

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (legis.state.nm.us). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

## FISCAL IMPACT REPORT

ORIGINAL DATE 02/17/11

SPONSOR Egolf LAST UPDATED \_\_\_\_\_ HB 176

SHORT TITLE Oil & Gas Act Enforcement SB \_\_\_\_\_

ANALYST Hoffmann

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY11	FY12		
	None		

(Parenthesis ( ) Indicate Expenditure Decreases)

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
<b>SLO-Total</b>	N/A	\$370.3+	\$368.3+	\$738.6+	Recurring	Oil and Gas Facilities Fund (new)  SLO - LGMF

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with House Bill 297

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Attorney General's Office (AGO) with the following disclaimer:

“This analysis is neither a formal Attorney General’s Opinion nor an Attorney General’s Advisory Opinion letter. This is a staff analysis in response to the agency’s, committee’s or legislator’s request.”

Energy, Minerals and Natural Resources Department (EMNRD)

State Land Office (SLO)

### SUMMARY

#### Synopsis of Bill

House Bill 176 proposes to amend the New Mexico Oil and Gas Act and the Geothermal

Resources Conservation Act (the Geothermal Act), both of which are administered by the Oil Conservation Division (OCD), to (1) provide clear authority to the OCD to assess civil penalties and outline the process for such assessments, (2) increase penalties for certain violations, (3) increase the amount of well-plugging and reclamation bonds required of oil and gas operators, and provide expressly that mineral owners and lessees, as well as operators, are responsible for well plugging and site remediation, (4) clarify the authority of the OCD to regulate discharges and potential discharges of water contaminants at oil and gas production and processing facilities, (5) clarify and expand the scope of the OCD's environmental powers, and (6) authorize expenditure of a portion of the Oil and Gas Reclamation Fund for acquisition of computer equipment and software in support of OCD reclamation activities.

*Enumeration of Powers:* **Section 1** of the bill amends the section of the oil and gas act that defines OCD's specific powers. It clarifies OCD's existing authority to adopt rules to protect public health, water, natural resources and the environment. Present law specifically authorizes OCD to adopt a variety of environmental rules, such as those governing disposition of produced water and oil field waste. The bill clarifies that the parameters of OCD's mandate to protect public health, surface water, ground water, natural resources and the environment encompasses all oil and gas operations. HB 176 further expands the authority of the OCD to include the authority to regulate the restoration and remediation of well production facilities, to require permits for certain activities related to Oil and Gas production, and to assess fees for the issuance of certain such permits.

*Bonding.* **Section 2** of the bill increases the amount of bonding an operator must furnish to assure that its wells will be properly plugged. Present law requires a \$50,000 blanket plugging bond for all of an operator's wells, regardless of the total number of wells operated in the state. The bill would change the bonding protocol from a "one-size-fits-all" approach to one that is correlated with the number of wells operated by the entity in New Mexico. The overall effect will serve to raise the bonding amount to \$5,000 per well, subject to a \$100,000 minimum and a \$1,500,000 maximum.

*Penalties:* **Sections 3 and 4** of the bill amend the penalty provisions of the Oil and Gas Act, and **Sections 9 and 10** of the bill make conforming changes to the Geothermal Act. These provisions:

(a) clearly set out OCD's authority to assess civil penalties by administrative hearing;

(b) eliminate the requirement that OCD prove that a violator acted "knowingly and willfully" in order to assess civil penalties;

(c) increase maximum civil penalty for discharge of water contaminants from \$1,000 per day (\$2,500 per day under the Geothermal Act) to \$10,000 per day; and

(d) increase penalties for criminal violations defined in the Oil and Gas Act from \$10,000 per day to \$15,000 per day.

**Section 5** relates to definitions.

*Reclamation Fund Changes.*

**Section 6** concerns the Oil and Gas Reclamation Fund, the fund OCD administers to plug abandoned wells and clean up abandoned oil and gas sites.

