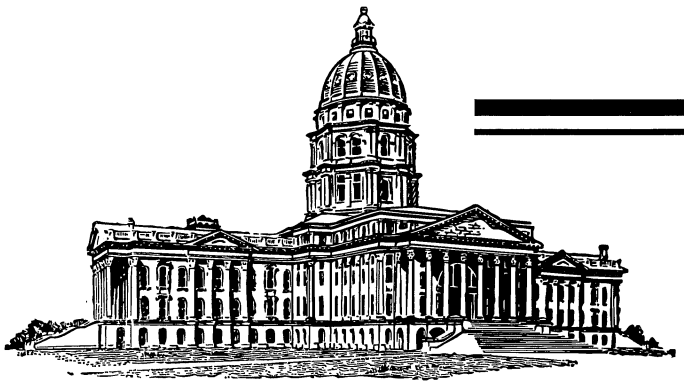

PERFORMANCE AUDIT REPORT

Reviewing the Activities of the Corporation Commission's Conservation Division: A K-GOAL Audit

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
February 1998

98-36

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about $8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

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February 20, 1998

To: Members, Legislative Post Audit Committee

Senator Lana Oleen, Chair	Representative Eugene Shore, Vice-Chair
Senator Anthony Hensley	Representative Richard Alldritt
Senator Pat Ranson	Representative Doug Mays
Senator Chris Steineger	Representative Ed McKechnie
Senator Ben Vidricksen	Representative Dennis Wilson

This report contains the findings, conclusions, and recommendations from our completed performance audit, *Reviewing the Activities of the Corporation Commission's Conservation Division: A K-GOAL Audit.*

The report also contains appendices showing the criteria the Division uses for assigning risk levels to Priority I abandoned wells, a comparison of the financial assurance provisions that Kansas and other states use, and the effect of increased production by certain wells in the Hugoton field.

This report includes several recommendations for improving the Divisions's oversight of oil and natural gas production. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Question 1: Does the Conservation Division Have an Adequate Program For Ensuring that Oil And Gas Producers Comply with State Regulations?

Question 2: Is the Conservation Division Effectively Dealing with the Backlog Of Old, Unplugged Oil And Gas Wells in the State?

Based on the information available, the Division has estimated that Kansas is responsible for plugging at least 49,000 abandoned wells, but there probably are more. *In 1995, Division officials began to try to identify all the abandoned oil and gas wells in Kansas that need to be plugged. It's nearly impossible to know how many abandoned wells there really are because many of the wells were drilled before regulation began in the 1930s, and detailed records never were made about the number and location of those old wells. Because so many abandoned wells still may be discovered, Division officials acknowledge the actual number of abandoned wells the State is responsible for plugging could be higher.* ..... page 18

The Division has estimated that nearly one-third of the known abandoned wells pose an environmental or safety risk, but it hasn't yet determined the level of risk posed by many of those wells. *In 1995, Division staff estimated that 15,000 of the 49,000 abandoned wells posed an ongoing risk to the environment or to the public's safety. These are known as Priority I wells. Since then, the Division has been involved in an ongoing effort to more carefully inventory and classify the wells identified in the 1995 estimate. As of January 1998, the Division has confirmed the existence of nearly 10,000 Priority I abandoned wells. But many sites known to contain Priority I wells haven't yet been inventoried.* ..... page 20

About two-thirds of the abandoned wells the Division plugged in fiscal year 1997 had been inventoried and classified as having the most potential for harm. *In fiscal year 1997, the Division plugged 427 Priority I wells, about 90% of which were in the most serious categories. Thus, the Division was plugging the abandoned wells that posed the most serious risk to the environment first.* ..... page 21

It could take until 2008 or beyond to plug the most serious abandoned wells that might exist in the State. *Historically, the Commission has spent about $500,000 per year to plug abandoned wells. The 1996 Legislature approved a six-year plan to give the Commission about $1.6 million in new money for that purpose. Division officials plan to use about $1.2 million per year for plugging abandoned wells and $400,000 per year for site remediation work. This means about $1.7 million will be spent in each of the next six years for plugging wells.* ..... page 22

When the enhanced funding expires in 2002, we estimate the Division will have plugged only 2,800 wells, leaving a significant backlog of risky or unsafe abandoned wells. If the Legislature were to extend the enhanced funding for at least six years beyond the planned cut-off date, we estimated it could take until 2008 at the earliest to plug Kansas' most dangerous abandoned wells.

For the small well-plugging projects contracted out by district field offices, we couldn't tell whether the State paid the lowest cost. *Abandoned wells are plugged by private companies hired by the State. The Division of Purchases has authorized the Conservation Division to award contracts expected to cost less than $10,000. For those less* ..... page 24

expensive well-plugging projects—which accounted for about one-third of the moneys spent in fiscal year 1997—the bid documentation was so poor that we frequently couldn't tell whether jobs were awarded fairly, or whether the districts' contracting process resulted in the lowest cost to the State. The Division also doesn't have any written procedures for field staff to follow when purchasing well-plugging services.

Question 3: Does the Conservation Division Have Adequate Controls to Ensure That the State Doesn't Incur Costs for Plugging Wells Abandoned by Operators?

 The 1996 legislation was designed to limit the State's liability for the costs of plugging abandoned wells. Starting in January 1998, operators must post a financial assurance—such as posting a bond—when they receive an initial license or renew their annual license.

Two forms of financial assurance allow operators to pay nonrefundable fees to the State rather than post a bond. However, the law doesn't specify whether these moneys are to be accounted for separately and allowed to grow to pay future well-plugging costs. Also, the law doesn't specify how long operators' financial assurances are to remain in effect.

Even if the cash the State receives under this law were set aside for plugging wells abandoned in the future, there's no certainty it will be enough. That's because there's no way to know yet how much will be collected, or how much will be needed in the future.

 By law, the Division can hold any one of several persons responsible for plugging an abandoned well. For a sample of contracts, district staff identified an operator who was legally responsible for plugging an abandoned well five times out of every six. But staff also indicated they couldn't find a way to make that person pay the cost of plugging the wells. The reasons they cited appeared to justify the use of State funds to plug abandoned wells. But because there was almost no documentation showing the extent of the research conducted, we couldn't tell whether Division staff pursued each operator as aggressively as they could have.

This audit was conducted by Cindy Lash, Joe Lawhon, Jill Shelley, and Sonja Erickson. Randy Tongier was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Lash at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (785) 296-3792, or contact us via the Internet at: **LPA@mail.ksleg.state.ks.us.**

Reviewing the Activities of the Corporation Commission's Conservation Division: A K-GOAL Audit

The Kansas Governmental Operations Accountability Law (K-GOAL) required Legislative Post Audit to conduct a performance audit of the Kansas Corporation Commission in time for the 1998 Legislature's consideration. The purpose of such K-GOAL audits is to periodically review selected agencies, identify areas of inefficiency and ineffectiveness, and provide information for potential legislative action to modify or terminate the agency's operations.

At the direction of the Legislative Post Audit Committee, this audit focused on the Commission's regulation of the State's oil and gas producers. Those regulatory activities are carried out by the Commission's Conservation Division. At the time the audit was approved, specific legislative questions or concerns were expressed about how the Division was dealing with the backlog of unplugged wells, and whether it had sufficient controls to hold operators responsible for abandoned wells. Legislators also expressed an interest in knowing how the Division was regulating prorated oil and gas fields. This performance audit answers the following questions.

1. **Does the Conservation Division have an adequate program for ensuring that oil and gas producers comply with State regulations?**

2. **Is the Conservation Division effectively dealing with the backlog of old, unplugged oil and gas wells in the State?**

3. **Does the Conservation Division have adequate controls to ensure that the State doesn't incur costs for plugging wells abandoned by operators?**

To answer these questions, we reviewed State laws and Commission regulations related to the production of crude oil and natural gas. We interviewed Division employees and examined Division records involving the drilling and plugging of wells. These included daily activity reports for district staff, bid documents, contracts and expenditure records for wells plugged using State funds, records showing the quantity of oil or gas produced from wells in prorated fields, and inventory records of abandoned wells that are the State's responsibility. We also contacted other states about their regulation of oil and gas production, and interviewed people with specific knowledge about oil and gas production within Kansas. In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

Our findings begin on page five, after a brief overview of the Conservation Division's efforts to regulate the oil and gas industry.

Overview of the Conservation Division's Efforts To Regulate the Gas and Oil Industry

The Conservation Division's Role Is To Protect Kansas' Environmental Resources by Overseeing the Production of Natural Gas and Crude Oil

The Conservation Division has 82 full-time-equivalent positions, and its expenditures for fiscal year 1998 are estimated to be about $6.9 million. The Division is funded almost entirely through fees assessed against the oil and gas industry. It's headquartered in Wichita, and has district offices in Chanute, Wichita, Hays, and Dodge City. The number of people assigned to the district offices ranges from 10 in the Dodge City district to 15 in the Chanute district.

To help ensure that crude oil and natural gas are properly produced in Kansas, and to prevent the waste of these resources, the Division oversees activities related to the following:

- drilling and plugging wells
- disposing of underground salt water that's obtained when pumping oil and gas
- repressuring and water flooding of oil and gas reservoirs
- remediation of sites contaminated by oil and gas activities

Staff from the district offices have most of the day-to-day contact with oil and gas well operators. Most district staff are field inspectors whose jobs require them to visit production sites and observe work in process. Field staff may observe the drilling or plugging of a well, witness the pressure testing of an injection well, or investigate a complaint or report of a spill.

Staff at the Division's central office in Wichita process most of the Division's paperwork. They issue operator licenses, approve permits to drill and plug wells (including injection wells), review operator-submitted reports that describe completed drilling and plugging activities, monitor the monthly production of wells located in about 25 prorated fields (fields that have limits on the quantity of oil or gas that can be produced from individual wells), and perform other tasks including data management and legal services.

Division staff specify methods for drilling and plugging wells that should prevent crude oil or salt water from mixing with and polluting the State's fresh and usable water supplies. They review drilling plans to ensure that well casing will be properly cemented to prevent the unwanted migration of oil, gas, or salt water. When spills occur, district staff inspect the site and verify that the spill has been cleaned up and the site remediated as necessary.

Division staff also review plans for injection wells to ensure that the saltwater brought to the surface during the pumping process is returned deep enough into the earth so it won't mix with usable groundwater. Commission regulations also require

Glossary of Terms for Oil and Gas Production

Commission order—Any official decision the Commission makes is summarized and recorded in an "order." Some orders direct a company to do something, while others may only state the Commission's findings or position regarding certain events.

Operator—The person or company who operates an oil or gas well.

Lease—An agreement in which an operator acquires the right to produce oil or gas on certain tracts of land.

Proration—The regulation of—and method by which limits are set on—the amount of oil or gas that can be produced by individual wells drawing from the same common source of supply. The amount set is known as the "allowable" level or limit.

Common source of supply—A unique underground reservoir of oil or gas that exists under two or more leases.

Allowable—The amount of oil or gas the Commission authorizes an operator to produce without negatively impacting the rights of other operators who are producing oil or gas from that same supply source.

Injection well—A well that places fluids into the earth at strategic levels in hopes of enhancing oil and natural gas production, or a well that returns fluids brought to the surface during oil and natural gas production.

