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STATE OF NEW MEXICO
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF PROPOSED AMENDMENTS TO 19.15.2, 19.15.5,19.15.8, 19.15.9, AND 19.15.25 NMAC

CASE NO 24683

<u>REBUTTAL TESTIMONY OF TREVOR GILSTRAP</u>

Q: You testified previously in this Rulemaking. Do you understand that the rebuttal testimony submitted today is sworn testimony submitted in writing in the same New Mexico Oil and Conservation Commission rulemaking proceeding?

A: Yes, I do.

Q: Please recap your experience for the Commission.

A: I am the Senior Vice President and National Energy Practice Leader with AssuredPartners, an international insurance brokerage. I regularly work with oil and gas clients to obtain insurance and surety placement for exploration and production companies. For the purpose of this rulemaking, I am the "Bond" guy—along with New Mexico Oil and Gas Association's expert witness, Douglas Emerick.

Q: Have you reviewed anything in preparation to offer rebuttal testimony?

A: Yes, I have reviewed parts of the direct testimony of the following witnesses: Western Environmental Law Center ("WELC") expert witnesses Thomas Alexander and Peter Morgan. I have also reviewed the some of the direct testimony of Mr. Emerick, submitted on behalf of NMOGA.

Q: In your opinion, what is the most important point the Commission members should take from your rebuttal testimony?

A: The most important point is this: bonds are not insurance. Throughout the record, there are repeated references suggesting that increasing financial assurance levels will "insure" the State or "decrease the risk" of orphaned wells. For example, Thomas M. Alexander states that requiring more adequate financial assurance "better insures the State in case of abandonment" (WELC Ex. 3, 33:15-17), and Peter Morgan opines that reclamation bonds "insulate" regulators from risk (WELC Ex. 15, 16:12; 17:3). These characteristics are fundamentally incorrect.

As I testified previously, bonds are simply a guarantee of payment, there is no shifting of "risk" among the three parties in a bond agreement. Further, while bonds are not an insurance policy—there is no transference of risk from the Operator to the Surety—Operators remain responsible for annual premiums to secure the bond. Increasing the total amount of the bond means operators will be paying more in annual premiums for the bonds, as well as increased collateral requirements tied to those bonds—both of which will draw on the operator's capex for actual plugging expenses. By raising bond requirements without regard to market realities, the state risks pushing responsible operators out of the market, reducing competition, and ultimately increasing the number of orphaned wells. That's not a win for the environment, the economy, or the state's long-term interests. If the goal is to ensure wells are plugged responsibly, then we need a collaborative approach that balances financial assurance with operational feasibility – not one that treats bonding like a limitless insurance policy in a market that's anything but.

Q: Can you walk us through the relevant steps in the bond process again?

A: Only when an event or inaction by the Principal (Operator) triggers or "calls" on a bond, does the Obligee (OCD) receive payment from the Surety. Surety companies are not in the business of losing money, and the Surety in turn requires reimbursement of that same amount from the Principal (Operator). In one, short-sighted way, increasing financial assurance levels potentially increases the amount of funds that OCD could be eligible for by reimbursement, but not immediately and certainly not available to actually plug the well in question. Claims under a surety bond are triggered by nonperformance, meaning that the OCD must also demonstrate to the Surety that the Principal (Operator) has failed to perform, typically through an administrative enforcement action. It is not as simple as sending an e-mail or making a phone call. Under most commercial surety or indemnity agreements underlying a bond, the Surety also retains the power to negotiate or settle calls on bonds, which all Sureties enforce zealously. OCD is familiar with this dynamic, with over $700,000 in bonding by Cano Petro and having collected just over $161,000 four years later. *See* IPANM Ex. 27, LFC Spotlight Report at 11 ($161,300 in bond forfeitures recovered in FY22); *see also* Testimony of EMNRD Deputy Secretary Dylan Fuge, House Judicial Committee Hearing on House Bill 133 Committee Substitute January 31, 2024[1] (explaining that only a "handful" of bonds are pursued, OCD must submit evidence of plugging prior to payment, and EMNRD recovered just $161,000 on 300 wells from Cano Petro). Thus, the claim must (1) triggered by nonperformance, (2) investigated and deemed valid by the Surety, and (3) the Obligee (OCD) will have to demonstrate that the well covered by the bond has either been plugged or substantial work completed, all before the Surety agrees to pay anything on the bond. *See* IPANM Ex. 27, LFC Spotlight Report at 10 (describing bond forfeiture process, to include "The

[1] New Mexico Legislature Webcast for January 31, 2024, House Judicial Committee at 10:57-10:59 p.m., last accessed September 10, 2025, available at https://sg001-harmony.sliq.net/00293/Harmony/en/PowerBrowser/PowerBrowserV2/20240131/-1/74593?startposition=20240131225753&mediaEndTime=20240131225945&viewMode=3&globalStreamId=3 or https://tinyurl.com/HJCHB133

surety will then initiate an investigation to determine the validity of both the bond and the claim. Investigations can be lengthy..."). WELC's expert witness Mr. Morgan does not seem to grasp the practical delays in the process, offering instead that when "the operator forfeits the financial assurance ... the proceeds are used by the state to pay a third party to complete the plugging." *See* Direct Testimony of Peter Morgan, WELC Ex. 15, 16:3-4.[2] This has not been OCD's lived experience. *See* Fuge Testimony, *supra*. Notably, the same process will apply in the future, regardless of the financial assurance levels. Moreover, WELC's proposed FA increases do not account for the negative, possibly unintended, economic effects of placing higher demands on operator capital: less development, less investment, and less available capital to plug the 95% of wells industry already accomplishes annually.

