

STAFF REPORT

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02/04/19

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CONSIDER SPONSORING LEGISLATION IN THE 2019-20 LEGISLATIVE SESSION TO ADDRESS THE DECOMMISSIONING OF OFFSHORE OIL AND GAS FACILITIES

SUMMARY:

This item recommends that the Commission sponsor legislation to address the decommissioning of offshore oil and gas facilities. Staff recommends two changes to current law. The first change is to specify when a lessee or operator accrues decommissioning obligations. The second change is to clarify the conditions the Commission may consider when considering an application to assign, transfer, or sublease an oil or gas lease and to define an assignee. The goal with both concepts is to provide the Commission with additional statutory tools to responsibly manage the state's remaining oil and gas leases.

BACKGROUND:

In California, existing law generally prohibits the Commission from issuing new offshore oil and gas leases. There are 19 leases or agreements for offshore production entered into decades ago that remain in force today. The Commission may approve an assignment, transfer, or sublease of an existing offshore oil and gas lease to a qualified person or corporation.

Between 1938 and 1968, the Commission issued roughly 50 offshore oil and gas leases. The bulk of which were issued subject to the Cunningham Shell Act of 1955 (Public Resources Code section 6827). Pursuant to this section, these leases lack end dates; they continue as long as oil or gas is producing in paying or commercial quantities. When production ends, the leases expire, terminate, or are quitclaimed by the lessee to the Commission. Existing law requires that oil and gas leases include security, usually bonds, to ensure performance, including a requirement that the lessee maintain an adequate bond to ensure the lessee complies with the lease, including its decommissioning responsibilities. California law lacks specific language requiring previous lessees or operators to accrue decommissioning costs when a lease is assigned, transferred, or sublet. While the Commission's practice has been to include this as a requirement when it approves a lease amendment or transfer, the statute does not specifically state that this is required.

In the past few years, two oil companies, Venoco LLC and Rincon Island Limited Partnership, declared bankruptcy, leaving California responsible for

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decommissioning offshore oil development sites in state waters. The bonds the lessees held fall far short of what will be necessary to fund decommissioning. In 2018, the Commission received an \$108.5 million appropriation from the General Fund to fund a portion of the costs to permanently secure, plug, and abandon infrastructure and wells associated with the quitclaimed leases. Some of the total costs, estimated to be hundreds of millions of dollars, will be paid by a former lessee, but the State of California will still incur significant financial liability. Staff believes that certain statutory requirements associated with federal oil and gas programs may provide a framework to better protect the State of California.

STAFF ANALYSIS AND RECOMMENDATION:

Clarification of when a lessee or operator accrues decommissioning obligations

The Bureau of Safety and Environmental Enforcement is the federal agency responsible for safety and environmental protection related to offshore oil and gas development on the Outer Continental Shelf. Regulations for oil and gas operations on the Outer Continental Shelf, including decommissioning requirements for oil and gas facilities, are in 30 Code of Federal Regulations, part 250, subpart Q. The regulations require, among other things, that a lessee or owner of operating rights remove all devices, works, and structures from the premises no longer subject to a lease within 1 year after the lease is terminated.

The federal regulations specify that lessees and owners of operating rights are jointly and severally responsible for meeting decommissioning obligations for facilities on leases, including obligations related to lease-term pipelines. Decommissioning obligations accrue when certain actions occur, including when an entity becomes a lessee or owner of operating rights of a lease on which there is a well that has not been permanently plugged, a platform, a lease-term pipeline, or other facility, or an obstruction. These obligations also accrue when a lessee or operator is or becomes the holder of a pipeline right-of-way on which there is a pipeline, platform, or other facility, or an obstruction, or when a lessee or operator re-enters a well that was previously plugged.

Staff recommends that the Commission sponsor legislation to add language to the Public Resources Code, similar to the federal regulations, that would make explicit that decommissioning obligations accrue when a lessee or operating right owner receives an entitlement to use state sovereign lands for the production of oil and gas or in furtherance of the production of oil and gas from state sovereign lands and that these obligations continue until all infrastructure and improvements have been decommissioned (see 30 C.F.R. § 250.1702); that would make those parties jointly and severally liable for those decommissioning obligations (see 30 C.F.R. § 250.1701); that would detail general requirements

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for decommissioning (see 30 C.F.R. § 250.1703); that would require those obligations to be performed within 1 year of a lease terminating, absent an extension of time being granted by the Commission (see 30 C.F.R. § 250.1725); and that would give the Commission authority to develop regulations on the matter. This proposed legislation is intended to reduce or eliminate the state's future financial liability for decommissioning oil and gas infrastructure and ensure that all lessees, including those who previously benefited from state lease operations, fulfill the decommissioning obligations in their leases.

