Statement of Basis, Specific Statutory Authority, and Purpose
New Rules and Amendments to Current Rules of the Colorado Oil and Gas Conservation Commission, 2 CCR 404-1

Cause No. 1R Docket No. 1412-RM-02
Enforcement and Penalty Rulemaking

This statement sets forth the basis, specific statutory authority, and purpose for new rules and amendments ("Enforcement and Penalty Rules") to the Colorado Oil and Gas Conservation Commission ("Commission") Rules of Practice and Procedure, 2 CCR 404-1 ("Rules"). The Commission promulgated the Enforcement and Penalty Rules on December 15-16, 2014.

The Commission is promulgating the Enforcement and Penalty Rules to implement amendments to Section 34-60-121, C.R.S., enacted by the passage of HB 14-1356 ("Penalty Bill"), and Executive Order D 2013-004, which directed the Commission to review, propose rules, and adopt guidance regarding its enforcement and penalty assessment procedure. The Enforcement and Penalty Rules are also promulgated to make certain Commission rules more consistent, effective, and efficient pursuant to Executive Order D 2012-002. The Enforcement and Penalty Rules are intended to deter noncompliance and encourage operators that are not in compliance to quickly and cooperatively come into compliance. As a result, they are also intended to protect public health, safety, and welfare, including the environment and wildlife resources.

In adopting the Enforcement and Penalty Rules, the Commission relied upon the entire administrative record for this Rulemaking proceeding, which formally began on June 6, 2014, when the Penalty Bill became effective.

Stakeholder and Public Participation

The Commission held stakeholder meetings regarding the proposed Enforcement and Penalty Rules on August 13, 2014, September 18, 2014, and October 3, 2014. The Commission invited and accepted written and verbal comments from stakeholders regarding the proposed Enforcement and Penalty Rules during these stakeholder meetings.

The Commission encouraged public participation in the Rulemaking by allowing the public to comment on the proposed rules in advance of or during the hearing. As well, persons or organizations desiring to do so could participate in the Rulemaking as a party. Parties could submit prehearing statements and comments, including alternative rules or amendments, and respond to the prehearing statements and comments submitted by other parties.

The Commission issued a Notice of Rulemaking Hearing concerning the Enforcement and Penalty Rules on **[October 15, 2014]**.

Statutory Authority

The Commission's authority to promulgate the Enforcement and Penalty Rules is derived from the following sections of the Colorado Oil and Gas Conservation Act ("Act"), §§ 34-60-101 – 130, C.R.S.:

- Section 34-60-105(1), C.R.S. (Commission has the power to make and enforce rules);

- Section 34-60-106(2)(a), C.R.S. (Commission has authority to regulate the "drilling, producing, and plugging of wells and all other operations for the production of oil or gas.");

- Section 34-60-106(2)(d), C.R.S. (Commission has authority to regulate "Oil and gas operations so as to prevent and mitigate significant adverse environmental impacts on any air, water, soil, or biological resource resulting from oil and gas operations to the extent necessary to protect public health, safety, and welfare, including protection of the environment and wildlife resources, taking into consideration cost-effectiveness and technical feasibility.");

- Newly amended Section 34-60-121(1) and (7), C.R.S. (Commission has authority to take enforcement action and impose penalties for violations); and

- Section 34-60-130, C.R.S. (Commission has authority to promulgate rules to implement the reporting of spills).

Identification of New and Amended Rules

The Commission adopted amendments to Rules:

- 100-Series Rules.
- 200-Series Rules: 204 and 205.
- 300-Series Rules: 303, 308A, 309, 311, 316A, 316B, 317, 318A, 319, 321, 325, 326, 327, and 330.
- 500-Series Rules: 506, 507, 521, 522, 523, and 530.
- 600-Series Rules: 603 and 605.
- 700-Series Rules: 710.
- 900-Series Rules: 901, 904, 907, 909, and 910.

Overview of Purpose and Intent

The primary purpose for the Commission's promulgation of the Enforcement and Penalty Rules is to implement significant rule and policy changes to the regulatory oversight of oil and gas operations. The necessity for these changes has been

demonstrated by formal action by the executive and legislative branches of Colorado's government.

The Commission is promulgating the Enforcement and Penalty Rules to implement the statutory changes to Section 34-60-121, C.R.S., respond to Executive Order D-2013-004, and address revisions suggested in the *Enforcement and Penalty Policy Review under Executive Order No. D 2013-004* ("*Enforcement and Penalty Policy Review")*. An additional purpose of the Rulemaking is to clarify specific requirements of some Commission rules.

In addition to adopting the Enforcement and Penalty Rules, the Commission is developing an *Enforcement Guidance and Penalty Policy* that will provide interested stakeholders written guidance describing the Commission's enforcement and penalty assessment procedures.

Penalty Bill

The Enforcement and Penalty Rules implement the Penalty Bill, which the General Assembly passed during the 2014 legislative session. The Penalty Bill is codified at Section 34-60-121(1) and (7), C.R.S. (2014), and took effect on June 6, 2014.

The Penalty Bill amended Subsection (1) to explicitly state two purposes of the Commission's enforcement and penalty authority: deter violations and encourage prompt compliance. The amendments also eliminate the existing $10,000 penalty cap for a violation, increase the daily penalty amount from $1,000 to $15,000 for each violation, and call for the Commission to assess a penalty for each day that the evidence demonstrates a violation occurred.

