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## FISCAL IMPACT REPORT

ORIGINAL DATE 02/02/09

SPONSOR Wirth LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Oil & Gas Act Financial Assurance & Oversight SB 361

ANALYST Woods

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
NFI	NFI		

(Parenthesis ( ) Indicate Expenditure Decreases)

### REVENUE (dollars in thousands)\*

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
None	None	\$600.0	Recurring	Oil and Gas Facilities (New)

(Parenthesis ( ) Indicate Expenditure Decreases)

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

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
<b>Total</b>	None	(\$360.0)	(\$360.0)	(\$720.0)	Recurring	Oil and Gas Facilities (New)

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Attorney General's Office (AGO)

New Mexico Environment Department (NMED)

Energy, Minerals and Natural Resources Department (EMNRD)

\* Projections provided by the Energy, Minerals and Natural Resources Department

No Responses Received From

Association of Counties

New Mexico Oil and Gas Association

**SUMMARY**

Synopsis of Bill

The Attorney General's Office (AGO) indicates that this legislation amends the Oil and Gas Act in numerous parts:

(1) Section 70-2-12 is amended to give the oil conservation division "division" additional authority to require financial assurance, to regulate the restoration and remediation of well sites and production facilities, to regulate oil and gas operations to protect public health, surface water, ground water natural resources and the environment, to require permits for activities regulated by Chapter 70 NMSA 1978, including permits for construction or operation of facilities that may discharge any water contaminant and to establish a schedule of fees for permits issued for the disposition of nondomestic wastes.

(2) Section 70-22-14 is amended to provide that financial assurance for blanket plugging shall not be less than one hundred thousand dollars nor more than one million five hundred thousand dollars and shall be determined by multiplying the number of wells operated by an operator on January 1 of each year that are not plugged or abandoned or covered by five thousand dollars subject to the minimum and maximum limits, authorizes the division to bring suit against the most recent owner of the minerals or most recent lessee of the minerals when the financial assurance proves insufficient to cover the cost of plugging.

(3) Section 70-2-28 is amended to include violation of permits issued pursuant to the act as an offense that the division shall bring suit against the person that violates the permit and further provides that the remedies provided by the section are cumulative and do not limit any other rights or remedies of the division or the commission.

(4) Section 70-2-31 is amended to provide that violations of the Oil and Gas Act, rules, orders, or permits which cause unauthorized discharge into the environment of any contaminant the civil penalty shall not be more than ten thousand dollars for each violation or ten thousand dollars for each day of a continuing violation. The amended section further provides that the division or the commission may assess the civil penalties after notice and an opportunity for a public hearing, that unpaid penalties may be recovered in a civil suit after 30 days and that, if any final order assessing a penalty is appealed, the commission may seek recovery of the penalty by a counter claim in that case. The section goes on to change the amount of a criminal penalty for violation of the act from five thousand dollars to fifteen thousand dollars and makes it a criminal offense to "procure, counsel, aid or abet the commission of any act described in this subsection." Lastly, this section is amended to provide that penalties assessed and collected pursuant to this section shall be deposited in the oil and gas reclamation fund.

(5) Section 70-2-33, the section on definitions, adds several definitions to the act.

(6) Section 70-2-38 is amended to allow use of the Oil and Gas Reclamation Fund for purchasing computer equipment and software not to exceed two hundred fifty thousand dollars per year.

(7) Section 7 creates a new section of the Oil and Gas Act to create an “Oil and Gas Facilities Fund” in the state treasury composed of all fees collected under Subsection B of 70-2-12 NMSA 1978 and the money in the fund is appropriated to the energy, minerals and natural resources department for the purpose of administering the rules adopted pursuant to Chapter 70 NMSA 1978.

(8) Section 8 creates a new section of the Oil and Gas Act authorizing the commission to require by rule that the operator of any facility subject to the jurisdiction of the division obtain a permit from the division for the disposition of nondomestic wastes and set criteria for the commission to follow in doing so.

(9) Sections 9 and 10 amend the Geothermal Resources Conservation Act to provide authority, penalties and remedies for violation of the act that are similar to those for violations of the Oil Conservation Act.<sup>2</sup>

### FISCAL IMPLICATIONS

EMNRD brings forth two primary fiscal implications associated with the legislation:

*Penalty Provisions:* If the penalty provisions of the bill are not enacted, and the New Mexico Supreme Court holds that present law does not give the Oil Conservation Division (OCD) power to assess civil penalties administratively, OCD will have to bring every enforcement action in district court, which will require significant additional general funds. OCD estimates that if it is forced to pursue all penalty cases in district court, it would need at least two more attorneys, as well as additional funding for travel, witness fees, depositions etc. This would cost approximately \$360,000 per year, estimated as follows:

Two additional attorneys (salary and benefits) @ \$ 110,000	\$220,000
Court reporter for 60 days of depositions /year @ \$2,000/day	120,000
Travel for attorneys and witnesses: 100days/year X two persons @\$85/ day	<u>17,000</u>
Total additional costs	<u>\$357,000</u>

*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. The bill 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.

