statutes showed on their faces that the amounts transferred were to be used indiscriminately for the general expenses and obligations of the state. Only the remaining eighty percent of the collections went to a special fund for the use of the commission in administering the provisions of the statutes. The Panhandle case held that the police power of a state is exceeded if the statute purports to assess expenses for regulation and supervision but on its face shows that part of the exaction is to be used for other purposes. 183 Kan. at 808.

Panhandle does not directly apply to the question posed here because it deals with the constitutionality of statutes which show on their face that the regulatory fees are to be used for purposes other than regulation and supervision. That issue will be addressed later. The case is relevant, however, in a more general sense, to the extent it describes what constitutes a valid exercise of police power.

The pronouncement in Syllabus ¶ 1 of Panhandle, supra, regarding the police power of the state to charge regulatory fees is not new. In State, ex rel. v. Cuminskey, 97 Kan. 343 (1916), the Kansas Supreme Court considered the validity of a law requiring inspection of petroleum products and prescribing a schedule of inspection fees, one-half of which were to be retained by the inspectors as compensation for their services, and the balance paid to the state treasurer. The court stated:

"As an incident of the police power the state may reimburse itself for the cost of inspection by charging the necessary expense upon the business or commodity creating the necessity for inspection. When, however, adequate remuneration has been secured the police power is exhausted." 97 Kan. at 352.

It was held that the fees grossly exceeded the amount required to effectuate the lawful purposes of the act, constituted revenue raising measures and were therefore void.

The rule announced in Cuminskey has been repeatedly recognized. In State, ex rel., v. Ross, 101 Kan. 337 (1917), the court found that the fees required of exhibitors of motion picture films for inspection under a censorship statute was not disproportionate to the expenses of enforcement and did not turn the act into a revenue raising measure under the guise of police power. In its determination, the court considered not only the direct costs of inspection but also the incidental expenses that would be required. 101 Kan. at 381. See also City of Beloit v. Camborn, 182 Kan. 228 (1958).

The constitutionality of an ordinance requiring building contractors to pay fees for the occupancy of streets and sidewalks for storage during construction was considered in Watson v. City of Topeka, 194 Kan. 585 (1965). The court reasoned that the city could, under its exercise of police power, regulate the extent to which street and sidewalk space could be used for storage purposes because it was the city's responsibility to further the safety and general

welfare of its citizens. 194 Kan. at 589. The test used was whether the fees fixed by the ordinance were reasonably related to the expenses they were intended to pay. The court found that the fees charged for the use of the street and sidewalk space bore no reasonable relationship to the costs of inspection and therefore exceeded the police powers of the state. As a revenue raising measure, the ordinance violated article 11, section 1 of the Kansas constitution which provides that the legislature shall provide for the uniform and equal rate of assessment and taxation.

In Fidelity Investment Co. v. Hale, 212 Kan. 321 (1973), a mortgage banker engaged in real estate loans challenged the application and validity of the truth-in-lending act, particularly that part requiring annual payment of a fee based on volume of business. The defendant banker argued that the fee was a revenue raising measure because twenty percent of the fees went to the state general fund to be used indiscriminately by the state. The court found that the fees collected were a reasonable reimbursement for supportive services performed for the regulatory agency and that these services were applicable to the consumer credit commission which enforced the truth-in-lending act.

The Kansas cases on the subject of regulation deal with whether the fees charged exceed the costs of regulating (the "how much" question), i.e., whether the fees charged are reasonably related to the costs of regulation thus making them a valid exercise of police power. However, none of them address the specific question of whether the purpose for which the fees are being charged is reasonably related to regulating (the "what for" question). It is our opinion that the purpose for which the fees are charged must be reasonably related to regulating the industry in order for the assessment to be a valid exercise of police power. The question thus becomes whether pollution control is sufficiently related to the regulatory function to make it a valid exercise of the police power.

In searching other jurisdictions, the most enlightening case found on the subject comes from New Hampshire. In the Opinion of the Justices, 117 N.H. 749, 379 A.2d 782 (1977), the New Hampshire Supreme Court addressed the question of using license fees to fund an oil pollution control fund. The questions propounded by the senate to the justices included:

1. "Can the general court within the provisions of the constitution of New Hampshire enact a

statute as proposed by House Bill 439, which provides for the establishment of an oil pollution control fund to be funded by license fees, penalties or other fees and charges [sic] generated by the chapter as well as any federal or other funds which are made available for the purposes of oil pollution control?"

2. "Can the general court impose a contingent annual license fee on an operator of an oil terminal facility having a storage capacity in excess of 500 barrels, within the framework of the provisions of the constitution of New Hampshire?"

3. "Would the provisions of this bill impose any unwarranted restrictions on interstate commerce in violation of the commerce clause of the constitution of the United States?"

