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FISCAL IMPACT REPORT

ORIGINAL DATE 03/07/11

SPONSOR HENRC LAST UPDATED _____ HB CS/297/HENRCS

SHORT TITLE Temporary Abandonment of Oil and Gas Wells SB _____

ANALYST Hoffmann

APPROPRIATION (dollars in thousands)

| Appropriation | | Recurring or Non-Rec | Fund Affected |
|---------------|------|-------------------------|------------------|
| FY11 | FY12 | | |
| NFI | NFI | | |

(Parenthesis () Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

| Estimated Revenue | | | Recurring or Non-Rec | Fund Affected |
|-------------------|------|--|-------------------------|--------------------------------------|
| FY11 | FY12 | FY13 | | |
| | | Indeterminate, but likely positive. See "Fiscal Implications" | Recurring | General Fund & Severance Taxes |

(Parenthesis () Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY11 | FY12 | FY13 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|--------------|------|---------|---------|----------------------|-------------------------|------------------|
| Total | | \$100.0 | \$100.0 | \$200.0 | Nonrecurring | General Fund |

(Parenthesis () Indicate Expenditure Decreases)

Conflicts with House Bill 176

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy, Minerals and Natural Resources Department (ENMRD)

SUMMARY

Synopsis of Bill

The House Energy and Natural Resources Committee substitute for the House Business and Industry Committee Substitute for House Bill 297 (CS/297HENRCS) would require the Oil Conservation Division (OCD) of the Energy, Minerals and Natural Resources Department (EMNRD) to promulgate and adopt new rules dealing with a) the inactive status and temporary abandonment status of wells, and b) enforcement and compliance.

The OCD must adopt the new rules by December 31, 2011, and the secretary of EMNRD must adopt a schedule for rulemaking, incorporating opportunity for public input and stakeholder negotiations.

In adopting the new rules the OCD shall consider whether the new rules:

- a. adequately address the time period for which a well is granted approved temporary abandonment status so as to provide an operator with a sufficient amount of time to manage its portfolio of wells;
- b. prevent a well with future beneficial use from being prematurely plugged and abandoned;
- c. require that a well is mechanically and physically sound so as to provide a satisfactory level of environmental protection that considers the individual characteristics of the well, including location, age, well design, current condition and repair history;
- d. allow for variations based on the size of the operator; and
- e. are based on the best available scientific information.

FISCAL IMPLICATIONS

As discussed below, the rulemaking required by HB CS/297/HENRCS is extensive, requiring not only a review of 19.15.25 NMAC (the current rules on inactive wells, plugging and temporary abandonment) and 19.15.5 NMAC (the current enforcement and compliance rule), but also the rules that reference those rules and are tied to their provisions. Depending on the rule changes made, the OCD may need to make changes to its administrative processes and changes to its database, which is currently set up to recognize inactive wells and wells on approved temporary abandonment status as set out in the current rules, and to track compliance under the existing compliance rules. The exact cost of these changes is unknown, however the OCD estimates the costs to be approximately \$200,000 spread out over two years.

The revenue table on page 1 shows a potential positive impact on state revenues beginning in FY13. The specific revenue streams that would increase, and the applicable rates are the Oil and Gas Severance Tax at 3.75%, the Oil and Gas Emergency School Tax at 3.15%, and the Oil and Gas Conservation Tax at 0.19%. This positive forecast is based on the assumption that the change proposed by CS/297/HENRCS would result in a larger inventory of wells that could be re-commissioned to production status and beneficial use as national demand for oil increases in the future.

SIGNIFICANT ISSUES

Since 1935, the Oil Conservation Commission has been charged with preventing oil, natural gas and water from escaping from the strata in which they are found into other strata. See Laws of New Mexico, 1935, Ch. 72, Section 10, now found at NMSA 1978, Section 70-2-12(B). The migration of oil, gas and water can cause waste of our oil and gas resources, and contaminate our fresh drinking water.

Inactive wells that are not properly plugged can act as conduits for the migration of oil, gas and water. In 1990, the Oil Conservation Commission adopted a regulatory structure for addressing inactive wells (Order No. R-9210). That basic structure has remained in place for over 20 years. The current version of the rules is found at 19.15.25 NMAC. The rules provide that after 15 months of inactivity, a well must be plugged or placed on “approved temporary abandonment” status (shorter time periods apply if drilling operations are suspended or if a determination is made that a well is no longer usable for beneficial purposes). 19.15.25.8 NMAC. To place a well on approved temporary abandonment status, the operator must demonstrate that the well has mechanical integrity by 1) passing one of the mechanical integrity tests described in the rule; 2) demonstrating that the well has been completed for less than five years and has not been connected to a pipeline; or 3) using another testing method proposed by the operator and approved by the OCD. A well may be placed on approved temporary abandonment for a period up to five years. An operator may apply for additional periods of temporary abandonment, but must again demonstrate that the well has mechanical integrity.