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<sup>2</sup> The AGO response carries the caveat, *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.*

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 years @ \$6,100	\$ 15,250
Permits to transport produced water 40 per years @ \$600	24,000
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>
Total	<u>\$584,750</u>

### SIGNIFICANT ISSUES

As background, the Environment Department (NMED) advises that the Oil and Gas Act governs the exploration, development, production, transportation and storage of crude oil or natural gas within New Mexico. A number of the statutory provisions in the Act have not been changed over the years as industry and public needs have changed. SB 361 proposes to address the changes necessary to ensure that oil and gas operations are allowed to be conducted in an efficient manner that benefits the operators, the people and interests of the state of New Mexico. This legislation seeks to accomplish this by:

- Clarifying the definitions of “inactive wells” and “oil and gas operations”
- Reorganizing and clarifying existing powers of the OCD, including the relationship between the Oil and Gas Act and the Water Quality Act.
- Adding new powers of the OCD to regulate the restoration and remediation of well sites and production facilities, to require permits for operations that discharge water contaminants, and to establish fees for permits issued for the disposition of nondomestic wastes to support the issuance of permits.
- Increasing the financial assurance requirements for oil and gas wells from a \$50,000 blanket bond to a minimum of \$100,000 and up to a maximum of \$1,500,000 to ensure that the state has sufficient bonding capacity to properly plug and abandon oil and gas wells when the operator either goes bankrupt or otherwise fails to conduct these activities.
- Clarifying that violations of permits are violations of the act and subject to penalties.
- Creating a new penalty for violations of the act that causes an unauthorized discharge into the environment of any contaminant consistent with the existing penalties imposed for such violations under the Water Quality Act.

- Clarifying the appeal mechanisms for the assessment of penalties.
- Increasing the penalty amount for criminal violations of the act that are knowing and willful.
- Allowing penalties collected to be deposited into the oil and gas reclamation fund so that they can be used for the plugging and abandonment of oil and gas wells.
- Creating an “oil and gas facilities fund” where permit fees would be placed.
- Creating statutory permitting requirements and processes for the disposition of nondomestic wastes that are consistent with existing statutory permitting requirements under the Water Quality Act.

NMED adds that the Geothermal Resources Conservation Act governs the exploration, and development of geothermal resources within New Mexico. SB 361 seeks to update outdated penalty provisions under the act by:

- Creating a new penalty for violations of the act that causes an unauthorized discharge into the environment of any contaminant consistent with the existing penalties imposed for such violations under the Water Quality Act.
- Increasing the penalty amount for criminal violations of the act that are knowing and willful.

EMNRD brings forth a number of items associated with the legislation including:

*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 fresh water, other 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. 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* from the Oil and Gas Reclamation Fund to plug orphaned wells (compared to an average of \$15,000 per well only four years ago). The level of bonds provided in the bill will insure availability of funds to pay for plugging and reclamation and protect responsible operators, who fund the Reclamation Fund through production taxes, from being mulcted for the defaults of irresponsible operators. In addition, the bill 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 clarifies the OCD’s authority to assess civil penalties by administrative hearing, increases civil penalties provided in the Oil and Gas Act for some violations, and deletes a limitation that penalties can only be imposed for violations that are “knowing and willful.”

The most important change that the bill makes in the civil penalty provisions of the Oil and Gas Act is to clarify the OCD’s power to assess civil penalties in administrative hearings. Although OCD strongly believes that present law gives it that power, an oil and gas operator has challenged that position in the courts, and the issue is now pending before the New Mexico Supreme Court. If the bill is not passed, and the Supreme Court does not sustain OCD’s administrative assessment power, OCD’s costs of enforcement will be greatly increased, and the number of enforcement cases it can successfully prosecute will accordingly be greatly reduced. Enforcement will have to be limited to the most egregious violations, leaving no sanction for violation of many important rules.

The Oil and Gas Act was enacted in 1935. 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. The provision for "recovery" of civil penalties by suit in district court that has led to the judicial challenge to OCD's authority to assess civil penalties administratively, was also part of the 1935 Act. 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 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 increase in the market price of crude oil from less than \$1 per barrel to more than \$40 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 environmental 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 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 (\$15,000)
- Radiation Protection Act, Section 74-3-11.1, NMSA 1978 (\$14,000)
- Hazardous Waste Act, Sections 74-4-10 and 74-4-12, NMSA 1978 (\$10,000)

- 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 (\$5,000)
- Surface Mining Act, Section 69-25A-22, NMSA 1978 (\$5,000)
- New Mexico Mining Act, Section 69-36-17 (\$10,000)

This bill represents a modest approach to conforming the penalty provisions of the Oil and Gas Act to modern reality. 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. 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, 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 if requested, the bill 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 insure that there would be no gap between its powers under the WQA and its powers under the Oil and Gas Act.

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 not 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 wellsites 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 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.