4. "Would any provision of the constitution of the United States or of this state be violated by the provisions of this bill?" 379 A.2d at 785, 786.

In pertinent part, the court found that license fees could be used to fund an oil pollution control program and that there was no apparent violation of either the federal or state constitutions apparent on the face of the proposed statute. This case allows regulatory fees to fund pollution control and clearly establishes a reasonable relationship between pollution control and the regulatory function.

Although there is no specific language actually stating that pollution control is a regulatory function, that conclusion is inescapable. That there exists a reasonable relationship between oil pollution control and regulation is implicit in this case.

Another case generally consistent with the reasoning in the New Hampshire case is State v. Washington State Utilities & Transportation, 93 Wash. 2d 398, 609 P.2d 1375 (1980). It deals with amounts expended by the state in defending and paying judgments in tort claims involving grade railroad crossing accidents. Plaintiff railroad companies charged that these costs were not regulatory costs

and not properly chargeable to the regulation of the industry. They sought therefore to prevent reimbursement of these costs from the railroad regulatory fee account. The question addressed in this case was whether these legal expenses could properly be considered a cost of regulating the industry. 609 P.2d at 1380. The court noted that the costs were a result of the commission not requiring more adequate safeguards at crossings (i.e., the commission's failure to regulate). The administrative costs of determining what grade crossing devices were to be used were to be paid by the separate Grade Crossings Protection Fund and not funded by regulatory industries through the Public Service Revolving Fund. The court found that it was not reasonable to expect the industry to reimburse the state for the state's failure to adequately govern the industry's actions. The court explained that regulatory fees were not in this instance available to benefit a third party not directed regulated and not included within the commission's regulatory power, and the legal expenses were not demonstrated by the state to be a reasonable cost of regulation. 609 P.2d at 1382.

The analysis in this case would apply in our present situation if the commission were attempting to use the conservation fee fund to pay an individual third party for damages as a result of oil pollution. Our case, however, is more akin to the state seeking reimbursement for the cost of supervising railroad grade crossings in order to make them safe. This is at least implicitly sanctioned under State v. Washington, 609 P.2d at 1381, 1382, where the court states:

It may not be reasonable to expect the industry to reimburse the state for the state's failure to adequately govern the industry's actions, particularly in the absence of proof of Commission involvement, even though the industry might be compelled to pay for additional Commission regulation that might prevent the state's liability. (Emphasis added).

By analogy, using the conservation fee fund to reimburse the state for the costs of making the environment safe from pollution resulting from oil and gas activities would be reasonably related to regulation and supervision of the industry.

Pollution is an incidental consequence likely to subject the public to some cost resulting from activities of

the business licensed. From our research, the payment of social costs attributable to the oil and gas industry as a regulatory function has not been addressed. In so far as pollution deals with public health, however, the state may exercise its police power to enact laws to promote and preserve public health. 39A C.J.S. Health and Environment § 5.

With the exception of the Opinion of the Justices case in New Hampshire, supra, we find no cases addressing the question of whether oil pollution is reasonably related to the regulatory function. To "regulate" is "[t]o fix, establish or control; to adjust by rule, method, or established mode; to direct by rule or restriction; to subject to governing principles or laws." Black's Law Dictionary, Revised Fourth Edition. That the legislature wanted and intended Fund monies to be used by the commission to regulate oil and gas activities and cleanup of pollution from those activities is clear from the language of K.S.A. 55-143, both prior to and after being amended by L. 1986, ch. 201, § 37. Although you have suggested that "cleanup, protection, and remedial activity" are not synonymous with "regulating" the industry, the key question is whether or not those activities are reasonably related to the business responsible for the need for regulation. In this instance, those activities appear to fall within the regulatory authority the legislature intended the commission to have. At this point it should be noted that our discussion focuses solely upon those activities referenced in section 37 which are regulated, as opposed to those not regulated, by the commission, and which are referenced therein [K.S.A. 65-171d, as amended by L. 1986, ch. 201, § 22(a)(2)(A)].

We are satisfied that use of the conservation fee fund for pollution control necessitated by oil and gas activities regulated by the commission is sufficiently related to the commission's regulatory function to make its use for such purposes a valid exercise of the police power. Conversely, it is our opinion that to use Fund money for purposes other than such regulatory functions is an invalid application of the police power. Such a use would make the regulatory fees a revenue measure in violation of article 11, section 1 of the Kansas constitution and the Fourteenth Amendment of the United States Constitution.