The Legislature also directed the Commission to consider the following presumptions when calculating the days of violation:

- A minor violation begins on the day an operator should have submitted a report or started the corrective action and ends when the operator submits the report or starts the corrective action;

- All other violations begin when the operator discovered or should have discovered the violation and ends when the operator starts the corrective action; and

- The days of violation does not include any period where the operator engages in good faith negotiation with the Commission and prompt, effective, and prudent response to the violation.

Importantly, the amended statute confirms that an operator's violation of a Commission order or Administrative Order by Consent is a separate violation that may result in the Commission assessing additional penalties against the operator.

Amended Subsection (1) requires the Commission to publish a quarterly report about each penalty assessed during the previous quarter. The report must include information regarding the amount of each penalty (both daily and total penalty amounts), whether the penalty was assessed by hearing or administrative order by consent, the days of violation, and whether the violation was part of a pattern of violations.

Amended Subsection (7) requires the Commission to hold a hearing if an operator's alleged conduct was grossly negligent or knowing and willful and caused an egregious violation or demonstrates a pattern of violations. If the Commission finds a violation after one of these types of hearings, it can now issue an order prohibiting the operator from receiving new permits, suspending the operator's Certification of Clearance, or both. If the operator later comes into compliance, the Commission can vacate its order.

Executive Order D 2013-004

Executive Order D 2013-004, signed on May 8, 2013, directed the Commission to review its enforcement program, penalty structure, and imposition of penalties. Similar to language passed by the General Assembly in the Penalty Bill, the Executive Order instructed the Commission to "reevaluate its enforcement philosophy and approach and strive to structure fines and penalties to ensure that operators comply with rules and respond promptly and effectively to any impacts from such violations."

As required by Executive Order D 2013-004, the Commission strategically reviewed its enforcement and penalty assessment program and, on December 10, 2013, issued the *Enforcement and Penalty Policy Review*.

The *Enforcement and Penalty Policy Review* proposed potential changes to Commission Rules 522 and 523, as well as changes to existing Commission enforcement policies and procedures. The following changes to Commission rules were proposed:

1) Establish criteria by rule to decide the degree of actual or threatened adverse impact to public health or the environment resulting from a violation;

2) Reduce the emphasis in current rules to rely upon informal procedures to resolve Notices of Alleged Violations;

3) Require a full hearing before the Commission to resolve an alleged pattern of violations;

4) Revise the Commission's Penalty Schedule (assuming a statutory change to the allowable maximum daily penalty was made) and specified aggravating

and mitigating factors to ensure penalties are appropriate to the nature of a violation;

5) Reduce the time period in which a complainant must object to (i) a decision by the Director to decline to issue a Notice of Alleged Violation and (ii) an Administrative Order by Consent; and

6) Conform existing Commission rules to any changes made to the Act.

The *Enforcement and Penalty Policy Review* proposed the following changes to Commission policies:

a) Develop a Penalty Matrix that establishes base penalties taking into account the seriousness of a violation and the degree of actual or threatened adverse impact to public health, safety, welfare, the environment, or wildlife resources (again, assuming a statutory change to the penalty amount);

b) Limit the extent to which a penalty may be reduced for mitigating factors;

c) Clarify in policy the criteria to be considered to determine the degree of actual or threatened adverse impact to the environment caused by a violation;

d) Retain appropriate flexibility to consider ability to pay when setting a penalty;

e) Allow appropriate penalty mitigation when large remediation costs have been incurred by a violator;

f) Describe in written policy the criteria and factors used to eliminate and consolidate claims that are asserted initially in a Notice of Alleged Violation as written in the field; and

g) Clarify in policy how a pattern of violations is to be determined.

Amendments and Additions to Rules

The most significant changes undertaken in this Rulemaking were to Rules 522 and 523. The changes to those rules are described below separately from changes to the other 500-Series Rules.

Rule 522. Procedures for Alleged Violations

The Enforcement and Penalty Rules substantially revised Rule 522 to describe the Commission's enforcement procedures. The Penalty Bill, Executive Order D 2013-004, and the Commission's *Enforcement and Penalty Policy Review* called for important changes to the existing enforcement procedures, and the Commission revised Rule 522 to implement these changes. In addition, the Commission used the factors set forth in Executive Order 2012-002 to clarify the language of the Rule.

522.a. Identification of Alleged Violations

Subpart (a) was revised to establish how the Commission can identify alleged violations and what persons, i.e. Complainants, can participate in enforcement proceedings. Previously, Subpart (a) regulated numerous aspects of the Commission's enforcement procedures: the receipt of complaints, the Director's discretion to issue a Notice of Alleged Violation ("NOAV"), under what circumstances a Complainant could seek Commission review of an alleged violation, and the NOAV process.

As amended, the Subpart's narrowed scope focuses upon two issues. First, Paragraph (1) describes the Director's discretion to issue an NOAV and is similar to the regulatory language in the previous Rule 522.a.(3). While the Commission eliminated the Rule's narrative description of "reasonable cause," the Commission retained "reasonable cause" as the same threshold determination necessary for the Director to initiate an enforcement action. This "reasonable cause" standard is now described more fully in the *Enforcement Guidance and Penalty Policy*.

Second, Paragraph (2) gives a specific title of "Complainant" to certain categories of persons that submit a complaint to the Director requesting issuance of an NOAV. However, the amendments made no changes to the categories of persons that qualify as Complainants. One of the purposes of the Penalty and Enforcement Rules is to better explain and clarify the NOAV process, so the Commission refined the regulatory language previously in this Subpart and moved the requirements into separate subparts of 522 as explained below.