Mechanical Integrity test—The process through which injection wells are tested to determine whether there are significant leaks in the underground casing. Significant leaks could lead to pollution of fresh and usable water.

injection wells to be pressure-tested at least once every five years to ensure that casing hasn't developed leaks, thereby allowing salt water to escape before being returned to the proper depth. Finally, Division staff review plugging reports submitted by operators to ensure proper plugging techniques were followed.

When operators fail to follow regulatory requirements, Division staff must coordinate their efforts to achieve compliance. District staff, central office staff, and the Commissioners all have roles in the process of enforcing State laws and Commission regulations, as shown below.

DISTRICT/CENTRAL OFFICE STAFF	LEGAL STAFF AND DIVISION DIRECTOR	COMMISSIONERS
- Identify problem - Direct corrective action - Document situation - if violation continues, recommend legal action	- Review documentation - Recommend order directing corrective action and assessing a fine	- Issue order directing corrective action and assessing a fine

As the table shows, these three groups are dependent on each other to properly enforce State laws and Commission regulations.

One of the Main Threats to Kansas' Fresh and Usable Water Supplies Is Abandoned Wells

Drilling for oil and gas started in eastern Kansas in the 1860s and moved to western Kansas by the 1920s. The Corporation Commission didn't begin regulating oil and gas producers until the early 1930s.

As Kansas oil and gas fields matured over the decades, production decreased and individual leases lost their value. Many times, the lease operators went bankrupt, died, or moved out-of-State, leaving behind abandoned, unplugged oil and gas wells. When this occurred, the State often became responsible for plugging these wells. These conditions continue to exist in Kansas today, which means that the number of abandoned wells that are the State's responsibility probably will continue to grow.

The 1996 Legislature approved a six-year plan to give the Commission more money to plug abandoned wells. According to Conservation Division officials, historically the Commission has spent about $500,000 a year to plug abandoned wells. To supplement this amount, the Legislature authorized the transfer of about $1.6 million annually (starting in fiscal year 1997 and ending in fiscal year 2002) to a newly created Abandoned Oil and Gas Well Fund. The sources of the new funding are as follows:

- $400,000 from the State General Fund
- $400,000 from the State Water Plan Fund
- $400,000 from the Commission's Conservation Fee Fund
- Half of all moneys received by the State from the federal government under the mineral leasing act (estimated to be about $400,000 annually)

The 1996 law states that this funding should be used only to investigate and remediate 109 specific sites of pollution from oil and gas activities, and to plug or repair abandoned wells drilled before July 1, 1996. Conservation Division officials told us they plan to allocate about $1.2 million per year toward plugging abandoned wells, while about $400,000 per year in State Water Plan Fund moneys will be used to pay for site remediation work.

Division officials also said they will continue to use the base $500,000 for plugging abandoned wells. That means about $1.7 million will be spent in each year of the six-year plan for plugging wells.

Does the Conservation Division Have an Adequate Program For Ensuring that Oil and Gas Producers Comply with State Regulations?

Although the Division has established reasonable regulations for oil and gas producers to follow, it hasn't developed written procedures to guide employees' regulatory actions. This may help explain why many of the actions taken by district staff weren't sufficiently documented to allow us—or Division managers—to fully assess the effectiveness of this program. When documentation was available, we generally could tell that Division staff were actively involved in monitoring activities and had taken appropriate actions, and that operators took corrective action when required. However, a number of shortcomings limit the effectiveness of those monitoring activities. These include inaccurate management information for determining whether wells are being drilled before they're approved, the lack of routine inspections, the absence of good complaint-tracking systems, and failure to specify deadlines for operators to correct problems.

The Division's enforcement efforts are weakened by significant delays within the Division in processing violations. In our sample, it took an average of six months for the Division's legal section to process and act on cases referred by district staff. The Commission also reduced or rescinded more than one-third of the fines it had ordered after operators appealed the fines and agreed to fix the problems. Finally, the Division hasn't enforced limits on the amount of natural gas produced by all wells in the Hugoton gas field. These and related findings are discussed in the sections that follow.

In General, the Commission Has Established Reasonable Regulations Regarding Oil and Gas Wells

Those regulations cover such things as drilling, operating, and plugging wells, and penalties for failing to do so properly. Both State law and Commission regulations provide a number of good controls that the Conservation Division uses to regulate the oil and gas industry. Examples include requiring operators to obtain a permit before they can drill a well, and requiring them to provide specific information when spills occur.

Commission regulations set fines for operators who violate these requirements, and State law allows the Commission to impose an additional penalty of up to $10,000 per day when operators fail to take a required action. As an additional check, when an operator fails to renew his or her annual license, district staff are notified and they may inspect that operator's leases. The major requirements for each area are summarized in the box on the following page.

Required Actions for Operators of Oil and Gas Wells, And Penalties for Failure to Comply

Requirements and penalties relating to drilling wells:

- Operators must file an application of "intent to drill" before drilling any well. Drilling can't start until the application is approved.
- Operators must contact the appropriate district office before drilling any well. This gives district staff a chance to verify that an application to drill was approved, and a chance to go to the site and observe the drilling work.
- Operators must submit a "well completion report" within 120 days after drilling begins on any well. This report provides a complete record about the results of the drilling.
- Potential fines range from a minimum of $250 for failing to notify the district office before drilling a well, to $1,000 for drilling without an approved notice-of-intent permit. In addition, State law says any person who drills a well without an approved permit shall be guilty of a class B misdemeanor. After the second violation, the operator is prohibited from drilling for six months, and for all subsequent violations, the operator is prohibited from drilling for 12 months.

Requirements and penalties relating to operating wells:

The Division requires varying types of information about non-plugged wells, which lets it determine, among other things, that the operator continues to assume responsibility for each well, that the well isn't polluting Kansas' fresh and usable water supplies, and that the operator has complied with Commission orders. A few examples are shown below:

- Operators must notify the appropriate district office within 24 hours of the discovery of a spill which isn't confined to a containment area.
- Operators of wells in prorated fields must report the quantity of materials (barrels of oil or cubic feet of natural gas) produced from individual wells.
- Injection well operators must have their wells pressure tested at least once every five years.
- Potential fines range from $250 to $1,000 for failing to notify the appropriate district office of a spill, or from $1,000 to $10,000 for failing to obtain Commission approval before using an injection well.

Requirements and penalties relating to plugging wells:

- Operators must either plug a well or file an application for temporary abandonment for any well that hasn't operated for 90 days. Temporary abandonment permits must be renewed annually, and Division policies allow up to nine renewals.
- Operators must plug wells in accordance with methods specified by the Commission.
- Operators must file a well plugging report with the Division within 60 days after plugging any well.
- Potential fines include $100 for failing to file the proper paperwork regarding either plugging or abandoning a well. Failure to notify the Commission before plugging any well is a Class C misdemeanor. Failing to plug a well is a severity level 10, nonperson felony.

Conservation Division Staff Have No Written Procedures To Guide Their Regulatory Actions, and Many of the Actions They Take or the Dates Things Happen Aren't Adequately or Accurately Recorded

Written procedures allow employees to know what actions they're expected or required to take in various situations. They also help ensure that those actions comply with applicable laws, regulations, and agency policies.

We found that the Division hasn't developed written guidelines for district staff to follow in the basic areas of investigating complaints, conducting routine monitoring activities, and carrying out enforcement actions. It has given officials in each district office the authority to carry out their work as they see fit, but none of those offices has developed written procedures either.

Without standardized procedures, there's an increased risk that field staff will handle cases inconsistently, won't act as quickly as they should, and won't require operators to take timely or appropriate corrective action.

Inadequate documentation makes it difficult for us—or for the Division—to assess whether many aspects of the oil and gas regulatory program are being properly carried out. The ability to make such an assessment depends on how readily someone can tell what actions were taken. That doesn't mean employees have to document every single action they take. But it does mean there should be an adequate and accurate record of the primary activities, findings, and decisions relating to the entities being regulated.

Although it was clear to us during our fieldwork that district staff are actively involved in monitoring oil and gas wells for compliance with applicable requirements, we found they often didn't record these activities or keep the results. Not having written procedures probably contributed to this problem. For example, we noted the following:

- *for 21 of 40 complaints we reviewed (53%), the date the complaint was received wasn't clearly documented.* Without that information, the Division can't be sure its staff are complying with the law requiring all complaints to be investigated within 72 hours.

- *in 16 of 54 cases where problems were identified and operators were ordered to take corrective action, we couldn't tell what follow-up action, if any, district staff had taken.* Without that information, we couldn't tell whether district staff actually verified that problems were corrected, or simply relied on what operators told them.

- *District staff frequently don't write-up the results of inspections that found no problems.* Without this information, the Division has an incomplete record of its inspection activities. If a district wanted to target its inspections to problem oper-

ators, for example, it would have to rely on employees' memories to know if an operator with no recorded problems was really "clean," or hadn't been inspected.

The Division's new Risk Based Data Management System, which is described in the profile below, will provide a standardized structure for district staff to record information about their activities when it becomes fully operational. This system may help address some of the documentation problems we saw.

The Division doesn't have accurate management information for determining whether wells are being drilled before they are approved. Before drilling a new well, Commission regulations require operators to obtain a permit from the central office and to contact the appropriate district office. The approval process and the on-site observations that accompany it are intended to ensure that the operator's drilling plans and actual practices will protect the State's fresh and usable water, and won't encroach on any other lease. Operators who drill a well before receiving approval are to be fined $1,000 by Commission regulation; State law specifies a number of other penalties that can or should be assessed.

In trying to determine whether wells had been drilled before they were approved, we analyzed the Division's computer data for the 32 months ending August 1997. These data showed that 47 wells had been drilled before drilling permits were issued. When we reviewed the files for these 47 wells, however, we found that either the date the well was drilled or the date the well was permitted had been entered incorrectly into the computer more than half the time. For 26 of these 47 wells, was wrong in the computer database. Division officials told us they don't have any procedures for ensuring that data entered into the computer are accurate.

Because these data are so unreliable, neither we nor the Division have any real way of knowing the extent to which wells are being drilled before they're approved. Our file review showed that only 9 of the 47 wells the computer initially identified

The Division's New Risk-Based Data Management System, When Fully Implemented, Should Provide Improved Tracking of the Status of Wells

Although the Division receives a great deal of information on wells, that information has been entered in several different databases, making it impossible to efficiently track the status of wells. In addition, data on things like complaints and inspections were kept only in the district offices, usually in paper files.

The new computer system, which was funded largely from a federal Department of Energy grant, will bring much of the Division's information about a well into a single, readily accessible location. The Division is finishing the process of transferring information from its master well database into the new system.

Officials told us they'll begin training district staff on how to use the new database in February 1998. Within six to eight months, they said, district offices should be able to enter data directly into the system about their activities, including complaint investigations, spill reports, results of mechanical integrity tests, and inspection data. Information showing the transfer of a lease between operators, which the Division has kept in a separate database, also will be entered into the new system.

(0.2% of all wells drilled during the 32-month period) actually had been drilled before a drilling permit was issued. However, the computer might have identified many more wells if the data had been accurate.

Division staff told us they weren't aware of this problem because they don't have time to make the kinds of comparisons we did. Not making some types of comparisons reduces their chance of identifying operators who are drilling wells in violation of State law.