The rules on inactive wells and temporary abandonment status are enforced in two ways under current statutes and rules. First, the OCD may order an operator to plug the well, and the OCD may plug the well, forfeit the applicable financial assurance, and seek reimbursement from the operator if the applicable financial assurance is insufficient. This remedy is set out in the Oil and Gas Act. Second, the OCD may, and in some circumstances must, deny certain privileges to operators who are seriously out of compliance with its rules (including the rule regarding inactive wells). See 19.15.5.9 NMAC. See also 19.15.14.10 NMAC; 19.15.9.9 NMAC; 19.15.26.8 NMAC; 19.15.26.8 NMAC; and 19.15.16.19 NMAC.

Approximately 3270 wells in New Mexico have been inactive for more than 15 months. Of those, approximately 1120 are on “approved temporary abandonment status,” and are being tested as required by existing rules. Approximately 2149 have been inactive for more than 15 months but are not on “approved temporary abandonment status,” and are not being tested as required by existing rules.

The OCD makes the following observations regarding CS/297/HENRCS:

- 1) The issues regarding inactive wells, approved temporary abandonment, and the regulatory and administrative structure for enforcing rules on inactive wells and approved temporary abandonment are complex, and interrelated. Rulemaking allows for input by all stakeholders, and allows the regulatory agency to identify the issues of concern and explore possible solutions. It also allows the regulatory agency the opportunity to evaluate what effects the possible solutions will have on the regulatory structure and the administrative process of the agency.
- 2) There is no need for a statute to require rulemaking. Existing procedural rules allow the

Oil Conservation Commission, “the division, an operator or producer or other person” to initiate a rulemaking. See 19.15.3.8 NMAC. In response to an executive order requiring agencies to identify rules to be reviewed, the OCD identified its enforcement and compliance rules (which necessarily involve inactive well issues which are addressed by those rules).

- 3) There is no need for a statutory requirement for “an opportunity for public input and stakeholder negotiations”. Public input on OCD rulemaking is already required by OCD rules (see 19.15.3 NMAC), and stakeholder negotiations are often part of OCD rulemaking.
- 4) The deadline of December 31, 2011 will be difficult to meet. Once the session is over, the OCD will have approximately 9 months to conduct stakeholder meetings on the wide variety of issues it must consider under the statute, draft a rule, go through the public notice process, have a hearing, get an order, and publish in the New Mexico Register. If the December 31, 2011 deadline can be met, it will only be met by making this rulemaking the number one priority of the OCD. There are many other issues the OCD may need to address in the coming months.
- 5) CS/HB 297/HENRCS proposes to give OCD the authority and direction to adopt “new rules” on inactive and abandoned wells and on enforcement and compliance. Such rules already exist, 19.15.5 and 19.15.25 NMAC, and the authority for OCD to adopt rules on plugging and abandonment already exists in the statutes (See NMSA 1978, Section 70-2-12.B). It is unclear whether a statutory requirement to adopt “new rules” will mandate that OCD repeal and replace the existing rules instead of just making amendments.
- 6) CS/HB 297/HENRCS requires the OCD to “consider” various factors when adopting the rules. Each one will need to be addressed in the order adopting rules, and will form a basis for challenging the rules in the courts if an aggrieved party believes the issue was not given the consideration required by the statute. By focusing attention on the listed issues, it appears to give them precedence over other issues that the stakeholders and decision makers may wish to consider. The rulemaking process may lead to additional or very different concerns.
- 7) Some of the factors to be considered appear to be at odds with existing statutes. HB 297 requires the OCD to consider whether the new rules “prevent a well with future beneficial use from being prematurely plugged and abandoned.” NMSA 1978, Section 70-2-14(B) uses plugging as an enforcement tool, without regard to whether the well has future beneficial use. And a leaking well may have future beneficial use, but plugging may be necessary to prevent loss of resources and contamination of ground water.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 176 makes significant changes to the Oil and Gas Act, including changes to NMSA 1978, Section 70-2-14.

SB 30 would change procedures for adopting rules.

TECHNICAL ISSUES

CS/HB 297/HENRCS provides that if the operator of a well has financial assurance for that well as set forth in Subsection A of this section, the operator of a well shall have an opportunity to place the well in inactive status or temporary abandonment status. (See page 2, lines 24-25, and page 3, lines 1-3.) Currently, the OCD does not require federal wells to post financial assurances. Under a plain reading of the bill, federal wells would not have the opportunity to be placed on inactive status or temporary abandonment status.

CS/ HB 297/HENRCS seems to presuppose that there will be a new status for wells. (See Page 3, lines 1 and 2, saying that the operator “shall have an opportunity to place the well in inactive status”). Operators don’t place wells into inactive status, wells are regarded as inactive if they show no activity. “Approved inactive status” is a status proposed by some of the earlier versions of the bill. It is not a status currently recognized by OCD rules. Whether that status is necessary is better left for the rulemaking process.

CS/ HB 297/HENRCS uses phrases in manners inconsistent with their current definitions under OCD rules. Currently the rules make a distinction between a temporarily abandoned well (a well that is inactive) with a well that is on “approved temporary abandonment status” (an inactive well that is in compliance because it is being properly tested).

ALTERNATIVES

Rulemaking can be conducted without a statute setting deadlines and agendas.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The OCC/OCD will continue to address the dangers posed by unplugged inactive wells through its existing regulatory structure that requires the operator to demonstrate that the wells are mechanically sound by testing them at least every 5 years, and will continue to use its existing rulemaking process for evaluating and changing existing rules and adopting new rules.

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