522.b. Complainant's Rights and Responsibilities

Subpart (b) was revised to describe a Complainant's rights and responsibilities. A Complainant is required to file a Form 18 written complaint to receive these rights. Filing a Form 18 ensures Commission staff has sufficient information to contact the Complainant regarding the complaint and track the issues directly raised by the Complainant. The Commission will continue to improve the clarity and simplicity of the directions and procedures for Complainant's to file Form 18s on its website.

Paragraph (1) requires the Director to investigate any complaint from a Complainant and verify whether evidence supports reasonable cause to believe a violation may have occurred. Further, the Paragraph requires the Director to notify the Complainant of the Director's resolution of the investigation pursuant to the new service Rule 521. The revised Rule maintains the Complainant's ability to comment on an Administrative Order by Consent ("AOC") at this stage in the process.

The amendments to this Subpart combine language from Rule 522.a.(4) and 522.b.(4) that described a Complainant's ability to file an application for an Order Finding Violation ("OFV") hearing if the Director does not issue an NOAV or if the Complainant objects to the settlement terms in an AOC. The new Rule also clarifies

that a Complainant may only comment or object to the "settlement terms" of an AOC "settling an alleged violation arising directly from the complaint." These changes ensure that an enforcement action can progress efficiently, while still affording a Complainant the ability to participate in the resolution of issues directly identified by the Complainant.

These revisions also clarified and changed some of the procedures for a Complainant's filing of an OFV application. First, the time period within which a Complainant must file an application for an OFV hearing was also condensed from 45 days to 21 days to allow for the expedient resolution of enforcement actions, in accordance with the suggestion provided in the *Enforcement and Penalty Policy Review*. Complainants will be informed of the proposed terms of an AOC before those terms are finalized. In most cases Complainants will know before they receive notice whether they intend to protest the AOC. Thus, 21 days should be sufficient time in which to file a notice-pleading stating the grounds of their protest and requesting an OFV hearing.

In addition, the Rule also clarifies the service procedures for a Complainant's OFV hearing application. The failure to a Complaint to properly serve an application under this Rule prevents the Commission from hearing the Complainant's application because proper service is a jurisdictional prerequisite for a Commission hearing. Consistent with the previous Rules, a Complainant bears the burden of proof in an OFV hearing initiated by the Complainant under this Subpart.

522.c. Resolution of Alleged Violations without Penalties

Subpart (c) was revised to better describe the limited situations in which the Director has the discretion to resolve alleged violations without seeking penalties. The Commission developed the procedure now codified in Subpart (c) during its implementation of Colorado's LEAN Process, which focused Colorado's agencies on making their procedures more effective, efficient, and elegant.

Consistent with the purpose of encouraging operators to swiftly come into compliance as articulated in the Penalty Bill and Executive Order D 2013-004, a resolution without penalties is only available if the operator timely performs all corrective actions and promptly returns to compliance. Further, resolution without penalties is only available if all of the following elements apply: the rule allegedly violated is either Class 1 or Class 2, as described in Rule 523; the operator has not previously received a Warning Letter or Corrective Action Required Inspection Report for the same or substantially similar violation; and the Director determines the alleged violation has not caused adverse environmental impacts, does not pose a threat of adverse impacts, and can be corrected quickly. Corrective Action Required Inspection Reports replace the Commission's current Unsatisfactory Inspection Reports.

If the Director chooses to resolve the alleged violation without penalties because all of the elements in Paragraph (1) apply, Paragraph (3) specifies the procedure to be followed, as well as consequences if the operator fails to come into compliance.

The changes to Subpart (c) also incorporate the *Enforcement and Penalty Policy Review's* recommendation to reduce the emphasis on informal resolution of alleged violations in three ways. First, the language that "informal procedures to resolve issues raised by an NOAV with the Director are encouraged" was completely removed. Second the amendments limit the situations in which the Director can resolve an alleged resolution without initiating an enforcement action. Finally, the Director retains the discretion to pursue an enforcement action even if all of the criteria to resolve an alleged violation without penalties are satisfied in Paragraph (2) and (4)B.

522.d. Enforcement Actions Seeking Penalties for Alleged Violations

Subpart (d) describes the procedure to initiate an enforcement action for an alleged violation for which the Commission is seeking penalties. Regulatory language from the previous version of Rule 522.a. regarding the NOAV process was relocated to this Subpart to describe the NOAV process in more detail and provide for general procedural matters. Locating this process in a different subpart further distinguishes it from those violations that qualify for resolution without penalties.

The Director commences an enforcement action by issuing an NOAV and the Rule specifies what information an NOAV may contain. Subpart (d)(2) now requires an operator to file an answer to an NOAV within 35 days, and provides that the Director may ask the Commission to enter a default judgment if an answer is not timely filed. This new answer requirement is intended to help Commission staff evaluate the alleged violation based on information from the operator and decide how to proceed next in the enforcement process. An answer also confirms that the operator is aware of the violation.

Paragraph (3) combines procedural matters that were previously spread throughout Rule 522. In addition, this paragraph also clarifies that service of an NOAV is the "commencement of an action or other proceeding" for purposes of § 34-60-115, C.R.S.

522.e. Resolution of Enforcement Actions

Subpart (e) was added to describe the process by which enforcement actions seeking penalties can be resolved and contemplates resolution by AOC under Paragraph (1) or by an OFV hearing under Paragraph (2).