One final note: when we pointed out the 9 improperly drilled wells our comparisons identified, central office staff indicated they would look into these situations to determine what fines should be assessed, and whether any other enforcement actions should be taken. These wells had been drilled from 1 day to 72 days before the drilling permit was approved.

Some District Monitoring Activities Need to be Strengthened To Provide Greater Assurances That Laws and Regulations Are Being Adequately Enforced

For those activities that were documented, it appeared to us that staff were actively engaged in oversight activities, although we couldn't always tell whether their actions were as thorough as they should be. Our findings are summarized below.

Three of the four districts don't have adequate systems for tracking complaints. In any regulatory program, complaints often alert regulators about who may be operating outside the approved requirements, where and what types of problems exist, and what harm those problems may be causing.

To determine how well the districts handled complaints they received, we reviewed a sample of 10 complaints from each one, or 40 in all. Based on these reviews we determined that district staff usually began their investigation of complaints within 72 hours as required by law. And when complaint investigations identified problems, district staff directed operators to take corrective action. But we found problems in the following areas:

- *all the districts processed complaints differently, and three of the four districts don't have a comprehensive log of complaints received.* As a result, these districts don't have any way of knowing how many complaints they receive, who complaints were against, whether those complaints were investigated (either at all, or within 72 hours), what matters were most often complained about, and the like. For example, one district office doesn't log in complaint calls separately. For calls that are complaints, office staff either inform a field technician about the complaint, or record some information about the call on a dry erase board in the district office. Once the necessary information is relayed to the field technician, the board is erased, eliminating centralized tracking information about that complaint.

- *district staff could provide documentation that only six of 40 complainants (15%) were notified about the outcome of each investigation.* Notifying complainants is a common courtesy that gives them some assurance their complaint was received, investigated, and appropriately acted upon. Complainants also may be more likely to report any other problems they see—including recurring problems with the thing they originally complained about.

- *district staff didn't begin their investigation of two complaints within 72 hours, as required by law.* In one case, district staff didn't investigate a complaint about an abandoned well for nine days. In the other case, district staff directed an operator to repair a leaking well and clean up the site the same day they received a complaint, but didn't inspect the site until more than two weeks later.

Although district staff do a lot of monitoring work, they don't conduct lease inspections on a regularly scheduled basis, which decreases their ability to independently verify the extent to which operators are complying with the law and protecting the State's water resources. One cornerstone of any regulatory agency's monitoring activities is periodic inspections of the people, facilities, or actions being regulated. Such inspections provide independent verification of how things actually are being operated, what problems may exist, and why. They also can act as a deterrent to ensure that the regulated industry is complying with all legal and regulatory requirements.

We noted that the Division doesn't systematically inspect oil and gas wells. Kansas law doesn't require periodic inspections, and Division officials told us their staff spend so much time observing other activities, like wells that are being drilled or plugged, they don't have time to perform inspections on a regularly scheduled basis. Instead, they told us, their staff do most inspections while performing other monitoring activities such as responding to oil spills and observing mechanical integrity tests, well drillings, and well pluggings.

We found that other oil- and gas-producing states don't conduct regular inspections, either. Nonetheless, not doing regular inspections limits a regulatory program's effectiveness because some sites may go for long periods of time without a review.

When the Division found that operators needed to take corrective action, they frequently didn't specify how quickly those problems should be corrected. As a general rule, when regulators identify problems they go through a process of formally notifying the violator about that problem, specifying how and by when it should be fixed, verifying that it has been fixed, and repeating the process if the problem hasn't been corrected.

Through our review of complaints and routine monitoring activities, we identified 54 cases where operators needed to take some sort of corrective action. Those

corrective actions ranged from cleaning up a spill, to conducting a pressure test on an injection well, to filing required paperwork. We looked at the timeliness and appropriateness of the actions taken by well operators and district staff in each of these cases. (Not all elements were applicable to all cases.)

Our review showed that, in 49 of 54 cases (91%), operators carried out the corrective action as required. In the five other cases, district staff forwarded the case to the Division's legal section for further action and possible fines.

Our review also showed, however, that district staff need to improve their handling of problem cases to provide greater assurance that such problems will be corrected. Our findings are summarized below:

- *In 24 of 48 cases (50%), we found no evidence that district staff specified the deadline by which corrective actions had to be taken.* In the absence of a clearly stated and documented deadline, the Division is less able to hold an operator accountable for failing to respond in a timely manner.

  For example, in one case a saltwater disposal line broke in a wheat field in early January, causing a large spill. The Division directed the operator to clean up the spill and submit a remediation plan, but didn't specify a deadline. The spill was cleaned up in a timely manner, but the operator never submitted the required remediation plan. The remediation work eventually was completed in mid-July, more than six months after the spill was first reported. (The operator said the landowner wanted him to wait until after harvest to remediate the site.)

- *When district staff found problems during monitoring activities, they didn't provide written notice of those problems to the operator about 20% of the time.* Written notification helps the Division hold operators accountable for complying with the law. In one case we reviewed, district staff determined that an operator had abandoned a well, but they didn't send him a letter about needing to file for a temporary abandonment permit. Field staff told us they talked with the operator when they first discovered the problem. But five months later, when we reviewed the file, the operator still hadn't requested the permit.

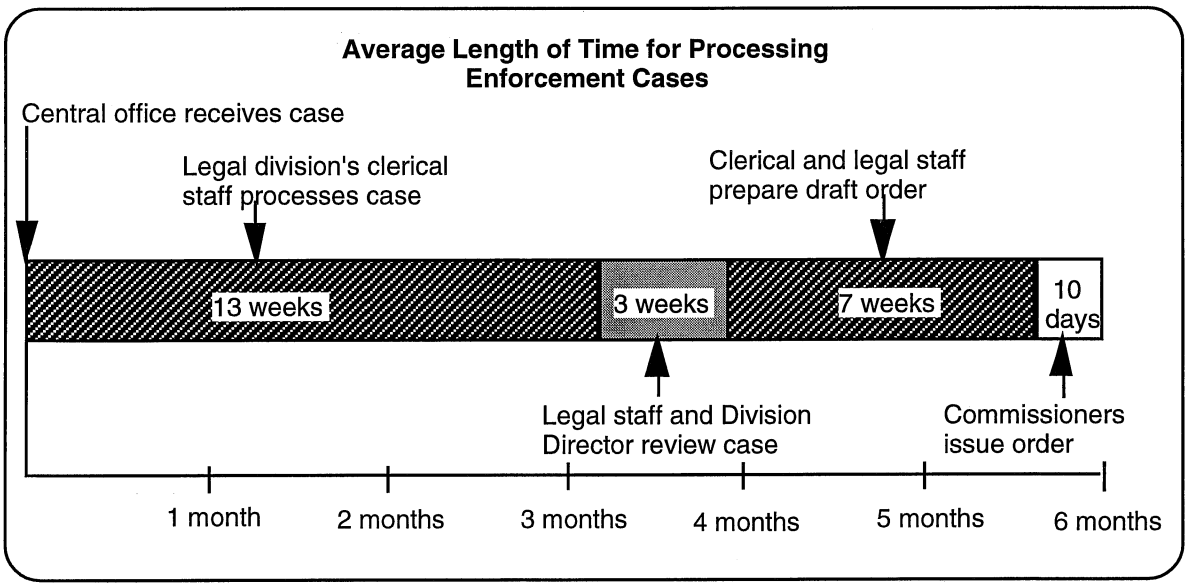
The Division's Enforcement Efforts Are Weakened by Delays In Processing Violations and Reductions in Assessed Fines

If problems remain uncorrected despite regulators' best efforts, their next recourse is to take appropriate enforcement action against the person being regulated until he or she comes into compliance or is shut down. Enforcement actions that are allowed or required may include issuing a fine, taking away someone's license or permit to operate, or bringing civil or criminal charges against a person.

When district staff identify problems that operators don't correct, they refer those cases to the Division's legal section for action. Usually their referral includes a recommendation for what type of penalty should be imposed, given the circumstances of the case. The Commission makes the final decision. In assessing how well the Commission handles enforcement actions, we reviewed a sample of 20 cases district offices had referred for legal action—10 from 1996 and 10 from 1997. We identified the two problems described below.

It took nearly six months for the Conservation Division's legal section to process and act on cases referred by district staff for legal action. Those cases included operators who hadn't reported spills, operated unlicensed wells, abandoned wells without plugging them, and drilled wells without proper authorization. In one case we reviewed, for example, district staff worked for 10 months with an operator who failed to have a mechanical integrity test performed on an injection well. After the operator missed a deadline for the third time and district staff found that the well was leaking saltwater into a sensitive groundwater area, the case was referred for legal action.

The graphic below shows how long it took, on average, to move these 20 cases through the various steps for processing them.



As the graph shows, it took an average of just over 24 weeks to process these cases and obtain a signed Commission order. For an average of 13 weeks, cases were backlogged with the legal section's clerical staff, who prepares them for attorney review. Cases also were backlogged an average of 7 weeks while the clerical staff prepared draft orders for the Commission.

Division officials told us they were aware of these delays; however, no action had been taken until the fall of 1997, when some of the clerical case preparation work

was eliminated. Division management told us they hope this change will reduce the time it takes to issue an enforcement order, but it's too soon to tell how successful this change will be.

The Commission reduced or rescinded more than one-third of the fines it had ordered operators to pay after those operators appealed the fines and agreed to fix the problems. Of the 20 cases we reviewed from 1996 and 1997 that involved enforcement actions, the Commission ordered fines in 19. These fines ranged from $250 for failing to notify the district office before drilling a well, to $4,000 for not conducting mechanical integrity tests on four wells by their due date, to the $5,000 fine described in the profile on page 14.

Our review showed that the Commission reduced or rescinded 7 of these 19 fines (37%) after the operator appealed the order and agreed to fix the problem. It's important to remember that some of these fines were levied only after operators repeatedly failed to take corrective action, and that the problems caused by the operators may have existed for many months by this point. The table below shows what happened in these cases.

Commission Actions To Reduce Fines

Action NOT Taken By an Operator	Date Case Referred to Central Office	Date of Comm. Order	Original Fine Amount	Original Fine Reduced to:	Action Taken by operator
repair or plug a well that failed a mechanical integrity test	10/10/95	4/12/96	$1,000	$250	fine paid, well plugged
file temporary abandonment permits and conduct a mechanical integrity test	10/31/95	5/6/96	1,200	250	fine paid, wells plugged
plug an abandoned well	1/17/96	5/6/96	1,000	0	well sold
conduct a mech. integrity test	2/27/96	5/6/96	1,000	0	well plugged
conduct 3 mech. integrity tests	9/27/96	4/30/97	3,000	2,000	fine not paid, 1 well plugged
conduct a mech. integrity test	10/28/96	6/18/97	1,000	0	well plugged
conduct a mech. integrity test	12/31/96	6/18/97	1,000	500	fine paid, well plugged

Division officials told us that, when an operator appeals an order, they often try to negotiate a settlement—sometimes offering to reduce or rescind the fine if the operator fixes the problem. They said proceeding with an appeal hearing is costly to the State, and their goal is to see that the problem gets fixed.

Some Cases Referred by District Staff Are Straightforward, While Others Are Complex

District staff encounter many types of situations trying to enforce Commission regulations and State law. Sometimes the violation is relatively simple and operators fix the problem and pay the assessed fine. Other cases can be much more complex. An example of each is described below.

