F I S C A L   I M P A C T   R E P O R T

SPONSOR Wirth **ORIGINAL DATE LAST UPDATED** 1-20-06 **HB** 22

SHORT TITLE Assurance for Plugging Oil and Gas Wells **SB**

ANALYST Woods

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY06	**FY07**		
	None		

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

House Bill 22 – Relating to Oil and Gas; Providing Financial Assurance to Plug Oil, Gas or Service Wells – seeks to amend Section 70-2-14 NMSA 1978 (being Laws 1977, Chapter 237, Section 3, as amended) Requirement for Financial Assurance, as follows:

> A. Each person, firm, corporation or association who operates any oil, gas or service well within the state shall, as a condition precedent to drilling or producing the well, furnish financial assurance in the form of an irrevocable letter of credit or a cash or surety bond [insert new language *"or a well-specific plugging insurance policy pursuant to the provisions of this section"*] to the oil conservation division [insert new language "*of the energy, minerals and natural resources department"*] running to the benefit of the state and conditioned that the well be plugged and abandoned in compliance with the rules of the oil conservation division.

Additionally, the legislation adds the following new language in its entirety:

> *F. An operator required to file financial assurance for a well pursuant to this section is considered to have met that requirement if the operator obtains a plugging insurance policy that includes the specific well and that:*

(1) is approved by the insurance division of the public regulation commission;

(2) names the state of New Mexico as owner of the policy and contingent beneficiary;

(3) names a primary beneficiary who agrees to plug the specified wellbore;

(4) is fully prepaid and cannot be canceled or surrendered;

(5) provides that the policy continues in effect until the specified wellbore has been plugged;

(6) provides that benefits will be paid when, but not before, the specified wellbore has been plugged in accordance with rules of the oil conservation division in effect at the time of plugging; and

(7) provides benefits that are not less than an amount equal to the one-well financial assurance required by oil conservation division rules.

G. If, subsequent to an operator obtaining an insurance policy as provided in this section, the one-well financial assurance requirement applicable to the operator's well is increased, either because the well is deepened or the rules of the oil conservation division are amended, the operator is considered to have met the revised requirement if:

(1) the existing policy benefit equals or exceeds the revised requirement;

(2) the operator obtains an amendment increasing the policy benefit by the amount of the increase in the applicable financial assurance requirement; or

(3) the operator obtains financial assurance equal to the amount, if any, by which the revised requirement exceeds the policy benefit."

SIGNIFICANT ISSUES

EMNRD indicates the legislation would allow an operator of an oil or gas well who is required by Section 70-2-14 NMSA, 1978 to provide financial assurance to the Oil Conservation Division (OCD) to meet its statutory obligation to a plug a well to satisfy the security requirement with an insurance policy in lieu of a surety bond, letter of credit or cash deposit. The well-plugging insurance policy would relate to a specific well and would obligate the insurer – at the time the requirement to plug the well became applicable under OCD rules – to pay the cost of plugging the well up to the policy's face amount. The insurer would pay a designated beneficiary upon certification that plugging had been completed pursuant to OCD requirements. If the designated beneficiary failed to plug the well as required, and OCD had to plug the well, the proceeds of the insurance policy would, in that event, be payable to the State as contingent beneficiary of the policy. Under the terms of the bill, if the OCD at any time increases the amount of the financial assurance required for a particular well, the operator would be required either to obtain an amendment increasing the face amount of the plugging insurance policy or to provide other financial insurance to meet the new requirement.

ADMINISTRATIVE IMPLICATIONS

None: EMNRD indicates that the administrative requirements associated with the proposed well-plugging insurance policies will not be significantly different from those associated with alternative forms of financial assurance now allowed.

OTHER SUBSTANTIVE ISSUES

EMNRD suggests that the proposed legislation would provide an additional alternative means for oil and gas operators to secure their obligation to plug abandoned wells, and would provide an equivalent level of security to the State that funds would be available to plug depleted or abandoned wells.

The plugging insurance policy would cover only the cost of plugging the well bore, and would not cover costs of surface remediation. Other forms of financial assurance apply to both plugging and surface remediation costs. However, that difference is less significant than might be supposed since the amount of financial assurance now required is usually less than the cost of plugging the well bore, leaving no funds from the financial assurance, in most cases, for surface remediation.

The degree of security for the operator's plugging obligation afforded to the State under this type of arrangement would depend upon the solvency of the issuing insurance company, just as it depends upon the solvency of the surety company in the case of a surety bond. Presumably the concept of this type of insurance would be that the contract between the insurance company and the plugging contractor who is the primary beneficiary would require the plugging contractor to plug the well for no more compensation than the amount of the policy proceeds. (The bill does not expressly require such a provision.) The arrangement would provide the State with additional security against cost of plugging in excess of the policy amount if the plugging contractor performed its contract. Obviously, a surety bond affords no such protection.

This type of security may prove more attractive to operators than providing a surety bond, letter of credit or cash deposit. The operator can pay the premium in advance on a one-time basis and will not be burdened with periodic payments that would be required to maintain a surety bond, nor will it have to tie up cash in an escrow as it would have to do to provide a cash bond, or, in most cases, a letter of credit. Plugging insurance policies, under the bill, must be well specific, and so could not be used to satisfy the $50,000 blanket financial assurance option. For primary plugging security most operators will likely still find it advantageous to provide blanket financial assurance rather than any well-specific financial assurance. However, these insurance policies could, and probably will, provide an attractive alternative to operators who are required, under new rules recently adopted by OCD, to furnish single-well financial assurances for inactive wells, in addition to their blanket financial assurance.

BW/mt