The bill makes two changes – it allows expenditure of up to \$250,000 per year from this fund for computer equipment and software that support reclamation activities, and it makes clear that mineral owners and mineral lessees, in addition to well operators, are liable to reimburse the State for clean-up costs.

*Waste Disposal Permits:*

**Sections 7 and 8** of the bill clarify OCD’s authority to permit facilities it regulates that dispose of oil field waste or discharge water contaminants, and to charge such facilities permitting fees to defray the costs of permitting and oversight. The OCD now permits some facilities under the Water Quality Act (WQA) and collects fees set by the Water Quality Control Commission (WQCC). The OCD permits other facilities under the Oil and Gas Act, which unlike the WQA, does not currently provide for the collection of fees. The bill would establish parameters for the duration of such permits, and would specifically authorize the collection of fees by the OCD for the issuance of such permits. The fees so collected would go to a new "Oil and Gas Facilities Fund" analogous to the Water Quality Fund, which would be appropriated to pay the costs of administering the program. The bill does not authorize fees for applications for permits to drill (APDs) for oil or gas wells.

*Actions for Violations*

**Section 9** would amend Section 71-5-20 NMSA 1978 (of the Geothermal Resources Conservation Act) to specify the remedies of that section would be cumulative and not limit any other rights or remedies of the commission with respect to any violation of the Act or any rule, order or permit made pursuant to the Act.

*Violations of the Geothermal Resources Conservation Act – Penalties*

Section 10 would amend Section 71-5-23 NMSA 1978. A person would not have to “knowingly and willfully” violate the Act to be subject to penalties. Unauthorized discharges into the environment would be subject to a civil penalty of not more than \$10 thousand for each violation or \$10 thousand for each day of a continuing violation. The OCD or the commission may assess the civil penalties after notice and a public hearing. They may consider the seriousness of the violation and any good-faith efforts to comply with the applicable requirement. A penalty not paid within 30 days after the order assessing the penalty becomes final would be recoverable by a civil suit filed by the attorney general on behalf of the commission or the division. If a final order assessing a penalty is appealed pursuant to Section 71-5-18 NMSA 1978 the commission would be able to seek recovery of the penalty by counterclaim in that case. The penalty for violating the Act would be raised from \$5 thousand to \$15 thousand.

## **FISCAL IMPLICATIONS**

The AGO points out that current law setting financial assurances and penalties is out of date, and the amounts are not adequate to pay the costs of wells needing to be plugged if an operator becomes financially unable to assure proper remediation or plugging. Failure to enact these

updates may result in state liability for such costs. Increased costs of enforcement will be balanced if not outweighed by updated amounts for financial assurances and penalties. Ultimate state liability for remediation when operators fail will be reduced.

The EMNRD contributed the following points to this analysis.

*Penalty Provisions:* In 2009 the New Mexico Supreme Court determined that under the current language of the Oil and Gas Act, the Oil Conservation Division/Oil Conservation Commission does not have the authority to assess civil penalties under Section 70-2-28 NMSA 1978 for violations of the Oil and Gas Act (or Rules promulgated pursuant to that Act). *Marbob v. OCC*, 2009-NMSC-113. The Court did, however, acknowledge that the existing statute is outdated and inadequate, and noted that it is the legislature who must address any changes to that statute.

As a result of the *Marbob* ruling, any penalty action by the OCD must now be brought in district court through the Attorney General's office, which requires significant additional general funds. To date, OCD has not pursued any such cases in district court due to lack of funding and resources. Moreover, since the opinion was issued and OCD has ceased assessment of penalties, the funds collected and placed in the reclamation fund have dropped dramatically. In Fiscal Year 2008, the OCD collected a total of \$479,250 in civil penalty assessments, and in Fiscal Year 2009, the OCD collected a total of \$727,500 in civil penalty assessments. By way of comparison, in Fiscal Year 2010 the OCD collected a total of only \$14,000 (largely through violations of the terms of agreed compliance orders).