- During one lease inspection, district staff identified an operator who was actively pumping oil on a lease, yet his operator's license had been expired for more than two years. District staff recommended a $500 fine and submitted the documentation to the central office on February 14. On June 30, the Commissioners signed an order assessing a $500 penalty against the operator. On July 14, the Commission received a $600 check from the operator—$500 for the fine and $100 for a new license.

- During a December 18, 1995, lease inspection, district staff found that an operator had abandoned the lease and removed all pumping equipment from the site. They found 16 wells on the lease that needed to be plugged, and wrote a letter to the operator the next day giving him 30 days to plug them. Staff reinspected the site January 22 and found nothing had changed. District staff recommended a $16,500 fine and submitted documentation to the central office February 12, 1996.

  Division records indicate this operator's license expired July 30, 1995; district staff said they thought he'd quit operating in Kansas before then. Apparently, a mineral rights owner had filed suit in court regarding forfeiture of the lease.

  Central office staff reviewed the documentation and reduced the recommended fine to $5,000. Commissioners signed an order September 18 assessing the operator a $5,000 penalty.

  On February 11, 1997, Division legal staff wrote to the operator and advised him the Division had directed district staff to seal off all the operator's wells because they hadn't been plugged, nor had the fine been paid. The Division referred the uncollected fine to the Department of Administration. The State was awarded a judgment against the operator July 22, 1997, in district court, but no collections had been made as of December 31, 1997.

  Unless a new operator assumes operation of these wells, it's likely they'll be added to the inventory of unplugged wells the State is responsible for plugging.

While that may be true, it appears to us that this approach reduces operators' incentive to voluntarily correct problems, and further undermines the efforts of district staff who've previously worked to get the operator to come into compliance. In addition, the monetary penalty for delaying corrective action becomes more of a "nuisance" cost of doing business, rather than a financial deterrent. Finally, reducing or eliminating fines means that "problem" operators are less likely to reach the $3,000 threshold in the financial assurance system that would require them to obtain a bond or other assurance. (The financial assurance system is discussed in question three.)

Our Review of Production Records for the Hugoton Gas Field Showed the Division Wasn't Enforcing Limits On the Amount of Gas Produced

Some oil and gas pools in Kansas extend under more than one lease, and numerous wells may draw from the same common source of oil or gas. To ensure that each well's operator has an opportunity to get a fair share of the oil or gas from this common source and doesn't negatively impact any other operator, the Commission has issued orders called proration orders for such fields.

We reviewed these orders for the three largest gas fields in Kansas. They specify (through a formula) how much each well in the field is authorized to produce in a month; this amount is called the well's "allowable." The order further specifies how much production beyond that will be tolerated. For example, the Hugoton order says production may not exceed 9 times the basic allowable.

These proration orders also say that a well whose production exceeds the tolerated level is to be "shut in," or not allowed to produce. A monthly report sent to each operator includes information about the basic allowable and the production level for all wells in the field, and identifies wells that exceed production tolerance levels.

Currently 20 oil fields, 1 oil and gas field, and 4 gas fields operate under proration orders. (Several hundred such orders were vacated in the early 1990s.) The vast majority of wells operated under proration orders are in the Hugoton, Panoma, and Greenwood gas fields. The Hugoton field is by far the largest.

Division staff didn't "shut in" any of the 20 overproduced wells in our sample, even when the well's production reached 43 times its allowable. This finding was based on our review of records for a sample of wells in the Hugoton field that were produced beyond tolerance levels in January 1996. (Less than 2% of wells in the Hugoton field were beyond tolerance levels that month.)

We asked Division officials what actions they take when wells are overproduced. They said they sometimes send operators a letter, but the only example they could provide was one they'd sent to each operator in the large gas fields whose wells were being overproduced in May 1996. Officials also showed us copies of operator responses to those letters, including plans to reduce production at the problem wells, and monitoring reports of wells that were overproducing in subsequent months. We saw nothing to suggest that Division officials had contacted operators again.

Division officials cited several reasons for not acting quickly to shut in wells, as allowed in the basic proration orders:

- many operators voluntarily reduce production when a well's production is excessive, the officials told us. We found that operators had reduced production for 15 of the 20 wells in our sample, but a year later production from only 7 of those wells had been brought down to acceptable levels.

- officials said that how much a well is overproduced can change drastically when its basic allowable is recalculated in January of every other year. Two wells in our sample demonstrated the big effect this recalculation can have. One well's accumulated overproduction was about 19 times more than its basic allowable in the January report, but was an acceptable 9 times the basic allowable in the February report. Another jumped from nearly 10 times the basic allowable in January to almost 28 times in February.

- officials said errors in production, well test, or other data could make it appear a well has been overproduced when it hasn't. We saw this for four wells in

our sample. When operators submitted corrected information, two of those four wells actually were producing within acceptable levels.

We also noted that the computer system the Division uses for the data on prorated fields doesn't allow a well's production status to be compared easily over time. The Division must use labor-intensive manual comparisons to determine whether an operator is reducing production at specific wells, and what progress that operator is making toward reaching an acceptable level of overproduction. The Division would have to gather this information before any enforcement steps could be taken.

Division officials told us they knew of only one complaint lodged by one well operator against another because of overproduction in recent years. In this case, records show that the Division had quickly contacted the offending operator, who submitted a plan for reducing production at the identified overproduced wells. The Division is continuing to monitor the amount of production from these wells. We also spoke with representatives of independent oil and gas operators and of large operators, and both agreed the Division will take appropriate action when it receives a complaint about overproduction.

Conclusion

In its regulation of oil and gas wells, the Conservation Division has reasonable monitoring and enforcement tools to work with. However, the Division hasn't provided its staff with appropriate guidance that would help ensure the best results. That guidance would deal not only with the actions staff should take, but also with the documentation staff should keep. As a result, the Division and its staff don't have all the information they need, and the Division can't be sure that it and the well operators it regulates are doing what's required by State law and Commission regulations.

In addition, some aspects of the Division's program don't provide much incentive for operators to take corrective action. When fines are reduced, timelines for corrective action aren't set, and production limits on wells in prorated fields aren't enforced, it can convey the impression that the Division is willing to tolerate noncompliance.

Recommendations

1. To help ensure that its staff take the appropriate actions when enforcing statutory and regulatory requirements, the Conservation Division should develop written guidelines or procedures that, among other things, address the following:

a. documenting all lease inspections and their results
b. developing systematic approaches for tracking all complaints received, handling and documenting investigations into those complaints, and notifying complainants about the outcomes of those investigations
c. dealing with problem situations, including when and how timeframes for corrective action should be set, when those timeframes can be extended, and when cases will be referred to the legal section
d. documenting follow-up inspections of problem conditions

2. To improve the accuracy of the data contained in its new computer system, which would make it more usable for management and oversight purposes, the Division should develop improved procedures for ensuring that data are entered accurately into the computer, should build appropriate edit checks into the computer system, and should regularly verify the accuracy of a sample of data being entered.

3. To help ensure that operators don't drill wells before receiving a permit, the Division should regularly compare permit dates against actual drilling dates, and should assess fines as required by Commission regulations against operators who've violated State laws and regulations in this area.

4. To help ensure that operators meet all statutory and regulatory requirements, the Division should consider the merits of establishing a regular inspection schedule.

5. To ensure that cases referred for legal action are processed on a more timely basis, the Division should evaluate its entire case-handling process to identify ways to streamline it. Special attention should be given to the steps involving the legal section's clerical processes.

6. To provide an incentive for operators to correct problems as soon as possible, and to help ensure that only relatively problem-free operators qualify for reduced financial assurances, the Commission should reconsider its practice of reducing or rescinding fines for operators who appeal Commission orders.

7. To ensure that Commission proration orders are properly enforced, Division staff should review the monthly production of individual wells, and take appropriate steps to limit the production of wells producing in excess of tolerated levels.

Is the Conservation Division Effectively Dealing with the Backlog of Old, Unplugged Oil and Gas Wells In the State?

In 1995, Division staff estimated there were more than 49,000 abandoned oil and gas wells in Kansas, about one-third of which pose an environmental or safety risk. They're conducting an inventory of abandoned wells to identify the specific risks from those wells, and finding more abandoned wells in the process. The wells now being plugged generally are the ones that pose the most serious risks. Responding to the problem of abandoned wells is a long-term, costly proposition for the State. If the Legislature were to extend its six-year commitment to provide $1.6 million a year in enhanced funding for plugging abandoned wells, it still could take until 2008 for the most problematic wells to be plugged. If those additional funds aren't extended, it could take until 2019.

The actual plugging of these abandoned wells is contracted out to the private sector. For the small plugging projects handled by district field offices—which accounted for about one-third of the moneys spent—there wasn't enough documentation to tell whether the selection of vendors was fair and resulted in the lowest price for the State. These and other findings are discussed below.

Based on the Information Available, the Division Has Estimated That Kansas Is Responsible for Plugging at Least 49,000 Abandoned Wells, But There Probably Are More

In 1995, Division officials began a concerted effort to try to identify all the abandoned oil and gas wells in Kansas that need to be plugged. Staff in each district used differing methods for estimating the number of abandoned wells. For example, one district studied old lease maps to identify wells that had been drilled but were no longer producing. Another district conducted a thorough lease inspection of an entire county and calculated the percent of abandoned wells actually found compared to the number previously on record. Staff then projected the "overage" for all the known abandoned wells in that district.

Division officials told us that, whatever the method used, in some parts of the State it's nearly impossible to know without more detailed and painstaking efforts how many abandoned wells there really are, or where they are. Here's why:

- in much of eastern Kansas—and especially in District 3 headquartered in Chanute—many of the wells were drilled so long ago that detailed records never were made about the number and location of old wells. Drilling in eastern Kansas started in the 1860s, but regulation didn't begin until the 1930s, and even then those early regulatory records weren't very complete.

- in many cases, older abandoned wells were cut off below ground level and the equipment was removed for salvage, so there's no visible evidence they ever existed and no one remembers them.

Sometimes an abandoned well is easy to see...

...and sometimes it isn't.

well pipe cut off at ground level

In 1995, based on the information available to it at the time, the Division estimated there were approximately 49,000 abandoned oil and gas wells that the State is responsible for plugging.

These wells have become the State's responsibility for a variety of reasons. Typically, the people or companies that are legally responsible for plugging them can't be located, have filed for bankruptcy, have gone out of business, or have moved out of State and can't be pursued in a cost-effective manner.

Because so many abandoned wells still may be discovered, Division officials acknowledge the actual number of abandoned wells the State is responsible for plugging could be higher. They said the problem was much worse in District 3. For example, a construction crew recently found 50 previously unknown abandoned wells when they were clearing a piece of land in Chanute for a new Wal-Mart parking lot.

The District 3 supervisor also told us that, although his staff used old lease maps and other available records in arriving at their 1995 estimates, since they began plugging and taking a physical inventory of abandoned wells, they've routinely found 20-25% more wells on a lease than those maps indicated. For example, one original lease map District 3 officials used in making their 1995 estimates identified 91 wells. A newer map for that lease, which a local citizen recently turned in, showed 34 more wells on that site, for a total of 125.

We took the pictures on the previous page at that site. Nearly all the wells on that lease had been cut off at or below ground level, making it extremely difficult to find them without a more detailed map and/or a metal detector.