The process for resolution by AOC in Paragraph (1) builds upon and clarifies language previously in 522.b.(3) regarding how an AOC is developed and the process by which it is presented to the Commission for review and approval. It also describes the involvement of a Complainant in the AOC process to ensure a Complainant has the opportunity to participate in resolving violations that the

Complainant directly identified. As well, the amendments clarify that a matter is remanded to the Director if the Commission does not approve the AOC.

Importantly, and consistent with the Penalty Bill and *Enforcement and Penalty Policy Review*, the Director cannot settle certain violations by AOC. Paragraph (2)(A) requires an OFV hearing before the Commission to resolve an alleged violation in three scenarios:

- The Director alleges the operator is responsible for gross negligence or knowing and willful misconduct that resulted in an egregious violation;
- The Director alleges the operator has engaged in a pattern of violations; or
- A Complainant files a timely application for an OFV hearing pursuant to Rule 522.b.(2).

The first two scenarios incorporate the Penalty Bill's mandatory hearings and the third codifies an already-existing requirement.

Paragraph (2)(B) describes the procedures for the Director to commence an OFV hearing whether the hearing is discretionary or mandatory. To commence a discretionary OFV hearing, the Director need only serve the NOAV and Notice and Application for Hearing. However, to commence an OFV hearing for one of the three mandatory hearing scenarios in Paragraph (2)(A) above, the Director is required to file a Notice and Application for Mandatory OFV Hearing. The different procedures are designed to notify operators at the outset whether the violation can be resolved by AOC. The Rule also reiterates how a Complainant may commence an OFV hearing and the Commission may initiate an OFV hearing by its own motion.

This paragraph clarifies that OFV hearings not governed by one of the circumstances in which a hearing is mandatory are commenced by service of the NOAV and Notice and Application for Hearing, without a separate application filed by the Director. In addition, in order to make sure that parties have time to prepare for hearing if settlement is not achieved, the amendments ensure that the OFV hearing will commence on the date stated in the Notice and Application for Hearing unless parties agree to an AOC not less than 7 days prior to that date. If the parties reach agreement on an AOC less than 7 days prior to the hearing, the parties may advise the Commission of this fact at the hearing and not engage in a full evidentiary hearing if the Commission determines it is unnecessary.

Paragraph (2)(C) explains the OFV prehearing and hearing procedures. The revised Rule also grants the Director the option to intervene as a matter of right in a Complainant's OFV hearing. Previously, the Director was a necessary party pursuant to Rule 522.c.(5). The discretionary intervention allows the operator and Complainant, which are the parties in dispute, to present the matter without consuming Commission staff's resources. Even if the Director does not intervene, Commission staff will still be available to answer technical and administrative

questions as the Commission requires during the proceeding. In addition, staff may also always present analysis without being a party to the proceeding.

522.f. Failure to Comply with Commission Orders

Subpart (f) was added to Rule 522 to conform with Section 34-60-121(1)(c)(I)(C), C.R.S., as amended by the Penalty Bill. Rule 522.f. provides that an operator's failure to implement corrective action required by an AOC, OFV, or other Commission order is a new violation independent of the original underlying violation. Consequently, an operator may be assessed penalties or required to perform additional corrective action if an operator fails to timely comply with the requirements of an AOC, OFV, or other Commission order.

The violation of a Commission enforcement order is a Class 3 violation in the Commission's Penalty Schedule, Table 523-1, because of its significant deviation from the purposes of the Penalty Bill, Executive Order 2013-004, and the *Enforcement and Penalty Policy Review*. The violation of a Commission general or field order is a Class 2 violation.

522.g. Cease and Desist Orders

Subpart (g) clarifies the previously existing regulatory language regarding the Commission's issuance of cease and desist orders. As amended, the Subpart makes clear that the Commission may issue a cease and desist order when an operator's alleged violation creates an emergency situation. The Director can also issue a cease and desist order under the same circumstances; however, the order must be reported to the Commission for review and approval. A cease and desist order is now served pursuant to the new general service Rule 521. Further, the Commission amended the Subpart to ensure that corrective actions required to address the emergency situation will not be stayed if an operator protests the cease and desist order. In an emergency situation, promptly undertaking corrective action is critically important to protecting the public health, safety, and welfare, including the environment and wildlife resources, from further harm. The Subpart was also clarified to address the process by which the Commission will hear an operator's protest of a cease and desist order.

Rule 523. Procedures for Assessing Penalties

Similar to Rule 522, the Commission's Rulemaking substantially revised Rule 523, which outlines the procedure for assessing penalties for a violation. Passage of the Penalty Bill eliminated the $10,000 penalty cap for a violation, increased the daily penalty amount from $1,000 to $15,000 for each violation, and called for the Commission to assess a penalty for each day that evidence demonstrates a violation occurred. The Penalty Bill also specified presumptions the Commission must incorporate into its Rule governing the calculation of a violation's duration to assess

penalties. The statutory changes as well as the Commission's recommendations in the *Enforcement and Penalty Policy Review* necessitated revisions and additions to Rule 523.

523.a. General

Subpart (a) was revised to focus the Subpart on providing only a general overview of the Commission's penalty assessment procedure. Paragraphs (1) – (4) were removed because the Paragraphs describe the Commission's historic procedure to assess penalties, and do not conform to the procedure established in Section 34-60-121, C.R.S.

523.b. Days of Violation

The Commission created a new Subpart (b) to explain how the duration of a violation is calculated. Because the $10,000 cap on the penalty per violation was eliminated by the Penalty Bill, many violations can potentially persist for multiple days and continue to accrue daily penalties if the operator does not commence corrective action.

