

Oil and Gas Technical Advisory Board
Bonding Program Workgroup Meeting Summary
February 15, 2005

The Workgroup meeting began at 10:00 and concluded at about 1:15PM. The meeting began with a summary of the January 27 Workgroup discussions and edits to the January 27 Workgroup meeting summary.

A discussion ensued about the history of development of the O&G Act and its bonding provisions. Steve Rhoads, POGAM, explained that the penal bond was written into the O&G Act by design. It was never intended to represent a “full cost” plugging bond, rather it was intended to be a penalty. The single and blanket rates were negotiated at that time and provisions were made to update those rates periodically to reflect Commonwealth plugging costs. The Department was again questioned as to why we were pursuing this as there is a high compliance rate and the present bonding system seems to be working. Alan Eichler indicated that the compliance rate only reflects inspections that are done and not all wells are inspected. Dave Hogeman also restated the reasons as contained in the January 27 meeting summary. Specifically the Department expressed concern that the present \$25,000 blanket bond is inadequate for the high numbers of wells that they frequently cover.

Dave Hogeman then gave an overview of several bond matrices developed after the last Workgroup meeting. The opinion expressed by industry was that the matrices reflect more of a performance bond system and not the penal bond system envisioned in the O&G Act. Industry also expressed the opinion that they could not get bonds at the higher blanket rates on the matrices. They would have to put up cash, which was not feasible. {**Note:** this is not the opinion expressed by the surety industry representatives that participated in the December 21, 2004 meeting by conference call as reflected in the minutes of that meeting as follows:

Surety Issues: Michael A. Toppi and Mathew M. Raino from St.Paul/Travelers Bond Insurance were connected by phone for a portion of the meeting and provided their perspective on PA’s current and proposed bonding system structure. Their input is summarized as follows:

- 1) Sureties see Oil and Gas drilling as relatively high risk
- 2) Small producers need to provide acceptable financial assurance to secure a bond
- 3) PA's proposed bond structure/categories looks good to them
- 4) The penal bond should approximate the anticipated plugging cost
- 5) They prefer to have the option of either paying the penalty **or** plugging the well}

Discussion then focused on further developing a penal bond proposal. Dave Hogeman suggested a system that established a four part penal bond, each part covering a specific permit responsibility, i.e. drilling, plugging, site restoration and water supply. Any

forfeiture would then only affect that individual bond, not all four. DEP concluded that all bonds would have to remain in effect for the life of the well. After some discussion, it was concluded that this system, although representing some additional flexibility, still wouldn't work, as it would ultimately be cost prohibitive to industry.

The Department was questioned about the status of its permit fee analysis. Dave Hogeman indicated that analysis is still underway and will be handled on a separate track from this bond rate analysis. Any permit fee increase will be handled as a regulation change. DEP does not anticipate asking TAB to help develop the permit fee proposal, but will present the proposal to TAB at the appropriate, as yet undetermined, time. The program has been directed to develop a permit fee system that would cover the Department's cost to administer the regulatory program. It would include a CPI adjustment factor. Steve Rhoads noted that DEP should be careful not to double-cover program costs in both a bonding proposal and a permit fee proposal. He also indicated that the CPI is 1.9 times the 1984 rate so that a blanket bond based on this rate alone should be increased to \$47,500. It was also noted that the option of additional permit fees to supplement the penal bond system would not be a good option considering that DEP is already reevaluating permit fees.

The discussion then focused on the goals of a bonding system. Steve Rhoads expressed the opinion that it is a penal bond by law and should be viewed as such. The bond is also only one part of the enforcement remedies available to the Department. DEP can also issue fines and penalties under several laws and DEP can pull permits. A discussion ensued about what in reality happens when an operator forfeits a bond? The conclusion was that because any bond forfeiture would involve a post-84 permit and almost all of the bonds are blanket bonds, the operator is essentially out of business. If it is a pre-84 permit, there is no bond and the operator could possibly stay in business. Paul Kucsma reiterated the point that one of the problems is that some operators that forfeit bonds have also disappeared and there are few remedies available when that happens.

Len Paugh, IOGA, presented AFE (Authority for Expenditure) cost estimates for plugging wells of various types and depths (copy attached). The 3 provided examples showed that salvage value from the well, mainly pipe and tubing, exceeded the plugging and site restoration costs in every case. There was general industry consensus that this is an accurate conclusion and that DEP could possibly look at forfeiture plugging as a profitable enterprise. Dave Hogeman noted that some prior examples could not document this "net profit" from plugging. In response to a question, the industry representatives indicated that they could not provide any additional plugging cost data. DEP also noted that the bond rate is to reflect DEP's plugging cost and that we could simply determine our historical plugging cost and update the bond rates accordingly.

The discussion then turned to further refinement of a penal bond system and the next steps for the Workgroup. It was decided that DEP would prepare and distribute to the group a summary of this meeting and a narrative description of a proposed updated penal bond system being discussed by the Workgroup. The factors discussed by the Workgroup for consideration in an updated proposal are:

- 1) A single and (1) blanket penal bond system should be maintained
- 2) Legislative changes are not necessary or warranted
- 3) The blanket well bond/single well bond equivalency could be adjusted
- 4) Factors to consider in updating the bond rates include:
 - a. The penal, not performance, nature of the bond
 - b. The potential net cost to DEP to plug post-84 wells
 - c. The need to achieve further industry compliance
 - d. Adjustments to industry plugging costs to reflect
 - i. DEP plugging program overhead costs (contract preparation, administration and inspection)
 - ii. Pre- vs. Post-84 plugging costs
 - iii. The CPI increase since 1984 is approximately 95%

Dave Hogeman indicated that the Department was not necessarily agreeing to this concept, but would take it under advisement. The Workgroup proposed another Workgroup meeting to further refine a proposal, including bond rates, before the April 14 TAB meeting. The next Workgroup meeting is scheduled for March 29 at 10:30 AM at the Moshannon DEP office.