In the western half of the State, Division officials told us, wells generally are newer, larger, and deeper, and most were drilled after the State began regulating well-drilling. As a result, information about the number and location of these wells is much more complete. Also, because wells in western Kansas generally are larger and deeper than in the east, operators had to invest a great deal of money to drill them and were less likely to abandon them.

The Division Has Estimated That Nearly One-Third of the Known Abandoned Wells Pose an Environmental or Safety Risk, But It Hasn't Yet Determined the Level of Risk Posed by Many of Those Abandoned Wells

Historically, when Division officials learned of abandoned wells, they classified them as belonging to one of two categories—Priority I wells, which posed an ongoing or potential risk to the environment or to the public's safety, and Priority II wells, which didn't present such a risk. That classification typically was based on the location and age of the wells, rather than on actual visits to the wells. Based on these efforts, staff estimated Statewide there were about 15,000 abandoned Priority I wells and 34,000 abandoned Priority II wells.

Division staff are developing a precise inventory of abandoned wells to identify the specific risks from those wells. When estimates were made in 1995, Division officials told us, wells near water sources or built before modern completion requirements went into effect were presumed to present an ongoing or potential risk, and were broadly classified as Priority I wells.

Since then, the Division has been involved in an ongoing effort to more carefully classify and inventory the wells identified in the 1995 estimate. This process has focused primarily on Priority I wells, although some Priority II wells have been included. The process involves visiting sites to confirm the number of wells and to specifically assess the condition of and risk posed by each well. Appendix A shows the criteria for assigning specific risk levels.

Based on those visits, Priority I wells are subdivided into three categories—A, B and C—with I-A wells being the most problematic. After the site visit, each well is entered into the Division's computer inventory of abandoned wells. The table at right shows the number of wells visited and inventoried as of January 1998.

The Division is a long way from completing its inventory, even when only the Priority I wells are considered. The true number of abandoned wells is unknown, but the 1995 estimate of 15,000 Priority I wells Statewide is believed to be low, based on

the additional wells district staff have found as they plug these wells. Because so many sites known to contain Priority I wells haven't yet been inventoried, there's a risk some dangerous abandoned wells haven't yet been identified.

Inventory of Abandoned Wells (a)
As of January 1998

District	Priority I				Priority II	Total
	A	B	C	Total		
District 1—Dodge City	6	6	24	36	2	38
District 2—Wichita	78	36	58	172	35	207
District 3—Chanute	938	2,035	6,355	9,328	607	9,935
District 4—Hays	95	114	184	393	0	393
	1,117	2,191	6,621	9,929	644	10,573

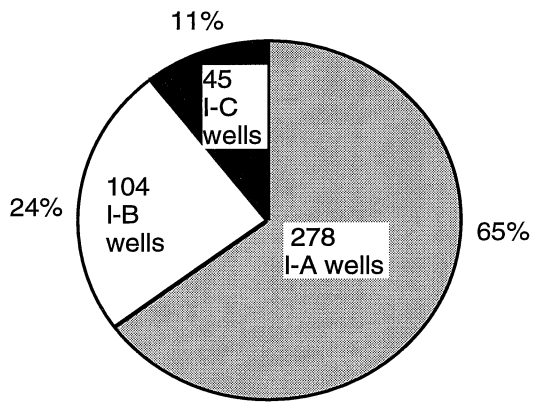
(a) The inventory includes all abandoned wells that have been classified, both those that have been plugged by the State, and those that remain unplugged. In addition, it's numbers change regularly because wells are continuously being added.

About Two-Thirds of the Abandoned Wells the Division Plugged in Fiscal Year 1997 Had Been Classified And Inventoried as Having the Most Potential For Harm

As of January 1998, the Conservation Division had inventoried about 9,900 Priority I abandoned wells. Of that number, 1,117 wells were classified as Priority I-A, and 2,191 were classified as Priority I-B. These wells pose the most immediate risks—an example of a I-A well would be one that actually is discharging into a lake or stream. An example of a Priority I-C well—which is the least problematic of the Priority I wells—is a non-leaking, abandoned gas well in a populated area.

Division officials said they are focusing their efforts on Priority I-A and I-B wells, with only a limited number of I-C wells currently being plugged. They also said they have no plans to plug Priority II wells in the near future. Industry sources note that future advances in technology may make it feasible to tap into the oil and gas reserves remaining in these wells. If those wells are plugged now, it would not likely be cost-effective to reopen them.

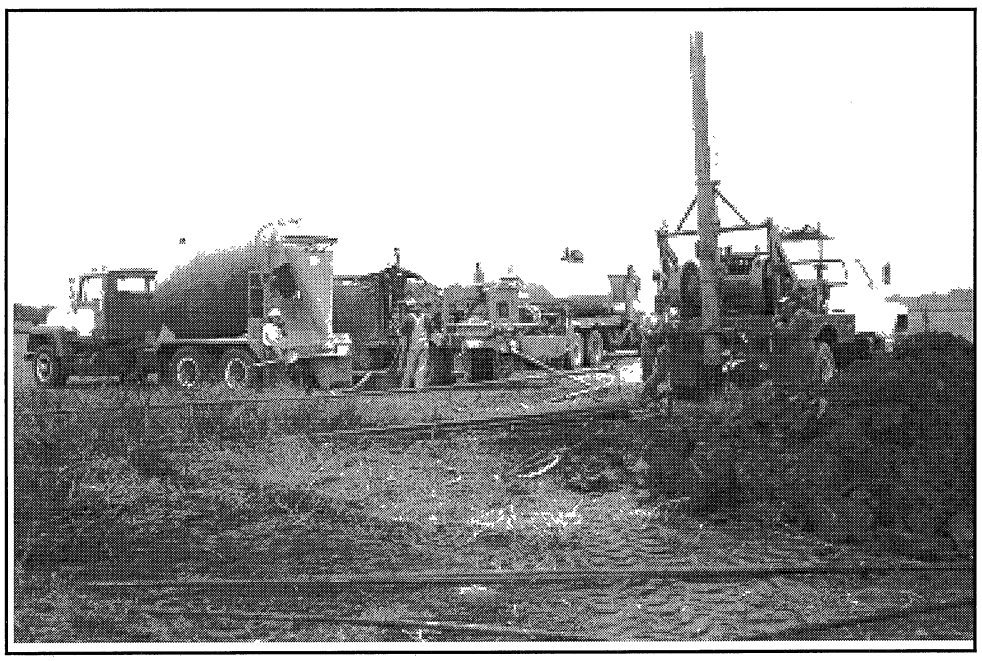
% of Different Types of Abandoned Wells Plugged in Fiscal Year 1997



The Conservation Division plugged 427 Priority I wells and one Priority II well in fiscal year 1997. Of those, 89% were Priority I-A or I-B wells, which pose the most serious risk to the environment. In other words, the Division generally was plugging the most dangerous abandoned wells first.

Our review of Division records showed that, in fiscal year 1997, the Division plugged 428 wells, all but one of which were classified as Priority I. In all, 89% of those wells were Priority I-A or I-B wells as shown in the graphic on page 21.

Division' officials explained that several things besides a well's classification could influence which wells are plugged first. For example, they said, weather conditions can influence plugging schedules if contractors aren't able to move plugging equipment to a site because of muddy fields. In addition, planting and harvesting can limit access to abandoned wells on farmland, and the Division generally tries to work with farmers when deciding the best time to plug an abandoned well. Also, availability of contractors to do the actual plugging can be limited, and can affect plugging schedules.



Heavy equipment at the plugging site, such as that shown above, can tear up the ground and damage crops during growing season. Also, if contractors try to plug while fields are muddy, the equipment can get stuck, and bulldozers would be needed to pull trucks in and out of the plugging site.

It Could Take Until 2008 or Beyond to Plug the Abandoned Priority I-A and I-B Wells that Might Exist in the State

As noted earlier, the Division will have about $1.7 million a year to spend on plugging wells for fiscal years 1997-2002. About $500,000 of that amount would come from the Conservation Fee Fund, and $1.2 million would come from the enhanced funding provided by the Legislature.

When the enhanced funding expires in 2002, we estimate the Division will have plugged only 2,800 wells, leaving a significant backlog of risky or unsafe unplugged abandoned wells. Based on the Division's actual expenditures for plug-

ging wells in fiscal years 1995-1997, we calculated an average cost of about $3,600 per well. (We used a multi-year average because plugging costs can vary greatly from well to well, depending on its location and condition.) Thus, with the funds it currently has available, we estimate the Division can plug an average of about 470 wells per year. At that rate, by 2002 the Division will have been able to plug only about 2,800 wells. When compared to the Division's 1995 estimate of 15,000 Priority I wells, it's clear there will be a large number of potentially dangerous wells still unplugged when the six-year program ends.

A Summary of the Division's Remediation Efforts

"Remediation" involves cleaning up sites that have been contaminated by damaged or faulty oil and gas wells, or by their by-products. Remediation efforts include repairing damaged wells; treating and reseeding soil contaminated by oil or saltwater; and drilling water wells for testing chloride levels in water contaminated by leaking wells or other exploration or production activities. Funding for remediating contaminated oil and gas well sites comes from both the Conservation Fee Fund and from the Abandoned Oil and Gas Well/ Remediation Fund.

The Division dedicates the $400,000 transferred from the State Water Plan to the Abandoned Oil and Gas Well/ Remediation Fund for remediation efforts.

Costs for remediation vary greatly per site, ranging from $2,500 to $3 million. The size of the site, the damage done, the potential environmental risk the site poses, and the resources that it threatens determine both costs and priority for action. Given these variations, we calculated the average cost to remediate an active site to be about $70,000.