Section 34-60-121(1), C.R.S., directed the Commission to assess the duration of a violation based on several presumptions. These presumptions largely codify existing Commission practice and the analysis set forth in the *Enforcement and Penalty Policy Review*. However, these practices were not previously established by rule. Based on these amendments, the Commission will presumptively assess the duration of a minor violation from the day an operator should have submitted a report or started the corrective action until the day the operator submits the report or commences corrective action. For all other violations, the Commission will presumptively assess penalties from the day the operator discovered or should have discovered the violation until the day the operator commences corrective action.

Revisions to Paragraphs (1) and (2) incorporate this language into the Rule and also provide examples of what an operator can do to commence corrective action. For circumstances that may qualify as commencing corrective action but are not included in this list, operators will need to demonstrate measures have been taken to control or contain immediate threats to public health, safety and welfare, including the environment and wildlife resources.

Paragraphs (3) and (4) were added to conform the Rule to the new statutory language. Under Paragraph (3), the Commission will assess a penalty for each day the evidence shows a violation continued, which amendment fulfills the Penalty Bill's directive codified at Section 34-60-121(1)(e), C.R.S. Lastly, Paragraph (4) explains that operators may have daily penalties subtracted from the total penalty amount for days during which the operator is engaged in good faith negotiation with the Commission concerning required corrective actions, or is waiting on a response from the Director on a proposed work plan.

523.c. Penalty Calculation

Subpart (c) was added to reflect the General Assembly's changes to the penalty cap and maximum penalty amount per violation, the *Enforcement and Penalty Policy Review's* recommendations, and the Governor's directives to establish minimum fine amounts for egregious or aggravating circumstances and to apply the statutory maximum as necessary to protect public health, safety, welfare, and environment.

The four paragraphs in Subpart (c) establish a step-by-step procedure for the Commission to follow when assessing a penalty: first, determine the base penalty for the violation; second, determine the daily penalty amount by increasing the base amount if the violation caused actual or threatened adverse impacts to public health, safety, and welfare, including the environment and wildlife resources; third, adjust the penalty per violation for aggravating or mitigating factors; and fourth, adjust the daily penalty amount for violations of long duration, if appropriate.

Section 34-60-121(c)(I) directs the Commission to establish a penalty schedule "appropriate to the nature of the violation." Executive Order D 2013-004 directs the Commission to "ensure that the penalties assessed are appropriate for the gravity of violations," which emphasizes the Commission's responsibility to classify violations. Previously, the maximum penalty for a violation of most Commission rules was a $1,000 base penalty due to the language in the Act before the Penalty Bill amended it.

Base Penalty

Paragraph (1) assigns a base penalty amount depending on the classification of the violation according to the Commission's Penalty Schedule. The base penalty amount does not account for a violation's threatened or actual harm because the Commission separately adjusts the penalty amount for "harm" pursuant to Paragraph (2). The Commission assigned base penalties for violations by considering: 1) the core principles of deterring non-compliance and encouraging prompt return to compliance when violations do occur; 2) the severity of potential harm associated with a violation of specific rules, ranging from "ministerial" rules to rules directly related to protection of public health, safety, and welfare, including the environment and wildlife resources; and 3) the new statutory maximum of $15,000 per day. The base penalty assumes there has been no actual or threatened harm.

The Commission has assigned rule classes to particular violations depending on the severity of the violation. The severity of a violation was determined by the consequences of a particular violation generally, without the application of particular circumstances of a case, and how great of a risk the violation of the rule was to the Commission's statutory mandate to foster responsible, balanced development and protect public health, safety, and welfare, including the environment and wildlife resources. Rule violations were classified as Class 1, 2, or

3 violations in the Penalty Schedule, Table 523-1. Rules described as N/A are administrative or descriptive and generally do not impose any specific requirements on operators. This classification is intended to provide consistency in how different operators are penalized for violations of the same rule by establishing a uniform base penalty. However, based on the circumstances of an alleged violation, the Rule grants the Director discretion to reclassify a discrete subpart of a Rule if the alleged violation of the subpart has different potential consequences from a violation of the remainder of the Rule.

The Commission relied upon the Penalty Bill's characterization of minor or other reporting violations to establish Class 1 violations and further defined them as those violations that do not present a direct risk. The Commission classified rules as Class 3 if a violation of the rule could per se cause harm and/or has a significant probability of impacting the elements of the Commission's statutory mandate. The Commission classified rules as Class 2 if they were more severe than Class 1, because they may cause harm, but were less severe than a Class 3 violation.

Daily Penalty

Paragraph (2) adds a second element to the daily penalty calculation: the degree of actual or threatened adverse impact resulting from a violation. This element takes into account the actual circumstances of a particular violation. For example, this element takes into account whether there was a water source nearby that was threatened or whether public property was damaged in this particular case. This fulfills Executive Order 2013-004's directive to "apply the statutory maximum as necessary to protect public health, welfare, safety, and the environment" and results in a case-specific analysis missing from the generic rule classification that establishes the base penalty amount as described above.

Aggravating and Mitigating Factors

Paragraph (3) amended the aggravating and mitigating factors the Commission can use to increase or decrease the penalty, which were previously listed in Rule 523.d. The Commission deleted three aggravating factors because Paragraph (2) obligates the Commission to adjust the base penalty amount for these same factors. The deleted aggravating factors were:

- The violation had a significant negative impact, or threat of significant negative impact, on the environment or on public health, safety, or welfare.
- The violation resulted in or threatened to result in significant loss or damage to private or public property.
- The violation results in significant, avoidable loss of wildlife or wildlife resources, including the ability of the land to produce vegetation supportive of wildlife.