*Waste Disposal Permits and Fees:* If the discharge permit and fee provisions of the bill are not enacted, OCD could lose permit funding it now receives. OCD's discharge permit program is funded by fees charged pursuant to the WQA. OCD's authority to require discharge permits under the WQA has been challenged. HB 176 would allow OCD to charge comparable fees under the Oil and Gas Act, and also provide a source of funding to cover administration of waste disposal permits currently issued and administered without fee under the Oil and Gas Act. OCD estimates it would receive approximately \$700,000 per year in fees under the bill, of which \$100,000 would replace funds it now receives under the Water Quality Act, and the remainder would be available to defray costs of additional permitting and supervision activity under the Oil and Gas Act. Additional revenues from permitting fees were estimated as follows (probable fees for classes of permits were based on a comparison of work involved with permits for which fees have been set under the WQA):

Surface waste management facilities** 2 or 3 per year @ \$6,100	\$ 15,250
Permits to transport produced water* 20 per year @ \$600	12,000
Injection permits* 80 per year @ \$2,600	208,000
Pit permits* 1,350 per year (assuming pits at 75% of well locations) @250	<u>337,500</u>
<b>Total</b>	<b><u>\$572,750</u></b>

*\*The OCD will need to amend Rules 19.15.34, 19.15.26 and 19.15.17 NMAC to provide for a duration/term limits (and for fee schedules) for these permits to be consistent with this new bill's language.*

*\*\* The OCD will need to amend Rule 19.15.36 NMAC to provide for fee schedules for these permits to be consistent with this new bill's language.*

The State Land Office forecasts the following impact.

Creation of the Oil and Gas Facilities Fund would provide for supplementary income for OCD administration of oil and gas rules. Industry may be fined for unknowing violations or potential violations at substantial levels, potentially becoming a substantial recurring source of revenue.

Increases in the bonding requirements would offset losses in the Oil and Gas Reclamation Fund and enforcement of orders, report requirements, and permit obligations would relieve OCD staff of repeated hearings requiring public notice and court reporters before division examiners and the commission.

Additional staff resources and legal fees could be required to address the consequences of this legislation. Staff resources would need to be augmented for evaluation of leases – at least 2 additional staff managers to evaluate leases coming up for renewal (approximately 50/month) at a cost of (\$85.25\*2) \$170.5 – includes salaries & benefits, equipment setup, operating expenses and travel); 2 attorneys – advanced level (\$99.9\*2) \$199.8– includes salaries & benefits, equipment setup, operating expenses and travel. Other unanticipated costs may result. Costs will recur as long as the legislation and regulations are in effect.

It is not clear whether these cost can be charged against the Oil and Gas Facilities Fund; if it cannot, the expenses will be borne by the Land Grant Maintenance Funds and reduces distributions to beneficiaries.

## **SIGNIFICANT ISSUES**

The EMNRD explains how the bill would support the mission of the OCD as follows.

*Environmental Powers:* The Oil and Gas Act contains many provisions that specifically authorize OCD to adopt rules for protection of the environment in particular contexts, *e.g.* disposition of produced water and oil field wastes. There is, however, no general provision authorizing OCD to comprehensively regulate oil and gas operations to protect the environment. The bill would authorize OCD to adopt rules for protection of public health, surface water, ground water, natural resources and the environment with respect to all "oil and gas operations," a term that is broadly defined in Section 5 of the bill.