## PERFORMANCE IMPLICATIONS

EMNRD notes the following:

*Penalty Provisions.* An oil and gas operator has challenged in court OCD's authority under existing provisions of the Oil and Gas Act to assess civil penalties administratively for violations of the law or of OCD rules. That suit is now pending in the New Mexico Supreme Court. As a result, some operators are raising that challenge in every enforcement effort. This situation is undermining OCD's ability to perform its mission of protecting the environment from improper oil and gas industry practices. If the Supreme Court concludes that OCD does not have power to assess penalties administratively, but must try all penalty cases in district court, OCD's enforcement efforts will be seriously hampered.

*Bonding.* The increased bonding and expanded liability for well plugging and site reclamation will facilitate the accomplishment of reclamation by providing a dependable and generally sufficient source of funding from the offending operator.

## ADMINISTRATIVE IMPLICATIONS

EMNRD notes the following:

*Penalty Provisions.* Eliminating the requirement that OCD establish that a violation was "knowing and willful" in order to assess a penalty will streamline enforcement hearings, since extensive evidence regarding an operator's state of mind will be unnecessary.

*Discharge Permits and Fees:* Consolidating OCD's discharge permitting under the Oil and Gas Act will improve administrative efficiency by eliminating uncertainties and controversies over which act applies. Also, OCD personnel would no longer have to operate simultaneously under two different sets of administrative rules.

## OTHER SUBSTANTIVE ISSUES

NMED suggests that enacting fair and balanced statutes for the efficient development of oil and gas resources while also protecting citizens in the state from threats to public health and groundwater and surface water contamination is a significant issue facing New Mexico. This issue has become an increasingly significant public concern as oil and gas resources are developed in new areas. SB 361 seeks to balance the needs of the state with the needs of operators to produce oil and natural gas. Many of the provisions of the Oil and Gas Act that SB 361 seeks to change are provisions that have not been modified over time to keep pace with economic changes. For example, the cost to plug and abandon oil and gas wells is well in excess of the current bonding limits in the Oil and Gas Act and leaves the state liable for cost overruns. The economic burden for plugging and abandoning those wells should lie with the operator who drilled the well and derived an economic benefit from the production of the oil and gas resources. In addition, the current penalties under the Oil and Gas Act and Geothermal

Resources Conservation Act are a relic of past days and past economic conditions. The penalties proposed under SB 361 are appropriate and not excessive for deterring operators from violating the acts. The proposed penalties are also consistent with penalties for similar violations that are currently allowed under other state laws such as the Water Quality Act.

NMED concludes that SB 361 would also work to streamline the permitting of the disposal of wastes from oil and gas operations by making them consistent with other existing statutory requirements that are familiar to oil and gas operators. The statutory language proposed in SB 361 for section 8 of the Oil and Gas Act regarding permits for the disposition of nondomestic wastes is consistent with statutory language in the Water Quality Act which applies to all other non-oilfield industries in New Mexico. Consistency of permitting requirements between different statutes is important to provide an economic balance between industry and basic fairness in the application of requirements throughout the state.

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

EMNRD suggests the following:

*Environmental Powers:* If OCD's environmental powers are not clarified, rules and orders it promulgates to protect the environment could be subject to judicial challenge based on perceived gaps in existing statutory grants of authority.

*Bonding provisions:* Existing bonding requirements for well plugging and site reclamation are wholly inadequate to cover costs of these activities. Thus, if bonding requirements are not increased, the State, through the Oil and Gas Reclamation Fund, rather than delinquent operators, will have to cover most of the cost of plugging orphaned wells and reclaiming abandoned well sites.

*Penalty provisions:* If the penalty provisions of the bill are not enacted OCD's authority to assess penalties in administrative proceedings will remain uncertain, thereby inviting evasion and noncompliance. If the Courts hold that OCD does not have penalty assessment authority, OCD would be compelled to expend resources in district court litigation to enforce its decrees. Due to the costs involved in court litigation, particularly litigation in counties where violations occur or violators reside (as present provisions may be construed to require), OCD could bring only a few enforcement cases, which would accordingly have to be limited to the most egregious violations. Routine violations would go unpunished. In difficult economic times, it is likely that violations will increase, as operators seek to cut corners to save costs, a problem that will be exacerbated if OCD's enforcement powers are weakened. Additionally, because present law requires OCD to prove that violations were "knowing and willful," investigations and hearings will be protracted, and many violations will escape sanction.

*Permits and Fees:* If the discharge and permit fee provisions are not enacted OCD may lose funding currently available to it under the Water Quality Act. Some operators have contended the Water Quality Act does not authorize certain permitting requirements that OCD now administers, and for which it collects fees, under that Act. Although OCD has the authority to require these permits under the Oil and Gas Act, it does not now have power to charge permit fees. Thus, if operators pursued this contention in the courts and

prevailed, it would reduce OCD's receipts from permit fees, undermining its ability to monitor compliance and enforce rules regarding waste disposition and contaminant discharge.

**AMENDMENTS**

None suggested by respondents.

BW/mt