The Commission also deleted the following aggravating factor, due to the addition described below:

- The violation was intentional or reckless.

The Commission added the following aggravating factors to fulfill the directive of Executive Order 2013-004:

- The violator acted with gross negligence or knowing and willful misconduct.

- The violator has engaged in a pattern of violations.

The first aggravating factor now incorporates the Act's contemplation of different treatment for these types of violations; however, it does not limit the aggravating factor to instances that resulted in an "egregious violation," which is a requirement for a mandatory OFV hearing. In order to have consistency, these terms replaced the previous state-of-mind terms of "intentional" and "reckless." The changes to the aggravating and mitigating factors also include minor adjustments to the language and phrasing in order to make them as clear as possible. There are now seven aggravating and seven mitigating factors.

Violations of Long Duration

Paragraph (4) was added to implement the directive to maintain appropriate flexibility required by the Executive Order D 2013-004 and the *Enforcement and Penalty Policy Review*. The Executive Order directed the Commission to develop penalty rules that "where applicable, allow a reasonable amount of flexibility and discretion." The *Enforcement and Penalty Policy Review* proposed adjustments for violations of long duration modeled after Colorado Environment and Public Health Department agencies' enforcement and penalty policies. Moreover, the Commission calculated penalties for violations of long duration from past enforcement examples and determined that a method for adjustment was necessary to ensure that the penalty is appropriate.

The Paragraph grants the Commission discretion to decrease the daily penalty amount for violations of long duration so long as the penalty amount is appropriate given the nature of the violation. The adjustment is described in further detail in the Commission's *Enforcement Guidance and Penalty Policy*.

Rule 523.d. Pattern of Violations, Gross Negligence or Knowing and Willful Misconduct

Subpart (d) was added to Rule 523 to incorporate changes from the Penalty Bill. The regulatory language in Paragraph (1) now implements the Bill by requiring the Director to apply for an OFV hearing if the Director determines an operator has engaged in a pattern of violations or acted with gross negligence or knowing and willful conduct and the actions caused an egregious violation.

Paragraph (2) also implements the Penalty Bill by stating the additional remedies the Commission may impose if it finds an operator has engaged in a pattern of violations or acted with gross negligence or knowing and willful conduct to cause an egregious violation. Under the previous rules, the Commission could only withhold new permits and could only withhold them for a pattern of violations. With its new statutory authority, the Commission can now suspend an operator's Certification of Clearance or withhold issuing new permits, or both, under either circumstance. The ability to impose this type of strict enforcement measure, when an operator does not take necessary measure to remediate significant adverse impacts to public health or the environment, furthers the important purpose of Executive Order 2013-004 and the Penalty Bill. The revised rule also authorizes the Director to lift the suspension if the operator demonstrates to the Director's satisfaction that the operator has brought each violation into compliance and paid all penalties.

A pattern of violations is a history of repeated abuse or violation of the Act, Commission Rules, orders, and/or permits that demonstrates an operator's habitual disregard of those legal requirements. Paragraph (3) clarifies the four non-exclusive factors the Commission may use to determine whether an operator has engaged in a pattern of violations, as suggested by the *Enforcement and Penalty Policy Review*. The four identified factors are: the number of NOAVs an operator receives as a percentage of the wells it operates; how frequently the operator violates the same or similar requirements; number of warning letters or corrective action required inspections an operator receives during a span of years; and any other factors to objectively determine whether an operator has a pattern and practice of noncompliance.

Rule 523.e. Voluntary Disclosure

A variation of Subpart (e) formerly existed as Subpart (b) to the Rule. Subpart (b) was rarely used. Operators may not have previously exercised the voluntary disclosure option, because it was limited to disclosures of a "significant adverse impact on the environment or of a failure to obtain or comply with any necessary permits." However, because voluntary disclosure can help meet the goals of avoiding non-compliance and quickly returning to compliance, the Commission has adjusted the provision to increase its utility.

Under Subpart (e), an operator must discover a violation that it voluntarily discloses as result of an implemented "regulatory compliance program," instead of through a "voluntary self-evaluation." The definition of a "regulatory compliance program" was added to the 100-Series Rules and is further explained in the enforcement guidance. An operator that invokes subpart 523.e. should be prepared to demonstrate that the regulatory compliance program is an established part of the operator's routine operating procedures. Indicia of such a program might include evidence of regularly scheduled compliance audits; clear assignments of specific personnel responsible for conducting compliance audits, as well as management-level personnel responsible for the audit program; paperwork associated with the

company's compliance audits (e.g., checklists or standard operating procedures for conducting audits); and reports generated as a result of compliance audits. The amendments did not otherwise change the conditions an operator must satisfy to receive the rebuttable presumption of a penalty reduction amount.

As amended, the voluntary disclosure presumptive penalty reduction can now apply to any violation of the Act, or any Commission rule, order, or permit. However, the amendments expand the situations where the presumptive reduction does not apply and decrease the minimum presumptive amount of penalty reduction to reflect the priorities set forth in the Penalty Bill. The voluntary disclosure presumption will not apply to violations that are part of a pattern of violations or were the result of the operator's gross negligence or knowing and willful misconduct. In addition, the presumptive penalty reduction is a minimum of 35% of the potential penalty for the disclosed violation and the Director has discretion to increase the penalty reduction percentage, including to eliminate a penalty entirely.