You also inquire whether regulatory fees in the Fund may be used to fund the study and cleanup of oil and gas pollution. For the reasons previously addressed, we are satisfied that the conservation fee fund may be used to fund

the study and cleanup of oil and gas pollution as provided by section 37 of L. 1986, ch. 201 to the extent that they are reasonably related to regulation and the prevention and cleanup of pollution arising from the activities of the oil and gas industry (L. 1986, ch. 201, § 1). For example, a situation where fifty percent of a study was reasonably related to oil and gas activities regulated by the commission, and the other fifty percent to agricultural contamination, only that portion spent on studies involving oil and gas activities regulated by the commission could be drawn from the Fund. To do otherwise would amount to a invalid application of the police power.

Finally, you ask whether the use of the Fund to cleanup pollution resulting from oil and gas activities not regulated by the commission is a valid exercise of the police power.

Prior to the enactment of L. 1986, ch. 201, the department had certain regulatory authority pursuant to chapter 55 of the Kansas Statutes Annotated, K.S.A. 65-171d and as further detailed in K.A.R. 28-41-1 et seq. Although the department no longer has independent regulatory authority (L. 1986, ch. 201), it does have authority in cooperation with the commission to clean up pollution from oil and gas activities regulated by the commission. K.S.A. 65-171d, as amended by L. 1986, ch. 201, § 22(a)(1).

The specific question presented is whether the inclusion of subsection (a)(2)(A) of section 22 of L. 1986, ch. 201, authorizing protection from oil and gas activities not regulated by the commission goes beyond the authority of the legislature under its police powers. From the reasoning previously noted in an analogous situation in Panhandle, supra, regarding a statute dealing with commission funds (K.S.A. 55-131) and use of Fund monies generated through regulatory fees and assessments pursuant to various statutory provisions (L. 1986, ch. 201, §§ 10, 17, 28, 39 and 40), it appears that the legislature exceeded its authority under its police powers.

In holding that the enactment amounted to a "tax and a revenue measure levied under the guise of a regulatory fee," the court in Panhandle found that it violated article 11, section 1 of the state constitution and the commerce clause of the Fourteenth Amendment of the United States Constitution. 183 Kan. at 808. In declaring segments of the objectional statutes void, the court stated that where a statute which purports to assess expenses of regulation and supervision

shows on its face that some part of the exaction is to be used for other purposes, the police power is exceeded. id. at Syl. ¶ 2.

In the instant situation, use of the conservation fee fund is broadened by section 22 of L. 1986, ch. 201 to cleanup not only oil and gas activities regulated by the commission, but also such activities not regulated by it. This amendment clearly represents a substantial expansion in the prior law which did not specifically authorize use of those funds for other than regulatory activities. Thus, we are of the belief that the inclusion of subsection (a)(2)(A) of K.S.A. 65-171d, as amended by L. 1986, ch. 201, § 22, and referenced in section 37 of that act (allowing utilization of commission conservation fee fund monies available to the department for activities not regulated by the commission), amounts to a revenue enactment which fails as a valid exercise of the police power. On its face that section shows that the Fund money is to be used for purposes totally unrelated to regulatory purposes within the commission's jurisdiction.

In conclusion, under its police power, a state may reimburse itself for the cost of regulating and supervising a business by assessing the necessary expenses to the business which created the necessity for such regulation and supervision. Use of conservation fee fund monies for the prevention and cleanup of pollution from oil and gas activities regulated by the state corporation commission is sufficiently related to the regulatory function to make its use for such purposes a valid exercise of the police power. The conservation fee fund may be used to fund the study and cleanup of oil and gas pollution pursuant to section 37 of 1986 House Bill No. 3078 (K.S.A. 55-143, as amended by 1986, ch. 201, § 37), to the extent that such study and cleanup are reasonably related to those activities of the oil and gas industry which are regulated by the commission.

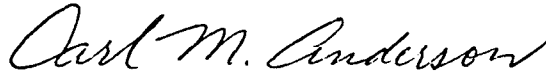
Use of the conservation fee fund by the state corporation commission for those oil and gas activities it does not regulate (as authorized by K.S.A. 55-143, as amended by L. 1986, ch. 201, § 37), which references subsection (a)(2)(A) of K.S.A. 65-171d, as amended by L. 1986, ch. 201, § 22), is contrary to the findings of the Kansas Supreme Court in Panhandle Eastern Pipeline v. Fadeley. Such use exacts revenue from the oil and gas industry under the guise of a regulatory fee in violation of article 11, section 1 of the Kansas constitution, and the commerce clause and the Fourteenth

Amendment of the United States Constitution.

Very truly yours,

A handwritten signature in cursive script, reading "Robert T. Stephan". The signature is written in dark ink and is positioned above the printed name.

ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS

A handwritten signature in cursive script, reading "Carl M. Anderson". The signature is written in dark ink and is positioned above the printed name.

Carl M. Anderson
Assistant Attorney General

RTS:CMA:sb