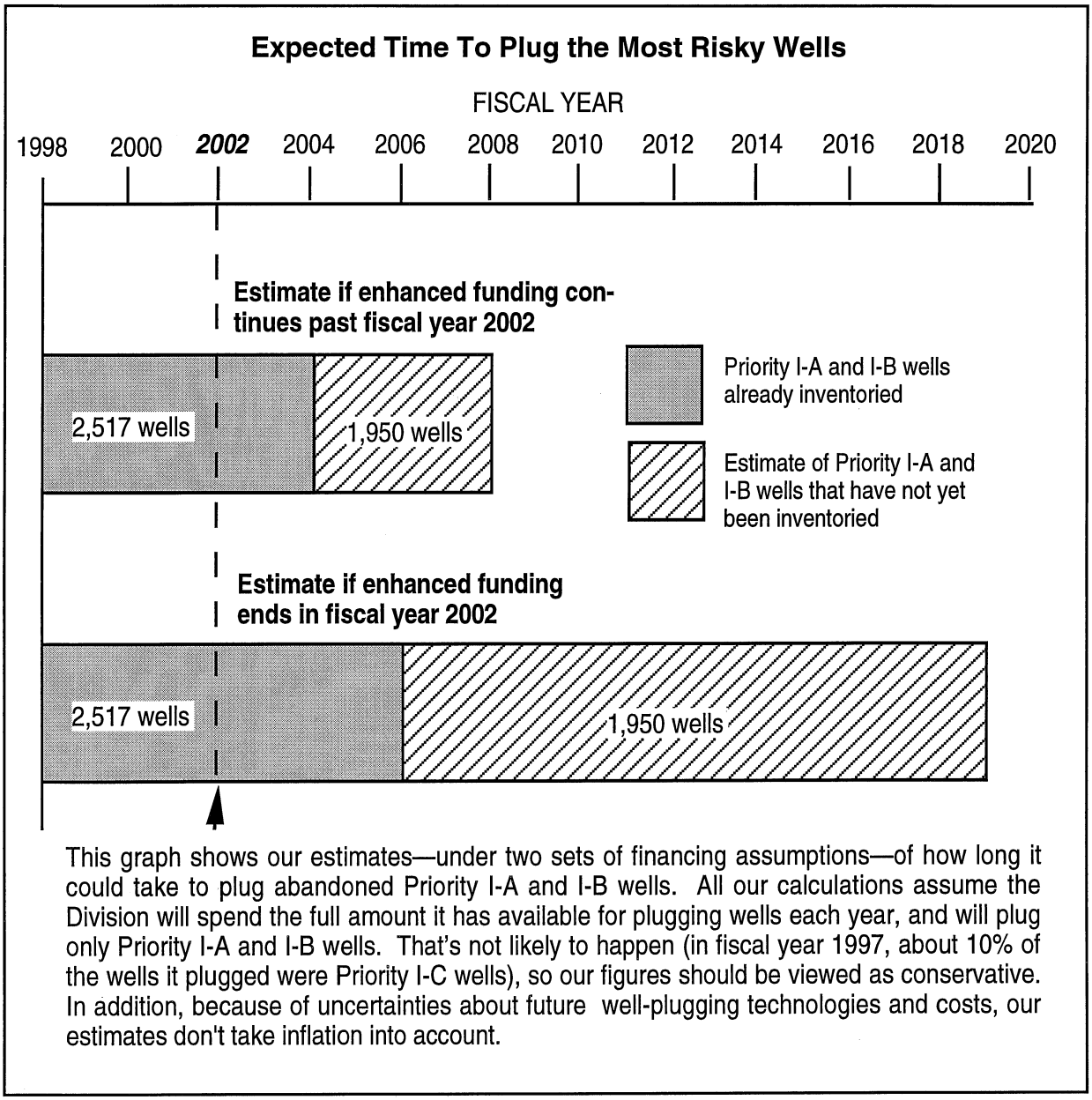
As of January 1997, the Division was responsible for remediating a total of 97 sites, most of which pose a low-to-moderate risk, and most of which are impacting domestic water or stock supplies. Given the moneys the Division has earmarked for remediation (about $400,000 a year), these 97 sites could be remediated within 17 years.

We estimated it could take until 2008 at the earliest to plug Kansas' dangerous abandoned wells, depending on the actual number of abandoned wells that exist, the State's funding levels, and the availability of contractors. The actual number of Priority I abandoned wells isn't known, but was estimated in 1995 to be about 15,000. It could be as high as 17,000, based on the fact that, Statewide, district staff are finding an average of nearly 16% more abandoned wells at sites than they estimated in 1995.

The amount of funding available also will influence how quickly wells can be plugged. The bar graph on the next page shows our estimates of how long it could take to plug the abandoned Priority I-A and I-B wells that have been confirmed to-date, and how long it might take to plug Priority I-A and I-B wells in Kansas.

The top bar shows that, if the Legislature were to extend its enhanced funding program for plugging wells beyond fiscal year 2002, all Priority I-A and I-B wells won't be plugged until 2008 at the earliest. That would be an extra six years and $10 million beyond what the Legislature has authorized. The bottom bar on the graphic shows how long this might take if the Legislature cuts off this enhanced funding after fiscal year 2002 as planned.

Even if the State wanted to address the problem more quickly by providing more funding, it might not be feasible to do so. The number of contractors available to plug wells is limited, as is the number of State staff available to oversee contractors' well-plugging activities.



This graph shows our estimates—under two sets of financing assumptions—of how long it could take to plug abandoned Priority I-A and I-B wells. All our calculations assume the Division will spend the full amount it has available for plugging wells each year, and will plug only Priority I-A and I-B wells. That's not likely to happen (in fiscal year 1997, about 10% of the wells it plugged were Priority I-C wells), so our figures should be viewed as conservative. In addition, because of uncertainties about future well-plugging technologies and costs, our estimates don't take inflation into account.

For the Small Well-Plugging Projects Contracted Out By District Field Offices, We Couldn't Tell Whether the State Paid the Lowest Cost

Abandoned wells are plugged by private companies hired by the State, and their selection must follow the State's contracting process. State law requires the Department of Administration's Division of Purchases to seek formal bids for all contracts expected to cost more than $10,000. The Division of Purchases has authorized the Conservation Division to award contracts expected to cost less than $10,000.

For well-plugging projects that cost less than $10,000, which accounted for about one-third of the moneys spent in fiscal year 1997, we couldn't tell whether the contracts were awarded to the lowest bidder. That year, a total of $1.5 million was spent plugging abandoned wells. Two-thirds of that amount was spent on nine contracts for more than $10,000 each that were awarded by the Division of Purchases. For these contracts, our reviews showed that all purchasing requirements had been followed and all contracts had been awarded to the lowest bidders.

We couldn't make that determination for a sample of 15 smaller well-plugging projects handled by district field offices, however. In such projects, district staff act as the general contractor and solicit bids for the individual services (such as drilling, water hauling, and cement) needed to plug a well. This procedure requires them to seek bids on as many as five different types of services for a single project. District staff told us they think this practice results in the Division obtaining lower prices than if it contracted with one vendor for the whole project.

Our review of these 15 projects showed that adequate bid documentation was lacking for every project. Often the only documentation available was handwritten notes that were incomplete or illegible. Some specific problems we found were as follows:

- *For the 34 separate services included in the projects we reviewed, the records showed that district staff got three or more telephone bids as required only five times (15%).*

- *There was no documentation that <u>any</u> bids were solicited for 20 of these 34 services.* This included 14 instances where vendors were listed as "local sole sources." However, there was no documentation to show this designation was appropriate.

- *In at least three instances, the lowest-priced bidder didn't provide the service.* District staff suggested this could have been because the vendor wasn't available on the day well plugging began. However, there was no documentation to support this claim.

- *Two projects should have been handled by the Division of Purchases instead of by local district staff.* In one case, the estimated cost was listed as $9,700 rather than $10,100 because of a math error. In the other case, Division staff split the plugging of two wells on the same lease into two projects, each with an estimated cost of less than $10,000. These well pluggings should have been treated as a single project and referred to the Division of Purchases. District staff told us this was an unintentional mistake.

- *For one 1996 project, the winning bidders were named on August 28, even though bids weren't obtained until September 3.*

Overall, the bids provided by individual vendors were so poorly documented that we frequently couldn't conclude whether jobs were awarded fairly, or whether the district's contracting process resulted in the lowest cost to the State.

The Division doesn't have any written procedures for field staff to follow when purchasing services for well plugging. In three of the four districts, field technicians are responsible for obtaining bids, recommending to management staff which vendor should provide the service, and arranging actual plugging times and dates with vendors. In the other district, the district supervisor handles most of this work.

Because these responsibilities are divided among so many people—who individually carry out the function so seldom—it's especially important to have explicit written guidelines for them to follow. These guidelines should contain information about the number of bids to seek, when the use of the local sole source designation is appropriate, and how to document things like substitution of vendors, local sole source designation, and the tally of bid information.

Abandoned Wells Can Have Other, Hidden Costs

In addition to the cost of plugging abandoned wells, the State may have to pay for other damage caused by these wells. For example, abandoned wells near Russell helped create two sinkholes near I-70. These sinkholes damaged the interstate, and required the Department of Transportation to complete a major fill and resurfacing project on the interstate in the early 1970s. That project fixed the immediate damage caused to the interstate, but didn't prevent future deterioration.

These sinkholes created ongoing costs to the State as well. The Department of Transportation spends $5,000 annually to survey these holes (and one additional hole near K-14 south of the Rice/Ellis County line) to make sure the road and nearby bridges haven't deteriorated further. The cost to survey the sinkholes isn't great, but the potential for future damage may be.

Conclusion

The problem of dangerous abandoned wells will be with the State for many years to come. Although most of the Division's numbers regarding abandoned wells are estimates, it's clear that there are more wells than staff originally estimated in 1995, and that it will take many years to plug them all. Although the six-year enhanced funding program approved by the Legislature begins to address the problem, that level of funding will need to be extended if the problem is to be resolved in a more timely manner. In addition, contracting procedures in the district offices must be improved if the State is to get the most for its money.

Recommendations

1. To help ensure that the abandoned wells most likely to harm the environment or pose a risk to public safety are plugged first, the Conservation Division should do the following:

   a. Develop a formal plan that calls for plugging Priority I-A wells before plugging Priority I-B and I-C wells, unless there are other extenuating circumstances.
   b. place a high priority on completing the inventory of Priority I abandoned wells
   c. periodically reinspect unplugged Priority I abandoned wells to determine whether individual priority levels assigned should be changed

2. To help ensure that these abandoned wells get plugged on a more timely basis so they don't continue to pollute the environment and threaten the public's safety, the Division should work with the Governor and the Legislature during the budget and appropriations processes to obtain additional funding for plugging these wells. Because there may be a limited number of contractors available to do this work, and because of the limited number of staff to oversee the plugging of wells, that additional funding may need to come in the form of extending existing funding for the enhanced funding program, rather than increasing the amount currently being provided.

3. To ensure that the Conservation Division pays a low but fair price for well-plugging services, and that its staff follow all applicable purchasing requirements, the Division should develop a written set of guidelines for staff to follow when seeking bids for services expected to cost less than $10,000. The Division should work closely with the Department of Administration's Division of Purchases in developing these guidelines. Among other things, the guidelines should require district staff to do the following:

   a. attempt to obtain three bids for each service expected to cost more than $500, and document reasons when fewer than three bids are received
   b. document the reason why a purchase is made using the local sole source designation
   c. create a bid tally sheet showing the vendors contacted, the vendors who actually bid, the date each bid was submitted, and each bid amount
   d. identify the vendor selected to perform the service(s), with documented rationale when the low bidder isn't selected
   e. document the reasons for having a vendor other than the selected vendor provide well-plugging services.

Does the Conservation Division Have Adequate Controls to Ensure That the State Doesn't Incur Costs for Plugging Wells Abandoned by Operators?

To help ensure the State doesn't pay the cost of plugging wells abandoned by operators, the 1996 Legislature required well operators to post "financial assurances"–such as requiring some operators to post a bond or pay a nonrefundable annual fee. These assurances were designed to limit the State's liability. However, it's too soon to tell whether they will work, because there's no way to know how much will be collected or what the State's future well plugging costs might be. A number of potential ambiguities in that law could undermine the Legislature's intent. For example, the law is unclear about whether these financial assurances are intended to cover all related plugging costs, how long they are to remain in effect, and how moneys collected under its provisions are to be used.

We also found that district staff check a number of sources before recommending that the State pay to plug an abandoned well, but we couldn't tell how thorough these checks were. These and other findings are discussed in the sections that follow.

Financial Assurances the 1996 Legislature Put in Place May Protect the State From Future Liability for Unplugged Wells, But It's Too Soon to Tell

Despite the requirements on operators to properly plug wells they abandon, the best way the State can ensure it doesn't have to pay these costs may be requiring well operators to post a bond or some other form of financial assurance. The State can then tap that source of funding to pay the costs if operators abandon their wells without plugging them.