*Bonding.* The bill raises the required amount of an operator's blanket well-plugging bond that secures the operator's obligation to plug its abandoned wells and to reclaim abandoned well sites. The present level of \$50,000 in was set in 1978 and requires the same amount regardless of the total number of wells being covered by the "blanket" bond. The cost of plugging wells has increased substantially, such that the OCD is now paying an average of \$40,000 to \$50,000 *per well* – and sometimes significantly more - from the Oil and Gas Reclamation Fund to plug orphaned wells (compared to an average of \$15,000 per well only six years ago). The new

proposed bonding approach is more reasonable because it is directly tied to the number of wells an operator has in New Mexico, and the increased required amount provided in the bill will ensure availability of funds to pay for plugging and reclamation without putting the state in the position of paying out of pocket to clean up after irresponsible operators. Further, the new bonding structure will protect responsible operators, who fund the Reclamation Fund through production taxes, from being mulcted for the defaults of irresponsible operators. The bill additionally imposes plugging and reclamation liability on owners and lessees of the mineral estate where a well has been abandoned, correcting an apparent typographical error in a former amendment to the Oil and Gas Act.

*Civil Penalties:* The bill firmly establishes the OCD's authority to assess civil penalties, and provides that the mechanism for such assessment is through administrative hearing. As noted above, the ambiguity in the statutory language as it currently exists has resulted in a Supreme Court opinion noting that the statute is inadequate, outdated and in need of updating, but nonetheless holding that based on the current language of the statute, the OCD does not have the authority to assess civil penalties except through the Attorney General's office in district court. The proposed language updates and clarifies the existing statute regarding penalty assessments, and updates the maximum amounts of civil penalties provided in the Oil and Gas Act for some violations. Finally, the bill language deletes a limitation that penalties can only be imposed for violations that are "knowing and willful." The proposed new language provides a clear process for the assessment of civil penalties, providing the OCD an opportunity to perform its statutory and regulatory duties in seeking compliance with the Oil and Gas Act, but also providing operators with an administrative process and an opportunity for a hearing regarding the assessment. The proposed language therefore serves the interests of both industry and the OCD.

As to the penalty amount increases that are being proposed, the Oil and Gas Act was enacted in 1935 – 76 years ago. The provision for civil penalties for violations of the Act (or rules adopted under it), not exceeding \$1,000 per offense, per day, limited to "knowing and willful" violations, was part of the original act, and has not been amended since that time. The penalty provisions of the Geothermal Act provide for a \$2,500 per day maximum, but otherwise track the Oil and Gas Act.

Much has changed since 1935. At that time the principal purpose of oil and gas regulation was to control competitive practices within the industry. Increasingly in recent years the focus has shifted to a balancing of the interests of operators and environmental protection. The OCD and the rules it adopts under the Oil and Gas Act are now the primary means by which the State of New Mexico protects its precious fresh water resources from deterioration that could result from imprudent oil and gas industry activity. Also the years since the Legislature adopted the \$1,000 per day maximum penalty for violations of the Oil and Gas Act have witnessed an exponential increase in the market price of crude oil from less than \$1 per barrel to nearly \$90 per barrel. To protect New Mexico's environment and water resources under present day economic conditions OCD needs enforcement tools comparable to those provided in other environmental laws.

Other New Mexico natural resource statutes uniformly provide strict liability for civil penalties. That is, a violator is subject to a penalty for any violation regardless of knowledge or intent, thereby placing affirmative responsibility upon industry to conduct its activities in a way that prevents violations from occurring. Virtually all other statutes provide for higher penalties than does the Oil and Gas Act and provide expressly for administrative assessment. The following natural resource and environmental statutes provide for civil penalties based on strict liability

and for administrative assessment, up to the maximum daily amounts indicated:

- Environmental Improvement Act, Section 74-1-10 NMSA 1978 (\$1,000)
- Air Quality Control Act, Section 74-2-12.1 NMSA 1978 (\$25,000)
- Radiation Protection Act, Section 74-3-11.1, NMSA 1978 (\$15,000)
- Hazardous Waste Act, Sections 74-4-10 and 74-4-12, NMSA 1978 (\$25,000)
- Water Quality Act, Sections 74-6-10 and 74-6-10.1, NMSA 1978 (\$15,000 for some violations; \$10,000 for others)
- Solid Waste Act, Sections 74-9-36 and 74-9-38, NMSA 1978 (\$10,000 and \$5,000)
- Surface Mining Act, Section 69-25A-22, NMSA 1978 (\$5,000)
- New Mexico Mining Act, Section 69-36-17 (\$10,000)

