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Oil Patch to Face Heightened Environmental Scrutiny

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Recent regulatory pronouncements indicate the oil patch will continue to face heavy regulatory scrutiny in 2018 and beyond. Recent action at both the federal and state levels will put increasing pressure on the exploration and production ("E&P") industry to focus on environmental compliance. These initiatives indicate impending compliance and enforcement approaches specific to the E&P industry. Of note, in May 2018 the U.S. Environmental Protection Agency ("EPA") announced development of an audit program specific to the E&P industry, while in June 2018 the Texas Railroad Commission ("RRC") announced its intention to inspect every on-shore well in the state within 5 years. These announcements carry substantial weight, and are discussed in greater detail below.

Environmental Protection Agency E&P-Specific Audit Programs

On May 15, 2018, EPA announced that it is developing a New Owner Clean Air Act Audit Program ("Audit Program") tailored to the upstream oil and natural gas industry. Although EPA released a New Owner Audit Policy in 2008, the proposed 2018 Audit Program is specific to E&P facilities and emphasizes air compliance and vapor control. EPA has developed a draft standard Audit Program Agreement template, for which it is seeking stakeholder comments until July 2, 2018.

As proposed, the Program would allow companies acquiring E&P sites to notify EPA within 6 months of an acquisition and seek to undertake an audit for air emissions compliance. The length of the audit is negotiated, and violations identified must be disclosed and addressed within 60 days. EPA states it will not seek penalties for violations that are corrected, with some exceptions, discussed below.

The importance of EPA's proposed Audit Program cannot be understated. By proposing an industry- and media-specific audit and immunity program, EPA is signaling that it will continue to focus heavily on the E&P industry and that it believes state regulation and enforcement may not be sufficient. This is an unusual step by EPA for at least two reasons. First, it is unusual for an audit and immunity program to be focused on a specific industry and, more narrowly, on that industry's air emissions. Second, in light of the overwhelming number of states which have been delegated Clean Air Act ("CAA") enforcement authority, EPA is signaling states may not be sufficiently focusing on this industry. In light of EPA's 2018 maximum per diem statutory penalties of $97,229 per violation for CAA violations, getting a jump on CAA compliance should be an important industry focus. (40 C.F.R. § 19.4, Table 2.)

The compliance parameters set by EPA's proposed Audit Program impose requirements which are not realistic given actual industry operations. For example, EPA's proposed 60 day compliance period fails to adequately consider practical, every day issues that confront the industry, including market availability of emission control devices, the time it takes to engineer and install control devices, tank repairs or replacement to account for emission controls, let alone crew and consulting expert availability to ensure compliant corrective action activities.

Further, EPA indicates it will continue to seek enforcement for violations that "could have been identified and disclosed" but were not, as well as for those violations that were not timely corrected where facts may be different than as represented by the regulated entity. Finally, this program applies to newly acquired facilities; it does not address existing owned facilities. Disclosures made under the Audit Program for newly acquired facilities may likely provide a roadmap for enforcement against existing facilities.

Takeaways

EPA is signaling heightened enforcement. At this time, industry should consider taking advantage of available state audit and immunity programs to get in front of the enforcement curve. Many states, including Texas, Oklahoma, Wyoming and others, have programs that allow industry to achieve compliance and mitigate penalties at the state level. Should EPA become involved, the potential for higher penalties will exist.

Railroad Commission Enhanced Investigation Initiative

In June 2018, the RRC released its Oil and Gas Monitoring Enforcement Plan ("Enforcement Plan"), pursuant to which the Agency advised it will inspect every well in the state within the next 5 years, an effort that the Agency has not undertaken in more than a decade. In FY 2019 alone, the Agency intends to increase the number of wells inspected within the last 5 years from 43% as of FY 2017 to 80%, *meaning that the Agency will heavily focus on wells not inspected within the last 5 years*. Overall, the RRC will inspect 100,000 of the state's 434,000 wells per year over the next 5 years. The Plan further stipulates that the Agency will inspect all offshore wells in state waters every 2 years.

While the RRC's Monitoring and Enforcement Plan reviews general compliance, environmental requirements will comprise a significant component. Environmental regulatory requirements imposed by the RRC include, among other things, H_2S monitoring and compliance, including equipment compatibility, public notice and contingency planning, as well as limitations on venting and flaring VOCs, pit management and closure.

The Agency will prioritize well inspections by taking into account, among other factors: (i) proximity to public or sensitive areas; (ii) operator's compliance history and (iii) knowledge or concerns specific to a given geographical area. The Agency emphasizes that responses to emergencies and complaints will continue to receive the highest priority, with incorporation of lower priority inspections as time allows.

Takeaways

In response to the increased inspection efforts, E&P companies should consider gaining a thorough understanding of facility operations and compliance prior to any inspection. A good option is to take advantage of the Texas Audit Privilege Act (the "Audit Privilege Act"), which provides immunity from administrative penalties for those violations discovered, disclosed and corrected during a self-audit for which the company provided advanced notice to the RRC. Generally, the RRC will allow 6 months to identify and disclose any violations, and another 6 months to complete corrective actions to rectify those violations. In terms of industry prioritization, an early focus on sour gas (H_2S) facilities would be appropriate as such facilities are heavily regulated at the state level (by both the RRC and the Texas Commission on Environmental Quality).

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the below.

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