Beginning this year, Kansas has such financial assurance requirements. These requirements, which had been debated over two decades, were included in the 1996 legislation that provided additional State moneys to plug old abandoned wells.

The 1996 legislation was designed to limit the State's liability for the costs of plugging abandoned wells. Starting in January 1998, operators must post a financial assurance when they receive an initial license or renew their annual license if they've:

- had a license for less than three years
- been fined $3,000 or more in the previous three years
- had five penalty orders issued against them in the previous three years

Under the law, those operators have several options regarding the type of financial assurance they can post:

- a performance bond or letter of credit for each well
- a performance bond or letter of credit for a group of wells
- a first lien on tangible personal property associated with oil and gas production
- a nonrefundable fee paid directly to the State equal to 3% of the bond amount (with this option, the State essentially is acting as its own bonding agent)
- any other type of financial assurance approved by the Commission

The amount of financial assurance operators must provide is determined by the number of wells covered and their depth. The amount is the same regardless of the option the operator chooses.

Operators who have acceptable records of compliance for at least three years are required to pay only an additional $50 fee each year, which is referred to as an "acceptable compliance" fee.

Kansas' financial assurance requirements were modeled after the requirements in Texas, which has had a wide range of options available to well operators since 1986. During this audit, we reviewed the financial assurance options available to operators in Texas, Oklahoma, Pennsylvania, and Colorado. Only Texas provides the range of options Kansas does, and its qualifications for the "acceptable compliance" fee are more restrictive than the ones Kansas adopted. Information about options in other states is provided in Appendix B.

The law is unclear about how moneys collected under these provisions are to be used. The law specifies that the moneys the State receives from the $50 "acceptable compliance" fee and the 3% nonrefundable fee are to be deposited into the Commission's Conservation Fee Fund. It doesn't specify whether these moneys are to be accounted for separately and allowed to grow to pay future well-plugging costs.

Division officials told us they haven't decided whether to segregate and accumulate any of these moneys. If the moneys are spent to finance the Division's ongoing operations, they won't be available in the future when the State needs them to pay for plugging abandoned wells.

The law also doesn't specify how long operators' financial assurances are to remain in effect. Draft documents the Division has drawn up show they're expected to remain in effect until the Commission determines the operator has met all plugging and remediation requirements. Further, the law doesn't define the circumstances under which the State can make a claim on a source of financial assurance. A Division official told us a claim won't be made until the Commission has ordered an operator to plug a well and the deadline for doing so has passed.

Even if the cash the State receives under this law were set aside for plugging wells abandoned in the future, there's no certainty it will be enough. We were told that the monetary amounts in the law were negotiated by representatives of

both independent oil and gas producers and major producers during the final days of the 1996 legislative session. There was no input from Division staff, and no revenue projections were made. Given the newness of this program, no one knows how many abandoned wells the State may have to plug in the future or how much plugging will cost.

There's also no way to know yet how much will be collected. The "acceptable compliance" fees and the nonrefundable 3% fees could raise a significant amount of money for future plugging operations if those funds are allowed to accumulate. Division officials told us 85% of the State's 2,882 licensed operators would qualify to pay the annual "acceptable compliance" fee in 1998. That would generate about $123,000 this year. No one knows how many of the other 421 licensed operators who'll have to provide some form of financial assurance will choose to pay the 3% nonrefundable fee rather than post a bond or letter of credit. But it's likely some of them will choose this option and generate additional moneys for the State.

In addition, there's no certainty that the financial assurance amounts in the law will be sufficient to cover plugging costs. If plugging costs exceed the amount of the bond, State funds will be needed to make up the difference. Officials in other states told us they don't expect the amounts they collect as a result of financial assurances to pay all their costs for plugging abandoned wells.

In sum, although using financial assurances to pay for plugging future abandoned wells that operators don't plug seems to have been intended in the 1996 law, it isn't clear as of yet how or whether that will work.

District Staff Check a Number of Sources Before Recommending That the State Pay to Plug an Abandoned Well, But We Can't Tell How Thorough These Checks Were

Important controls for ensuring the State doesn't unnecessarily incur costs for plugging abandoned wells include knowing when wells are drilled, in operation, or plugged; requiring operators to plug wells they plan to abandon; and penalizing operators who don't provide the required documentation of their activities or who don't plug abandoned wells.

Because the Division's procedures and practices in these areas are described in other questions of this report, we won't repeat them here. Instead, this section focuses on district staff efforts to ensure that either the well operator or some other responsible party pays the cost of plugging abandoned wells.

By law, people who can be held financially responsible for plugging an abandoned well include the current or most recent operator, the original operator who plugged or abandoned the well, or any person who tampered with or removed equipment from the abandoned well. The landowner can't be held responsible unless he or she has operated the well, deliberately tampered with it, or assumed responsibility by written contract.

In 83% of the cases we reviewed, district staff identified an operator who was legally responsible for plugging an abandoned well, but indicated they couldn't make that person pay. Before district staff suggest using Commission funds to plug an abandoned well, they review a variety of records to try to identify a person or company that can be held responsible. The records most often reviewed include district and central office files, and records maintained by the county assessor and county register of deeds. Other steps district staff may take include contacting the local electric utility (because it provides electrical power to the well), adjacent operators, the landowner, and adjacent landowners. They also may review records maintained by the Kansas Geologic Survey.

We examined the Division's efforts to find a financially responsible party for the 24 large and small contracts for plugging abandoned wells we reviewed in Question 2. District staff identified a responsible person or company in 20 of these 24 cases. However, their documentation showed that they couldn't find a way to make that operator pay the cost of plugging the abandoned wells in any of those cases. The reasons they cited were as follows:

Reasons Cited by District Staff
For Not Being Able to Make Responsible Parties
Pay for Plugging Abandoned Wells

Reason	Frequency
Couldn't locate the operator	8
Operator declared bankruptcy	5
Operator was no longer in business	4
Operator had died	2
Operator was in prison	1
Total	20

These reasons may justify the use of State funds to plug abandoned wells. But because there's insufficient documentation showing the extent of the research conducted, we couldn't tell whether Division staff pursued each operator as aggressively as they could have. For example, in the case of the operator in prison, we noted that the lease was operated by a company, which might have had some assets.

The typical cost of plugging an abandoned well can be as little as $500 or may exceed $9,000. Division staff emphasized that researching ownership of wells takes time, and that time is money. They told us it sometimes was more cost-effective to use State funds to plug an abandoned well than to try to locate a potentially responsible party who may or may not have the money to plug the well, or whom the Commission may not have authority over. While this may be true, without better documentation of district staffs' research activities neither we nor the Division can know whether all reasonable options have been explored.

Conclusion

It's difficult to tell whether the Division can ensure the State doesn't incur unnecessary costs for plugging wells abandoned by operators for at least two reasons. First, the State's financial assurance program is too new to estimate reliably the program's revenues and costs. Even so, State law doesn't make it clear whether these financial assurances are supposed to cover all related plugging costs, whether cash fees generated by the program are to be accumulated to cover future plugging costs, or whether those moneys even have to be used for plugging abandoned wells. At the very least, however, these assurances can provide the State more financial protection than it had before. Second, although Division staff generally seem able to identify parties responsible for abandoned wells, better documentation of their efforts to locate those parties and get them to pay would give greater confidence that State moneys aren't being spent unnecessarily.

Recommendations

1. To clarify the Legislature's intent regarding how moneys raised through the newly instituted financial assurances requirements should be used, the Legislative Post Audit Committee or another appropriate legislative committee should introduce legislation amending K.S.A. 55-155. That legislation specifically should clarify the following:

   a. whether the financial assurances operators are required to post are supposed to cover all related plugging costs

   b. whether cash fees generated by the program are to be accounted for separately within the Conservation Fee Fund and allowed to grow over time to cover future well-plugging costs

   c. whether these cash fees have to be used for plugging abandoned wells, or whether they could be used to finance the Division's ongoing operations

   d. how long well operators' financial assurances are to remain in effect, and under what circumstances the State can make a claim on a source of financial assurance.

2. To ensure that State funds aren't used to plug abandoned wells when other responsible parties could and should pay those costs, the Division should make certain its staff are making and documenting all efforts to locate those parties and determine their financial viability before concluding that the Division should not pursue them further.

APPENDIX A

Criteria for Assigning Specific Risk Levels to Priority I Abandoned Wells

Well Level	Surface Water	Ground Water	Public Safety
I-A	Well is actively discharging, posing a significant risk	Well creates significant ongoing or potential impacts to groundwater supplies	Well poses an ongoing or current threat (e.g. active gas flows with danger of explosion in urban or suburban settings)
I-B	Well is intermittently discharging, posing ongoing risk	Well creates ongoing or potential impact through loss of water or water quality degradation	Well poses a current or potential threat to public safety (rural or low population settings)
I-C	Well is located in a sensitive groundwater area and is intermittently discharging or potentially may discharge	Well is located in sensitive groundwater area and might pose a risk to groundwater supplies or loss of water	Well creates a potential threat to public safety (e.g. a secured gas well in a populated area)

APPENDIX B

Comparison of Financial Assurance Provisions for Kansas and Other States

Provision	Kansas	Texas	Oklahoma	Pennsyl-vania	Colorado
"acceptable compliance" fee	Yes, $50 available if acceptable level of compliance in past 3 years; not available if operator hasn't had a license for at least 3 years	Yes, $100 available if acceptable level of compliance in past 4 years, no outstanding violations, and no major company official is connected to another company with violations; not available if operator hasn't had a license for at least 4 years	Yes, financial statement only; available if acceptable level of compliance for 3 years	No	No
bond for individual well	Yes varies by depth	Yes, after the first year of operation varies by depth	Yes, if the plugging estimate is less than $25,000	Yes $2,500	Yes $5,000
bond for a group of wells ("blanket bond")	Yes varies by depth and number of wells	Yes varies by number of wells	Yes $25,000	Yes $25,000	Yes varies by number of wells
irrevocable letter of credit	Yes	Yes	Yes	No	Yes
nonrefundable fee	Yes 3% of the bond amount	Yes 3% of the bond amount	No	No	No
give state first lien on tangible property	Yes oil and gas equipment only	Yes oil and gas equipment only	No	No	Yes, with Commission approval
another type of assurance	Yes, with Commission approval	No	Yes bank certificate of deposit, cash held by Commission	Yes bank certificate of deposit, surety, U.S. Treasury bond	Yes, with Commission approval; for an inactive well, the operator may provide only a plugging schedule

APPENDIX C

Effect of Increased Production by Certain Wells In the Hugoton Field

The Corporation Commission uses complex formulas to set allowable production levels for wells in prorated fields. The goal of such formulas is to enable each developed lease to ultimately produce approximately the amount of gas or oil underlying the lease.

In a 1994 modification of the proration order for the Hugoton field, Commissioners changed a portion of the formula, which allowed certain wells to increase production. Concerns have been raised that this increased production could cause the field to be drained in a manner that would leave some gas reserves unrecoverable. Specifically, the concern is that withdrawing gas more quickly could be damaging the field by causing areas around wells to become flooded with saltwater before all gas can be removed.