Q: In your recent experience, is the Surety market accessible or available to most operators?

A: Not at today's collateral requirements, underwriting guidelines, and premium rates. I mean no offense, but obtaining the level of financial assurance required by WELC's proposed rules in today's market is nowhere near the experiences of Mr. Alexander or Mr. Morgan as typical consumers. While most markets for goods are characterized by abundance, flexibility, and relatively low barriers to entry, in contrast the P&A surety market is undergoing a period of significant contraction and increased scrutiny. There is not a simple supply-and-demand problem. *Cf.* Morgan, 49:7-13 ("If there is demand for a certain type of

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[2] *But see Morgan*, Ex. 15, 19:15-16 (citing WELC Exhibit 23, which states "OCD has the authority to forfeit any applicable financial assurance once plugging work is complete."); and *id.*, 26:16-19 (describing forfeiture process to require legal action which may be contested).

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financial assurance instrument, the market will fill that demand."). Surety providers are tightening underwriting standards, demanding higher collateral, and increasingly requiring personal indemnities. This is not a market flush with options – it's a market where even well-capitalized operators are struggling to secure bonds. To suggest that operators can simply shop around for bonds and pay a 1% premium ignores the reality of today's financial environment and the long-term obligations these bonds present. *See* Morgan, Ex. 15, 36:15-17 (estimating annual premiums for surety bonds between 1%-2.5%, based on a study of the 2001 Texas bonding change). I strongly disagree with Mr. Morgan's synopsis of the current surety market that "most operators" will be able "satisfy financial assurance requirements by posting surety bonds." Morgan, Ex 15, 36:12. As I stated previously, typical annual premiums ranging from 2.5% - 3.5% (or more) of the bond amount are regularly required of well-capitalized companies in the surety market.

Q: Does WELC's proposal to increase financial assurance levels for marginal wells to $150,000 merely target the "Bad Actors"?

A: No, the bonding increases will affect every operator in New Mexico and disproportionately burden smaller, independent operators of later-life assets. There are no carve-outs or safe harbors in the proposed rule changes for compliant, responsible, prudent operators. Additionally, WELC has not offered evidence in support of its "risk" theory that marginal well operators are more likely to be out of compliance or more likely to abandon wells. In contrast, however, than abundance of testimony for the Commission to consider from actual small, mid-size, and independent operators reflecting responsible operation of wells in New Mexico from end-of-life through decommissioning and reclamation. *See, e.g.*, *Direct Testimony of Kyle Armstrong*, 9:6-13 (operator of 75 wells plugged 16 since 2019); *Direct Testimony of George Sharpe*, 2:18-21 (Merrion Oil & Gas, operating for forty years, has plugged twice as many wells—144—as it currently operates). There is also ample testimony that the impact of WELC's financial assurance rule would be astronomical: $9.45 million; (*Sharpe*, 4:17-18); $27 million (*Direct Testimony of Jeff Harvard*, 4:16-17), $11 million (*Direct Testimony of David Mitchell*, 2:17-19), both at the outset in capital commitment and in continuing to service those bonds. But according to Mr. Morgan, if a smaller, responsible operator cannot comply with the new levels, it is simply good-riddance, being "high risk" and "irresponsible" operators who deserve to be pushed out of the market. *Morgan*, Ex. 15, 34:5-7, 37:9-11. I strongly disagree with that position, from a personal and financial perspective. I likewise disagree with Mr. Alexander's position that "This class of operator has no business remaining in business if the operator cannot 'pay' for adequate financial assurance." *See* Alexander, Ex. 3, 12:23-13:2. It is unrealistic and uneconomic for an operator to carry millions in bonding, pay out hundreds of thousands in premiums, and still take on the cost of plugging and reclaiming that well when needed with the prospect of bonding for that well being released sometime thereafter.

Q: Do you see other problems with WELC's proposed financial assurance rules the Commission should consider?

A: After reviewing Mr. Alexander and Mr. Morgan's testimony, there are two more areas I would like to bring to the Commission's attention. First, I do not disagree with the idea that Mr. Morgan proposes, that "Operators who have profited from oil and gas production should be the ones to bear the costs of cleanup," Morgan, Ex. 15, 37:12-13. This makes perfect sense, which is probably why the Oil and Gas Conservation Tax has been in place for decades, capturing the "costs of cleanup" throughout the life of the well by taxes on production. However, the fact that the New Mexico Legislature has re-allocated conservation funds to other purposes does not now support increasing financial assurance levels. Nor does targeting marginal wells proportionately distribute the burden of plugging and reclamation costs over the life of the well, which makes the most economic sense in the vein of recouping from available profits. Second, although a minor addition in the overall WELC proposal, the requirement that sureties be listed on the IRS Treasury Circular 570 further restricts an already narrowing market for operators. In conjunction with the sky-high FA levels proposed by WELC, Circular 570 carries with it a requirement that Sureties follow and comply with 31 CFR 223.9, which establishes a limit on underwriting any single risk exceeding 10% of paid-up capital and surplus, further narrowing the qualifying, available surety companies.

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I hereby affirm under the penalty of perjury of the laws of the State of New Mexico that the above statements are true and correct to the best of my knowledge, information, and belief.

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