LOUISIANA LEGISLATIVE AUDITOR

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Report Highlights

Oversight of the Louisiana Oilfield Restoration Association's Efforts to Address Orphaned Oil and Gas Wells

Office of Conservation – Department of Energy and Natural Resources

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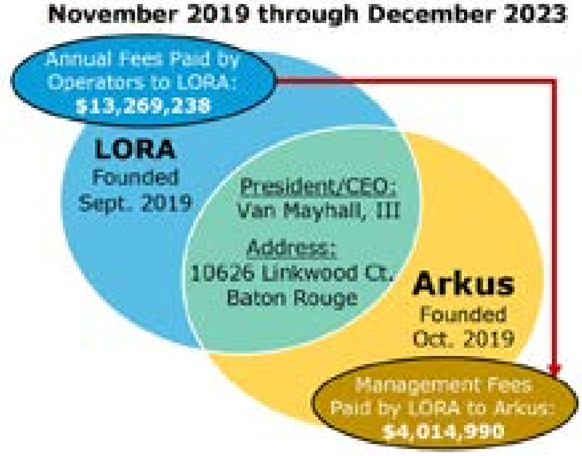
Why We Conducted This Audit

We evaluated the Department of Energy and Natural Resources (DENR) - Office of Conservation's (OC) oversight of the Louisiana Oilfield Restoration Association (LORA) during calendar years 2020 through 2023. In November 2019, OC entered into a Cooperative Endeavor Agreement (CEA) with LORA to help address the state's orphaned oil and gas well population (orphaned wells). The CEA requires LORA to: (1) provide affordable financial security[1] to help more operators comply with state regulations, thereby preventing more wells from becoming orphaned, and (2) use a portion of financial security fees collected from operators to assist OC's Oilfield Site Restoration (OSR) Program with plugging orphaned wells.[2] This is one of two reports on how the state is addressing the growing population of orphaned wells. Our other report[3] evaluated OC's progress toward addressing issues identified in two previous performance audits and found that the number of orphaned wells continues to increase despite the state's efforts to address them.

What We Found

As of October 2023, LORA provided $157.3 million (45.5%) of the total $346.1 million in financial security for Louisiana wells, a greater total amount than any other entity. The CEA requires LORA to divide the financial security fees it collects between deposits to its reserve account to cover future obligations, costs to plug orphaned wells, financial security paid to OC, and amounts retained by LORA for administrative expenses, which the CEA calculates as a set percentage of fees regardless of LORA's actual expenses. After OC executed the CEA with LORA, LORA entered into a management agreement with Arkus Management Services (Arkus) to perform all of LORA's operations, as LORA itself does not have any employees. LORA pays the full amount it retains for administrative expenses as management fees to Arkus, which has the same President/CEO and owners as LORA.

Flow of Funds from LORA to Arkus November 2019 through December 2023



Source: Prepared by legislative auditor's staff based on information from Secretary of State and LORA's finances.

We found that OC does not conduct sufficient monitoring to ensure that LORA remains financially solvent and complies with the CEA requirements, such as prioritizing plugging wells for which it provided financial security that are orphaned. In addition, OC's CEA with LORA does not establish clear and comprehensive terms for LORA's operations, does not adequately protect the state from financial risks of LORA's insolvency, allows LORA significant flexibility on how to spend its funds, and provides no timelines for how long LORA has to fulfill its plugging obligations. Overall, we found the following:

[1] Financial security is similar to insurance in that it provides the state with funds to plug secured wells if they are orphaned due to operator abandonment or noncompliance.
[2] The OSR program was created in 1993 to properly plug orphaned wells. Orphaned wells are oil and gas wells with no responsible operator. These wells deteriorate over time and can pose threats to public safety and the environment.
[3] "Progress Report: State Efforts to Address Orphaned Oil Wells – Office of Conservation – Department of Energy and Natural Resources"

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Office of Conservation – Department of Energy and Natural Resources

What We Found (Cont.)

- **OC has sole oversight of LORA, but it does not conduct sufficient monitoring to protect operators and the state from the risk of LORA failing to fulfill its financial obligations.** LORA is not subject to federal and/or state regulations that apply to financial institutions, so its operations and solvency are not monitored by the regulatory agencies that oversee other companies that provide financial security.

- **Although LORA provided 45.5% of all financial security for Louisiana wells as of October 2023, OC does not have a contingency plan to address financial and safety risks to the state if the CEA is terminated or LORA cannot cover its obligations.** In addition, OC also has not evaluated whether the minimum reserve balance required in its CEA with LORA is sufficient to cover its financial obligations even though LORA's $5 million reserve was only 3.2% of the $157.3 million it secured as of October 2023.

- **Although OC has never exercised its authority to monitor LORA's actual administrative expenses to determine if the percent of fees allowed for this purpose is reasonable, OC allowed LORA to increase this percentage from 20% to 36% after the minimum reserve balance was met.** As a result, LORA retained an additional $1.1 million from June 2022 through December 2023 that could have been used to plug orphaned wells. In addition, we found that in the three-month period after OC allowed LORA to begin retaining 36% of fees as administrative expenses, quarterly earnings from Arkus for the five individuals who own LORA and Arkus increased by an average of 151.5%. Because OC has not requested information to evaluate the actual administrative expenses Arkus paid to perform LORA functions, including Arkus profits and salaries, OC does not know if these wage increases resulted from significant changes to these individuals' job duties or hours after LORA began collecting the additional 16% in administrative expenses.

Change in Arkus Employees' 3rd and 4th Quarterly Salaries after LORA Administrative Percentage Increased July to December 2022

Arkus Employee	2022 Q3	2022 Q4	% Increase
Employee 1	$14,000	$43,240	208.9%
Employee 2	7,500	35,195	369.3%
Employee 3	7,500	9,896	31.9%
Employee 4	7,500	9,896	31.9%
Employee 5	6,000	8,658	44.3%
Total	**$42,500**	**$106,885**	**151.5%**

Source: Prepared by legislative auditor's staff using LWC wage data.

- **OC did not include important provisions in its CEA with LORA to help ensure that LORA operates in the state's best interest. Specifically, the CEA does not address how LORA should spend investment income, does not establish measurable targets for evaluating LORA's performance, and does not contain an audit clause to allow the legislative auditor to access LORA's records.** For example, the CEA does not specify how investment income should be spent; however, OC allows LORA to retain investment income in addition to administrative expenses rather than using this income to plug wells, which may incentivize LORA to delay plugging wells to maximize time for investing funds.

- **OC did not ensure that LORA prioritized plugging its secured wells that were orphaned, as required by the CEA. Of the 175 wells secured by LORA that were orphaned through December 2023, 130 (74.3%) remained unaddressed as of October 2024.** In addition, OC needs to provide additional guidance and monitoring for LORA's transfers of viable secured orphaned wells to new operators, which can also decrease the orphaned oil well population without incurring plugging costs.

- **OC did not ensure that LORA operated cost-effectively to plug wells at lower costs than the OSR program, especially when factoring in the characteristics of wells plugged and administrative expenses.** Since allowing LORA to provide financial security poses financial risks to the state, it is important for OC to accurately evaluate the benefits that LORA provides compared to these risks, including all relevant factors that impact these calculations.

This report had 14 recommendations to DENR and DENR agreed with all of them. The report also had one matter for legislative consideration.