We talked with an official of the Kansas Geological Survey who thought this was unlikely to happen. He explained that, as gas is removed from the porous rock, other gas will likely migrate in from areas of higher pressure to take its place. At the same time, if there is also water in the pores with the gas, the water will rise as the gas is removed. It's possible the water could rise high enough to block gas from migrating into the pore. However, this wouldn't mark a permanent loss of access to the gas, because if production from the well were temporarily stopped, the water would subside and gas could rise above it. He thought such flooding was particularly unlikely to be a problem on the west side of the field, where gas is located much higher than water.

APPENDIX D

Agency Response

On February 9, 1998, we provided a copy of the draft audit report to the Kansas Corporation Commission. The Commission's response is included as this appendix.

Kansas Corporation Commission

Bill Graves, Governor John Wine, Chair Susan M. Seltsam, Commissioner Cynthia L. Claus, Commissioner

February 17, 1998

Barbara J Hinton, Legislative Post Auditor
Division of Legislative Post Audit
Mercantile Bank Tower
800 SW Jackson, Suite 1200
Topeka, Kansas 66612-2212

Dear Ms. Hinton:

The Kansas Corporation Commission appreciates the opportunity to respond to the draft copy of the Division of Legislative Post Audit's review of certain elements of the Commission's regulation of the State's oil and gas industry.

First, we would like to thank the audit team, under the direction of Ms. Cindy Lash, for the professional manner in which it conducted its work at both the field and central offices of the Conservation Division. The team spent many hours with our Conservation Division staff becoming familiar with oil and gas operational procedures as well as the regulatory process employed by the Division. The team's draft report contains many positive observations as to the efforts of our field and central office staff to provide a reasonable regulatory environment in which oil and gas producers can operate while still maintaining effective protection of the state's resources. Under separate cover we will be providing the audit team with specific responses to the conclusions and recommendations contained with the draft report.

The Commission notes that many of the recommendations speak to two general concerns: 1) the development of written guidelines or procedures, and 2) the documentation of actions. The Commission agrees with the need to provide appropriate written policy and procedures to facilitate consistent effective regulatory action, while maintaining sufficient flexibility for site and situational specific conditions. The Commission also agrees that proper levels of documentation should be maintained so that both regulatory programs and responses by industry can be routinely monitored for effectiveness. As noted in the draft report, the Division's new Risk-Based Data Management System will be a valuable tool to improve the Division's ability to effectively track individual wells, including the Division's inspection and regulatory actions.

With respect to the draft report's conclusions and recommendations concerning the Conservation Division's Abandoned Well / Site Remediation Program and Financial Assurance Program, the Commission notes that both of these programs have been in place for only a short time. The recommendations concerning documentation of the internal contracting procedures for plugging abandoned wells are well taken. The Conservation Division has already begun the process of working with the Department of Administration's Division of Purchases to implement these recommendations. The Financial Assurance Program for Kansas oil and gas operators has been in place for less than sixty days. The Division plans to monitor the effectiveness of this program on an ongoing basis.

The Commission, like most other state oil and gas regulatory agencies, faces many challenges in its efforts to provide regulatory oversight of oil and gas activities. One such challenge is the trend to spin-down to the states federal regulatory responsibility for resource conservation and environmental protection. Such increases in responsibility, coupled with the current volatile market conditions in the energy sector, reinforce the need to maintain reasonable and cost-effective approaches to the regulatory process. Many of the suggestions offered by the audit team will enable the Commission's Conservation Division to focus on those kinds of approaches.

Finally, we are looking forward to visiting with the audit team in the future to discuss the Commission's progress in implementing the team's recommendations.

Sincerely,

John Wine, Chair

Susan M. Seltsam, Commissioner

Cynthia L. Claus, Commissioner

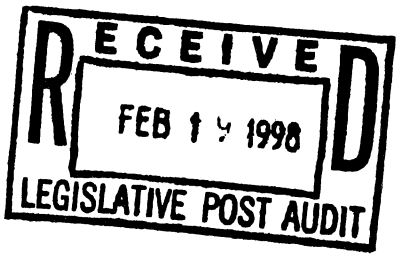
JW:ps

Kansas Corporation Commission

Bill Graves, Governor John Wine, Chair Susan M. Seltsam, Commissioner Cynthia L. Claus, Commissioner

February 19, 1998

Ms. Cindy Lash, Principal Auditor
Division of Legislative Post Audit
Mercantile Bank Tower
800 SW Jackson, Suite 1200
Topeka, Kansas



Dear Ms. Lash:

On February 17, the Kansas Corporation Commission submitted its formal response to the draft copy of the Division of Legislative Post Audit's review of certain elements of the Commission's regulation of the State's oil and gas industry. As part of that response, the Commission indicated that it would provide the audit team with specific responses to the conclusions and recommendations contained in the draft report. Enclosed you will find our response.

The audit team provided us with many useful recommendations, some of which we've already begun to implement. The Commission will internally prioritize remaining projects and initiatives so that staff may direct its efforts consistent with meeting the Commission's highest priority objectives.

Should you have any questions or if any member of the Division staff can be of further assistance please do not hesitate to contact us.

Sincerely,

Maurice Korphage by gom

M.L. Korphage
Director, Conservation Division

CC: John Wine, Commission Chair
Commissioner Susan Seltsem
Commissioner Cynthia Claus
David Heinemann, Executive Director
File

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Kansas Corporation Commission Response to
The K-GOAL Audit of the Conservation Division
Conducted by the Legislative Division of Post Audit

February 17, 1998

Recommendations Page 16 and 17:

Recommendation 1
The Division has relied on the use of the Commission's General Rules and Regulations for the Conservation of Crude Oil and Natural Gas as a general written guide for staff to use in meeting regulatory goals of the Division. The Division supplements this with "in house" training at the Central Office and District levels. We agree that written policies and procedures would allow the Division to standardize its operational procedures. Some progress already has been made in standardizing procedures. The Division is in the final stages of developing a very detailed Quality Assurance Project Plan for water sampling by District field staff.
Recommendation 1a
The Division agrees with post audit recommendation that documentation of lease inspections and their results needs improving. This Division is currently developing a standard operating procedure for lease inspection It appears the "surface facilities module" of the Risk-Based Data Management System (RBDMS) will effectively schedule and track such inspections.
Recommendation 1b
As the audit team noted, only one District office had a systematic approach for tracking all complaints received and documenting subsequent investigations. The second District now has a system for tracking complaints. Division-wide staff will be reviewing and recommending modifications before the system is implemented on a Division-wide basis.
Recommendation 1c and 1d
Again the Division agrees with the audit recommendation that current procedures for dealing with problem situations need to be expanded and formalized as written procedures.
Recommendation 2
The newly acquired RBDMS does have some built in data entry checks which should reduce data entry error. The Division will also seek assistance from the Commission's Information Services section as to additional efforts that could result in better quality control of data entry. Staff will also develop a monthly edit check for data entry validation.
Recommendation 3
Staff will develop a " raised exception" error check program for date validation (spud date and intent date verification, etc.) A central office staff person will be assigned to perform this review and another staff person will enter the data.

Recommendation 4
The Division agrees that scheduled and regular lease inspections should be increased and properly documented. The RBDMS "surface facilities module" appears to offer the best method of reaching this goal. Once properly customized and implemented the system would allow the district offices to properly track what leases have been inspected and when.
Recommendation 5
Division management took steps in the fall of 1997 by eliminating most of the clerical preparation work. The Commission will take additional steps to assure the timely handling of enforcement cases.
Recommendation 6
The Division would note that corrective action required by a Commission compliance order is not waived. The compliance problem that caused the order to be issued must be corrected. When a compliance order is appealed, the monetary penalties in that order are sometimes settled for a reduced amount, provided the underlying compliance problem has been satisfactorily corrected. An appeal of a Commission order requires a hearing. Holding such a hearing costs the Commission time and money. Field personnel who investigated the case must spend time preparing testimony and traveling to the Division office to testify at the hearing. Legal staff must prepare for the hearing and the case must be heard. In many cases a settlement of the monetary penalty is cost effective for the Commission. Second and subsequent penalties issued against the same operator are rarely mitigated. Mitigation of a monetary penalty was never intended to affect whether an operator qualifies for reduced financial assurance.
Recommendation 7
The Division agrees that it should ensure that all proration orders are properly enforced. In an effort to bring "out of tolerance" wells into compliance, without incurring negative impacts to agricultural gas users in the field areas, the Division will notify all operators with "over tolerance" wells to immediately limit production to 75 mcf per day or less. Production department staff will perform quarterly reviews of the status of "over tolerance" wells and instruct operators who have failed to maintain limited production by letter that the well or wells are to be shut-in until such time as compliance with the proration order is achieved.

Recommendations Page 27
Recommendation 1a
While the plugging practice set out in this recommendation represents current Commission practice, the Commission will set this out in a formal plan as suggested by the auditors.
Recommendation 1b and 1c
The Division does place a high priority on the orderly completion and reinspection of abandoned well sites. Use of technological improvements such as GPS (Global Positioning Systems) has allowed the Division to complete rapid and precise mapping and documentation of over 1600 abandoned well sites in the District III field area during the last six months. A grant application for support of additional GPS equipment has been filed with the Environmental Protection Agency (EPA), and when implemented will allow even more rapid and widespread use of this technology through out the Division. Additional GPS units will be purchased for District III where the vast majority of the sites are located.

Recommendation 2
The Division agrees with this recommendation. Satisfactorily resolving the number of abandoned wells that need to be plugged can only be achieved with supplemental outside funding. The Abandoned Well / Site Remediation Fund which was created by house Substitute for Senate Bill 755 of the 1996 legislature is set to expire on June 30, 2002. The Commission concurs with the audit recommendation that an extension of the program as opposed to additional current funding is the most practical method to achieve the desired results as set forth in S.B. 755.
Recommendation 3
Currently the Division, through its District offices, does seek bids for services for well pluggings and remediation activities where those costs are expected to be less than $10,000. However the Commission has requested the State's Division of Purchases to assist in preparing a standard bid procedure for well plugging and remediation services. Procedures are being drafted and adopted for use by District staff following those guidelines as suggested by the audit team in this recommendation. In addition the Division has contacted the Department of Administration, Division of Purchasing seeking assistance in staff training. The Commission plans to streamline its current procedures.

Recommendations Page 32

Recommendation 1
The recommendations made in this section call for legislative action to correct perceived deficiencies in the statute covering financial assurance (K.S.A. 55-155) and Commission regulations based on that statute. The Division would note that the Financial Assurance Program has been in place less than sixty days and there is little data currently available to warrant significant changes as the program applies to producers. However legislative clarification as to segregation and use of the funds derived from the program would be helpful.
Recommendation 2
Currently when an authorization for expenditure request is received, it is reviewed by the legal department to determine that the field inspector has reviewed the files of the Register of Deeds, the County Assessor, the Conservation Division including the District office, and the U.S. Bankruptcy Court. The Districts will now also check with past oil and gas purchasers for records that might reflect potentially responsible parties. Generally a determination not to pursue a potentially responsible party is based on a number of factors which include among others: a filing of bankruptcy, ability to locate the party, and death. Sworn financial statements indicating an inability to pay have also been accepted in a limited number of cases. In addition, now that the Division is working closely with the Department of Administration on collection of fines and recoupment of costs, other recovery vehicles are available such as Order in Aid proceedings through District Courts. The Division is developing a procedure to ensure that all reasonable efforts are taken to pursue responsible parties, and that such efforts are appropriately documented.