HB 176 represents a modest approach to conforming the penalty provisions of the Oil and Gas Act to modern reality – and to the general trend found in other natural resource statutes. It increases the maximum civil penalty to \$10,000 only for violations that actually result in a contaminant release, leaving the existing \$1,000 (\$2,500 in the Geothermal Act) limit for all other violations, such as paperwork violations, again making a more meaningful distinction in its framework rather than taking a “one size fits all” approach. While the bill provides for strict liability, as opposed to the existing “knowing and willful” standard, it also expressly requires OCD to take into consideration “good faith efforts to comply,” thus providing an objective standard for judicial review of penalties challenged as excessive. Finally, and of significance, unlike most of the above-cited statutes that provide for assessment of penalties in a compliance order issued by the agency *ex parte* with provision for a subsequent hearing only if requested, HB 176 provides for penalty assessment only after notice and hearing.

*Waste Disposition Permits and Fees:* The provisions of the bill regarding permits and fees are not designed to change existing OCD regulatory practices, but are designed to consolidate OCD regulation of the contaminant disposition under the Oil and Gas Act. OCD now has broad authority to regulate the disposition of wastes from oil and gas production facilities under the Oil and Gas Act [Section 70-2-12.B(21) NMSA 1978] and to regulate disposition of wastes from downstream facilities such as natural gas treatment plants and oil refineries under either the Oil and Gas Act or the WQA [Section 70-2-12.B(22)]. Issues have arisen as to whether certain facilities can properly be regulated under the latter act. The bill would specifically authorize OCD to adopt, under the Oil and Gas Act, permitting requirements analogous to those it now administers under the WQA. The OCD would retain its power to administer the WQA as to facilities within its jurisdiction, but the bill would ensure that there would be no gap between its powers under the WQA and its powers under the Oil and Gas Act. The new language serves to provide clarity to both operators and the OCD regarding what is expected of each and what the process is for permitting of such facilities.

The bill would further authorize OCD to charge permitting fees for discharge permits. This would maintain the status quo by allowing OCD to continue to charge fees for permitting activities now permitted under the WQA, and it would also authorize fees for waste disposition permits now issued *gratis* under the Oil and Gas Act. OCD would have to adopt a schedule of fees in a rulemaking proceeding in which reasonableness of the fees would have to be demonstrated by evidence, subject to judicial review.

The bill would still not go so far as to authorize OCD to charge fees for permits to drill wells, notwithstanding that the United States Bureau of Land Management charges substantial fees for such permits on federal lands, and conservation agencies in many states charge fees for such permits.

*Use of Reclamation Fund for Computer Equipment and Software.* The Oil and Gas Act appropriates the Oil and Gas Reclamation Fund to the Energy, Minerals and Natural Resources Department to be spent for surveying and reclamation of abandoned well sites and production facilities. OCD uses its computer systems, among other things, to keep track of whether or not facilities are active, who are responsible parties, and what financial assurance is available for reclamation of particular facilities. The OCD also maintains a wealth of publically available information through its computer systems that operators, other state and federal agencies, and members of the general public regularly access, use and rely upon. The bill would specifically authorize use up to \$250,000 per year of funds from the Oil and Gas Reclamation Fund to purchase hardware and software as needed for these purposes. These funds will allow the OCD to better meet its statutory and regulatory obligations as well as to better provide electronic information to the public.

The SLO had the following concerns.

One of the issues this bill creates for the New Mexico State Land Office (NMSLO) is, if the bill is passed, the NMSLO could be subject to litigation because the bill includes the mineral estate owner within the group of persons who could be sued for an operator's failure to have proper financial assurance for proper plugging or replugging of a well.

