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PLUGGING LIABILITY: A FRAMEWORK FOR RISK AND FINANCIAL SECURITY

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Plugging Liability: A Framework for Risk and Financial Security

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Avoiding financial liability for inactive oil and gas wells is a perennial problem for the U.S. exploration and production industry. Plugging and abandonment are arguably the most expensive operations in the life of a well because the well no longer generates revenue to offset the cost.

These liabilities are particularly relevant in today's market. Given the industry's current focus on high-risk high-reward unconventional resource plays, conventional oil and gas fields tend to be less financially attractive, even if they are still productive. They are often sold off to smaller operators, recycled for horizontal development, or simply ignored. Less productivity in these old fields means more abandoned wells and more plugging liability.

This paper summarizes the risks and liabilities of non-compliance with Texas state laws and regulations regarding plugging and abandonment of Texas onshore oil and gas wells. Note that this paper does *not* address the related topics of casualty liability, contractual liability, or liability for environmental contamination or non-compliance with federal environmental laws.

The P-5 Organization Report

In 2009, the Texas Legislature enacted House Bill 2259, which established new requirements for oil and gas operators relating to inactive land wells and associated surface equipment.[1] Effective September 11, 2010, the Railroad Commission of Texas (the "Commission") amended Statewide Rule §3.15 (Rule 15) to implement the new legislation.[2] Together, HB 2259 and Rule 15 require operators to address their inactive land inventory annually in order to have their Organization Report (Form P-5) renewed.[3] A current organization report is required to conduct oil and gas operations in Texas that are subject to the Commission's regulatory jurisdiction.[4]

The Commission requires operators to renew their organization reports annually.[5] Each operator must complete and file a Form P-5,[6] meet specific financial security requirements,[7] and pay the necessary renewal fee.[8] The Commission mails out notification and information to each organization for update of the organization report file annually[9]—this is generally referred to as the "P-5 Renewal Packet."

1 TEX. NAT. RES. CODE § 89.021-030.
2 16 TEX. ADMIN. CODE §3.15.
3 TEX. NAT. RES. CODE § 89.021-030; 16 TEX. ADMIN. CODE §3.15.
4 16 TEX. ADMIN. CODE §3.1(a)(1).
5 16 TEX. ADMIN. CODE §3.1(a)(7).
6 *Id.*
7 16 TEX. ADMIN. CODE §3.78.
8 *Id.*
9 *Id.*

Requirements for Inactive Wells

The P-5 Renewal Packet also includes a list of that operator's inactive wells. In addition to maintaining a current P-5, the Commission also requires any operator of inactive wells to meet the plugging requirements of Statewide Rule §3.14 (Rule 14)[10] and certain surface equipment cleanup and removal requirement of Rule 15.

The Commission defines "inactive well" as "[a]n unplugged well that has been spudded or has been equipped with cemented casing and that has had no reported production, disposal, injection, or other permitted activity for a period of greater than 12 months."[11] Rule 14 requires that plugging operations commence on a dry hole or inactive well within one year of the date drilling or operations cease.[12] It further requires that plugging operations proceed with "due diligence" until completed, unless the Commission approves a plugging extension under Rule 15.[13]

The specifications for plugging operations can also be found in Rule 14. Additionally, the Commission provides estimates of plugging costs for each district (calculated average per-foot costs) on its website.[14]

The alternative to plugging is to return the inactive well to active operation. In December 2016, the Commission adopted amendments to Rule 15, effective January 1, 2017, which modified the standards for returning an inactive well to active operation and the definition of a "producing" well.[15] As of January 1, 2017, an oil well is considered "producing" if it produces either: (a) 5 barrels each month for 3 consecutive months; or (b) has produced 1 barrel each month for at least 12 consecutive months.[16] A gas well is considered producing if it produces either (1) 50 MCF each month for 3 consecutive months; or (2) 1 MCF each month for 12 consecutive months.[17] An inactive well must meet these oil and gas production requirements to be returned to active operation.[18]

Surface Equipment Cleanup and Removal Requirements

The inactivity period of each well governs what surface equipment cleanup and removal requirements the operator must meet.[19] If the well is inactive less than 5 years, the operator is required to disconnect the electricity to that well.[20] If the well has been inactive for at least 5 years but less than 10 years as of your next P-5 renewal date, then the operator must also purge all fluids from tanks, pipes, and vessels.[21] Any wells inactive for 10 years or longer must remove all surface equipment and related piping, tanks, tank batteries, pump jacks, headers, fences and

[10] 16 TEX. ADMIN. CODE §3.14.
[11] 16 TEX. ADMIN. CODE §3.15(a)(6).
[12] 16 TEX. ADMIN. CODE §3.14.
[13] *Id.*
[14] Cost Calculation: Plugging Cost Estimates, http://www.rrc.state.tx.us/oil-gas/compliance-enforcement/hb2259hb3134-inactive-well-requirements/cost-calculation/.

[15] 16 TEX. ADMIN. CODE §3.15(a)(1), adopted in 41 TEX. REG. 9465 (Dec. 2, 2016).
[16] *Id.* Prior to the amendments that took effect January 1, 2017, an oil well was not considered producing unless it was producing 10 barrels each month for at least 3 consecutive months.
[17] *Id.* Prior to the amendments that took effect January 1, 2017, a gas well was not considered producing unless it was producing 100 MCF each month for at least 3 consecutive months.
[18] *Id.*
[19] 16 TEX. ADMIN. CODE §3.15.
[20] *Id.*
[21] 16 TEX. ADMIN. CODE §3.15. For example, if your current P-5 expires on April 30 and you are filing your P-5 renewal for the year beginning May 1, 2018, then you would need to include all wells with a shut-in date between June 2008 and May 2013.

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