Clarification of the conditions the Commission may consider when considering an application to assign, transfer, or sublease an oil or gas lease and to define an assignee

Lessees occasionally request that the Commission transfer, assign, or sublease their lease—or a percentage of the lease—to another operator, which requires Commission approval at a public meeting. The Commission has approved dozens of assignments and transfers over the past few decades.

The Commission and the lessee can agree to include new lease terms in an assignment, transfer or sublease. Examples of new terms included in recent assignments are increasing the bond amount and terms, requiring compliance with current or new relevant regulations during the life of the lease, requiring capital expenditures, requiring a lease management fee to reimburse staff for lease administration and implementation costs, and requiring consent for Commission staff to perform safety audits.

When the Commission considers an application, it carefully reviews the applicant's financial information to ensure it can perform under the terms of the existing lease. The Commission typically requires the assignee, transferee, or sublessee to maintain the bonding and insurance requirements applicable to the existing lessee, and to be responsible for paying all rent and royalties associated with the lease. But while this is the Commission's practice, the statute, Public Resources Code section 6804, lacks specificity about what factors the Commission should consider when reviewing an application.

Public Resources Code section 6804 authorizes the Commission to transfer, assign, or sublease an oil or gas lease or permit. This statute, however, does not specify the conditions the Commission should consider when evaluating an application to transfer, assign or sublease an oil or gas lease permit.

Existing law can be improved by specifying that when considering an oil or gas lease assignment, transfer, or sublease, the Commission may consider whether a proposed assignee is likely to comply with the provisions of the assigned lease

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for the duration of the lease term as determined by: 1) the proposed assignee's prior experience with offshore oil production; 2) any financial or economic considerations that may affect a proposed assignee and its ability to comply with the lease terms; 3) any information about the proposed assignee's compliance or noncompliance with other contractual obligations to the state or to another party; and 4) any record of noncompliance with other laws or regulations.

Existing law can also be improved by defining an assignee as the person or entity in whose name the lease will be held and any other person or entity that has functional management and control over that person or entity. This definition clarifies that not just changes to the assignee, but mergers, acquisitions or changes in the overall controlling structure where the leasing entity, such as a corporation or limited liability company, remains unchanged but the ownership or control of that leasing entity changes, constitutes an assignment that must be approved by the Commission. This protects the Commission and the state from operational changes that could affect a leasing entity's ability to meet its ongoing obligations under its lease.

Similar legislation was introduced in 2017 in AB 1472 (Limón). Though the Legislature approved the bill with bipartisan support, the Governor vetoed it because he thought it was unnecessary given the Commission's existing broad authority. Staff, however, believes that the proposed clarification is beneficial and will better protect the Commission and the state from operational changes that could affect a leasing entity's ability to meet its ongoing obligations under its lease, including its decommissioning obligations.

In conclusion, staff recommends that the Commission sponsor legislation to address the decommissioning of offshore oil and gas facilities because such legislation will provide additional tools to the Commission to support the responsible management of the remaining state oil and gas leases and the ultimate decommissioning of the associated infrastructure. Staff believes that legislation will help with the orderly decommissioning of offshore oil and gas facilities in the future and potentially reduce the state's potential abandonment liability by clarifying lessee and operator obligations. Codifying decommissioning obligations will also highlight the expectations of the state when the Commission is considering an oil and gas lease assignment to ensure future operators have the financial capacity to perform those obligations.

OTHER PERTINENT INFORMATION:

This action is consistent with Strategy 1.1 of the Commission's Strategic Plan to deliver the highest levels of public health and safety in the protection, preservation, and responsible economic use of the lands and resources under the Commission's jurisdiction.

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RECOMMENDED ACTION:

It is recommended that the Commission:

Sponsor state legislation, as described above, to address the decommissioning of offshore oil and gas facilities.