The NMSLO administers thirteen million mineral estate acres, which the State of New Mexico holds in trust; three million of which are encumbered by oil and gas leases. The NMSLO would be forced to take a regulatory role over NMSLO's lessees in order to implement the bill's requirements about financial assurance and the plugging / replugging of wells. By being obliged to become a regulatory agency, the NMSLO would have to devote staff and resources the NMSLO does not have to monitor lessees' financial assurances and the plugging and replugging of wells.

Statutory oil and gas leases confer to a lessee the right to pull well casing either during or within 2 years after the term of the lease, if all due payments have been satisfied. New lessees may purchase improvements on the lease, but new lessees may also decline to purchase well bores and thus they remain the obligation of previous lessees. This bill would attempt to transfer plugging obligations to persons who do not assume that obligation when awarded an oil and gas lease from the SLO. The SLO only issues statutory oil and gas leases, so conflicts between implementation of Acts would arise under House Bill 176.

## **ADMINISTRATIVE IMPLICATIONS**

The SLO would be obligated to take a regulatory role in order to assure lessees have the proper financial assurance at all times and that a lessee has properly plugged / replugged a well; a task formerly performed by the regulatory agency, OCD.

The SLO does not have the staff or expertise to evaluate every lease upon expiration for continuing obligations arising from other regulatory agency rules. Nearly 200,000 acres were leased for oil and gas during 2010 for \$55 million in bonus revenues for the Maintenance Fund.

The Land Office only employs 13 District Resource Managers who each must inspect approximately 1 million acres in their respective districts. The SLO and its lessees cannot assume the liability of repayment to the Oil and Gas Reclamation Fund for plugging operations on wells unplugged or needing additional plugging due to previous lessees.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

HB297 proposes to amend the New Mexico Oil and Gas (“the Act”), administered by the Oil Conservation Division (OCD), to (1) increase the maximum permitted “blanket plugging financial assurance” that the OCD may require oil and gas operators to post in order to operate in New Mexico from \$50,000 to \$500,000; (2) eliminate OCD’s authority to require a single-well financial assurance, in addition to the blanket bond, for any well that has been “in temporary abandonment status” for a period of two or more years, and (3) add language providing a statutory framework for “approved temporary abandonment” of wells, in lieu of the stricter framework now provided in OCD rules.

### **OTHER SUBSTANTIVE ISSUES**

The SLO noted conflicts with existing statutes.

According to the bill, a person is subjected to a civil penalty for any unauthorized discharge into the environment of any contaminant. (proposed Amendment to NMSA 70-2-31). This provision directly conflicts with the SLO’s rule which allows for the Commissioner to grant an exemption for a spill cleanup, when the lessee can demonstrate compliance would be impracticable. (19.2.100.66(E)1)

Leasing of oil and gas by the SLO is prescribed by statute. Specifically, NMSA 19-10-4.3 Oil and Gas Lease Development Form states that a lessee shall not remove machinery, fixtures or casing until all obligations to the SLO have been met. NMSA 19-10-4.3 paragraph 12. Because this bill allows the OCD to increase its permitting authority the OCD may deny in a permit removal of all casing when the statutory lease allows it.

### **ALTERNATIVES**

The SLO states an alternative to the bill as presented is to not include the SLO or current lessees within the class of mineral estate owners or responsible parties for a previous lessee’s operator’s liability of not being properly financially assured or for a well not being properly plugged/replugged.

### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The SLO foresees the following consequences of not enacting this bill.

The OCD will continue to require violators of settlement agreements to participate in public hearings and attempt to enforce Commission orders through other legal remedies.

Section 70-2-26 NMSA 1978 would not be repealed so appeals of Commission orders and decisions would be held in a public hearing before the secretary of EMNRD.

Abandoned oil and gas wells would continue to be plugged under the Oil and Gas Reclamation Fund.