These adjustments to the voluntary disclosure presumption are designed to balance the directive from the Governor in Executive Order D 2013-004 and the General Assembly in the Penalty Bill to (1) strongly deter violations by ensuring penalties are appropriate and (2) encourage operators to promptly and cooperatively correct violations by providing a mechanism to reduce penalty amounts under certain conditions. Further, the Commission anticipates operators implementing a regulatory compliance program will operate at the highest standard and be more protective of the public health, safety, and welfare, including the environment and wildlife resources.

Rule 523.f. Public Projects

Subpart (f) previously existed in Rule 523 as Subpart (e). The revised Subpart requires that the public project must benefit the public health, safety, and welfare, including the environment and wildlife resources for an operator to offset costs. The amendments also clarify that an operator must voluntarily undertake the public project and an operator cannot offset costs of a public project if the operator is otherwise legally required to undertake the project. Subpart (f) grants the Commission discretion in approving a dollar-for-dollar or some lesser ratio offset of project cost to penalty amount.

Rule 523.g. Payment of Penalties

Subpart (g) regarding payment of penalties formerly existed in Rule 523 as Subpart (f). The Commission clarified the language of this subpart, but did not make any substantive changes to this subpart.

Other Rule Additions and Amendments

The Commission made the following additions and amendments to the below-listed rules. These changes were primarily designed to clarify specific details of these rules or to conform them to the amendments to Rules 522 and 523.

100-Series Rules

Bradenhead was defined to provide greater clarity for Rules 207.b. and 341.

Container was amended to provide a non-exhaustive list of examples.

Produced Water Pits was amended to clarify that the definition includes pits that service multiple wells on an oil and gas location.

Regulatory Compliance Program was added to define for operators what the Commission would require from a program for an operator to voluntarily disclose a violation pursuant to Rule 523.

Suspended Operations Well was added to clarify suspended well operations and that they do not include wells in which only conductor pipe has been set and the well has not yet been spud. The definition was added to ensure operators could comply with the mechanical integrity testing requirements in amended Rule 326.d.

Tank was amended to clarify that separation equipment and process vessels, other than gun barrels, are not included within the Commission's definition of "tank."

Temporarily Abandoned Well, as clarified, is now defined as a well that has all downhole completed intervals isolated with a plug that an operator sets above the highest perforation. Setting the plug in this way ensures the well cannot produce without removing the plug.

Voluntary Self-Evaluation was deleted because the Commission changed regulatory language in Rule 523 from voluntary self-evaluation to regulatory compliance program.

Waiting on Completion Well was added and defined as a well that an operator has drilled and cased to the final depth but has not perforated. The definition was added to ensure operators could comply with the mechanical integrity testing requirements in amended Rule 326.d.

200-Series Rules

204. was amended to change the title to accurately reflect the Rule's substantive requirements.

205.c. was amended with the addition of non-vehicular. This was added to make it clear that the existing requirement to track fuel storage is applicable to only fuel stored in tanks that are not part of the vehicle. Fuel stored in saddle tanks on the vehicle, in tanks mounted on the bed and attached to the vehicle, or in a tanker trailer used to transport fuels are not required to be tracked.

300-Series Rules

308A.a. was clarified to require an operator to submit a "Preliminary" Drilling Completion Report, Form 5, within 90 days of suspending drilling activities only if the operator has not resumed drilling operations.

308A.b. was clarified to state what information an operator must include in a "Final" Drilling Completion Report, Form 5. As well, the requirements regarding Drilling Completion Report, Form 5, that were previously located in Rule 317.e. were consolidated in 308A.b. to make the Rules easier to understand and more efficient.

316A.a. was clarified to include examples of Class II wastes that an operator can inject into any formation in a dedicated Class II Underground Injection Control well with prior approval from the Commission. The clarification should make compliance with the Rule easier to understand.

317.e. was clarified to ensure consistent and effective regulatory oversight. The clarified Rule requires operators to obtain the Commission's approval before operators make changes to gross interval perforations in completed formations. As well, the requirements regarding Drilling Completion Report, Form 5, previously found in Rule 317.e. were consolidated into 308A.b.

317.r. was added to codify an engineering control that better protects people and the environment and has been utilized by the Commission as a condition of approval on permits for a year. The Rule now requires operators to perform an anti-collision evaluation of all existing offset wellbores that may be within 150 feet of a proposed well. An operator must perform the evaluation before drilling the well and must include surveys of the offset wells. Only if the results of the evaluation show that drilling the proposed well will not risk collision or harm to people or to the environment can the operator drill the well. If the well is drilled, the operator must submit an as-constructed gyro survey with the Drilling Completion Report, Form 5, to the Commission when drilling operations are complete.

317.s. was moved from current Rule 318.A.n and moved into Rule 317 to create a fracture stimulation setback between wellbore's treated intervals applicable statewide instead of just applying to the Greater Wattenberg Area ("GWA"). If a proposed wellbore's treated interval will be located within 150 feet of an existing oil or gas wellbore's treated interval owned by a different operator, the operator of the

proposed well must submit a signed written consent from the operator of the encroached upon well with the Application for Permit-to-Drill, Form 2A similar setback applied to fracture-stimulated wells in the GWA under Rule 318.A.n., but the GWA-specific rule was eliminated during the Rulemaking because the Commission adopted a statewide setback.

318A.f.(5), as amended, clarifies that sampling analysis shall comply with Rule 910.b.(2) and that the same sampling standards and analysis are required under Rule 318 as Rule 609.

318A.n. was deleted because the Commission amended Rule 317.s. to include a fracture stimulation setback requirement to all wells throughout the state, not just fracture stimulated wells in the GWA.

319.a.(1) was amended to describe the steps an operator must complete before setting a cement plug. The amended regulations codify the API standards and engineered controls as requirements to consistently and efficiently regulate plugging requirements for abandoning a well.

321 was clarified to make the Rule easier to understand.

325.c.(7) and 325.d.(6) were clarified to state that the Commission's intent is that the maximum or minimum amount stated on the permit is an absolute, not an estimate.

326.d. was added to state what mechanical integrity tests are required for wells that are waiting-on-completion or in suspended operations. The revision ensures consistent regulatory oversight because it requires operators to perform integrity testing on these types of wells. The definitions of waiting-on-completion and suspended operations wells were added to the 100-Series Rules.

327 was revised to explain what constitutes a significant well control event for purposes of the Rule. The revision will make the Rule more effective as it assists operators seeking to comply with the reporting requirements of Rule 327. A significant well control event occurs when formation fluids flow into the wellbore unexpectedly and gaining well control requires increasing the weight of mud already in the well by 4% or more.

500 Series Rules

506.a. was amended to require an applicant to submit an application for a hearing no later than 70 days in advance of the date that the applicant requests the Commission to hear the matter, which allows additional time to prepare or resolve the matter. The Secretary retains the discretion to accept applications filed within 70 days of the requested hearing date.

507.a.(1) was amended to allow additional time between the notice of hearing and the hearing. Presently, the Commission must provide notice 20 days before a hearing to the persons identified in Rule 507. The Rule now requires the Commission to provide notice at least 35 days in advance of the hearing to the persons identified. The amendment affords involved parties additional time to prepare or reach resolution.

521 was formerly "reserved," but has now been utilized to describe the requirements necessary to serve a person when service is required by the Rules. The inclusion of a Rule dedicated to service is intended make service procedures easier to understand and locate the requirements for service in a single Rule. Where the term "electronically" is used in this rule, it refers in most cases to email, but could also refer to the faxing of documents if such service is necessary.

530.a. was amended to accord with current Commission practice. The Rule now states that an application for involuntary pooling becomes effective either on the date the operator filed the application with the Commission or on a date determined by the Commission. Some circumstances may demand a different effective date and the Commission wants to ensure its flexibility if those circumstances arise.

600 Series Rules

603.e.(3) now requires operators to test blowout prevention equipment using both high and low pressure tests following API Recommended Practice 53 with one modification: 250 psi is the minimum pressure for a low pressure test. For operators testing rig pumps against casing, the resulting pressure loss cannot be more than 10%. For operators using a test plug to isolate casing from the blowout prevention equipment, there cannot be any pressure loss from a test. Codifying best management practices for testing blowout prevention equipment better protects the public health, safety, and welfare, including the environment and wildlife resources.

700 Series Rules

710 was changed to "Reserved," because it previously described the Oil and Gas Conservation and Environmental Response Fund, which is duplicative of the Act and outdated due to statutory amendments. House Bill 14-1077 raised the cap for the fund from $4 million to $6 million.

900 Series Rules

901.e. has been clarified to include examples of acceptable methods to gather data for sensitive area determinations. This clarification makes the Rule easier to

understand and is intended to increase consistency in gathering data for sensitive area determinations.

904.a. was amended to clarify that pits constructed before May 1, 2009 on federal land or before April 1, 2009 on other land must also comply with permit conditions existing when the pit was constructed. This clarification makes the Rule easier to understand and is intended to ensure consistency in the regulation of pits.

904.b. was clarified to state subpart (b) applies to all pits that are required to be lined by either rule or permit condition. This clarification is intended to ensure consistent, effective regulation of all lined pits.

907.c.2.(D) was clarified to state an operator may only use road spreading to dispose of produced water with an approved waste management plan. This clarification is intended to ensure consistent, effective regulation of produced water disposal.

907.e.(2) was amended to require operators to submit a Site Investigation and Remediation Work Plan, Form 27, and receive the Director's approval before beginning land treatment of any oily wastes. As well, the land treatment cannot interfere with an operation's compliance with Rules 1003 and 1004 and must comply with Rules 909 and 910. Previously, a Site Investigation and Remediation Work Plan, Form 27, was only required if land treatment onsite caused a threatened or significant adverse environmental impact. The amendment also clarified that operators must notice the surface owners of land proposed to be treated with oily waste if on an Oil and Gas Location. This clarification is intended to ensure consistent, effective regulatory oversight of operators disposing of oily waste via land treatment. As well, the amendments are better protective of the public health, safety, and welfare, including the environment and wildlife resources.

910.b.(3)(E) was amended to require analyzing hydrocarbon-impacted soils for organic compounds identified in Table 910-1 other than Total Petroleum Hydrocarbons ("TPH") as determined by site-specific conditions and process knowledge. Before the Rulemaking, hydrocarbon-impacted soils had to be analyzed for TPH. The Rule, as amended, is better protective of the public health, safety, and welfare, including the environment and wildlife resources.

Effective Date

The Commission adopted the Enforcement and Penalty Rules, which add new rules and clarify and amend other Rules, at its hearing on December 15-16, 2014 in Cause No. 1R Docket No. 1412-RM-02 are effective per Section 24-4-103, C.R.S.