

KIRKLAND ALERT

April 13, 2016

EPA's Plan to Make Sweeping New Change to Regulation of Methane Emissions from Existing Oil and Gas Sources and Potential Next Steps

On March 10, 2016, the U.S. Environmental Protection Agency ("EPA") announced a plan to limit methane emissions from existing oil and gas sources in an effort to tackle climate change and reduce greenhouse gases from the energy sector. This announcement follows recent regulatory proposals by EPA to decrease methane emissions from new and modified oil and gas sources. EPA will begin drafting proposed methane standards for existing oil and gas sources, which are anticipated to apply to the production, gathering, processing, transmission and storage segments of the oil and gas sector. While methane regulations for existing oil and gas sources are unlikely to be finalized during the Obama administration, investors and operators in the oil and gas market should monitor EPA's proposal and actively engage in EPA's rulemaking process to promote favorable outcomes for their businesses.

EPA plans to propose new methane emission standards for existing oil and gas sources. Rule will be developed through the Information Collection Request process, before issuance of proposed regulations.

Plan to Develop the Existing Source Rule

- In September 2015, EPA proposed methane emission standards for new and modified oil and gas sources (the "New Source Rule"), which EPA expects to finalize in June 2016.¹ The New Source Rule was announced as part of EPA's strategy for addressing methane and smog-forming emissions from the oil and gas industry.
- On March 10, 2016, the United States and Canada announced a wide range of initiatives as the next steps to combat climate change, including a plan to reduce methane emissions from the oil and gas industry by 40-45% below 2012 levels by 2025. In tandem, EPA announced that it will commence drafting proposed methane emission standards for existing oil and gas sources (the "Existing Source Rule"). EPA plans to begin a formal process to require companies operating existing oil and gas sources to provide information to assist in the development of the Existing Source Rule.
- To start, EPA will develop the Existing Source Rule through the Information Collection Request ("ICR") process, which will require companies operating existing oil and gas sources to provide information on existing sources of methane emissions, as well as available emissions-reduction technologies and the costs of those technologies. After engaging with stakeholders, EPA will sign a draft ICR in April 2016. This draft ICR will be made available for public comment and then sub-

mitted to the Office of Management and Budget for review. Once the ICR is approved, it will be sent to industry, which is required to respond and attest that the information it provides is accurate. Once the ICR process is complete, EPA will issue proposed regulations.

Timing of the Existing Source Rule

While EPA has expressed a desire to “work swiftly” to develop the Existing Source Rule, EPA is unlikely to finalize the Existing Source Rule under the Obama administration.

- EPA expects to receive the first phase of information under the ICR process in late 2016, making it difficult for EPA to finalize a rule before Obama leaves office in January 2017.
- Moreover, because of its potential impacts on industry, the Existing Source Rule is likely to be contentious, slowing the timeline for finalization.
- Recent experience with the New Source Rule demonstrates that the regulatory process can proceed more slowly than EPA desires — EPA initiated the process for creating the New Source Rule in January 2015 and is not expected to issue a final rule until June 2016.

Substance of the Existing Source Rule

Given the forthcoming shifts in the presidential administration, it is difficult to predict the ultimate content of the Existing Source Rule. It is likely, however, that the Existing Source Rule will bear some resemblance to the New Source Rule.

- If a Republican president were to take office, the rule developed under the Obama administration would likely either be significantly curtailed or withdrawn completely. On the other hand, an incoming Democratic president would likely continue the work of the Obama administration, announce even stricter measures, or possibly pursue a scaled-back version of the Existing Source Rule.
- The proposed New Source Rule seeks to limit methane emissions from centrifugal compressors, reciprocating compressors, pneumatic controllers, pneumatic pumps, well completions, equipment leaks at natural gas processing plants and liquid unloading operations, as well as fugitive emissions at well sites and compressor stations. Similarly, in the Existing Source Rule, EPA plans to address the production, gathering, processing, transmission and storage segments of the oil and gas sector.
- In the New Source Rule, EPA proposes to establish tailored requirements for regulated emission sources that include reductions in percentages of emissions, the implementation of certain pollution control technologies, operational requirements, emission location and source repair, and recordkeeping and reporting. EPA’s Existing Source Rule would likely establish similar requirements for existing sources, including tailored requirements for each type of emission source.

The ultimate substance and timing of the final rule is unclear. It is apparent, however, that the Existing Source Rule will bear some resemblance to the New Source Rule and that EPA plans to address the production, gathering, processing, transmission and storage segments of the oil and gas sector.

Potential Implications and Concerns

Industry experts predict that imposing requirements on existing sources similar to those included in the proposed New Source Rule would undermine the economic viability of older oil and gas wells.

- Older oil and gas wells are more likely to have methane leaks and frequently do not produce as much oil or gas as newer wells.
- If oil and gas prices remain low, additional costs for monitoring and reducing fugitive methane emissions may make oil and gas production from existing infrastructure economically nonviable.
- Experts expect that operators of older, vertically drilled wells and related facilities would be hit particularly hard by more stringent requirements, while newer, horizontally drilled and hydraulically fractured wells would fare slightly better. Putting more financial pressure on old, vertical wells could cause operators to decide to abandon leases and the legacy wells holding those leases (and thus trigger new plugging and abandoning obligations).

Next Steps

Investors and operators in the oil and gas market should monitor and actively participate in the ICR process and later stages of EPA's rulemaking process to promote favorable outcomes for their businesses. Early engagement with EPA will ensure that the agency understands the economic ramifications of installing advanced pollution control technology on existing oil and gas wells. Next steps to consider include:

- When EPA conducts shareholder outreach, working with EPA to help craft an initial ICR that addresses cost-effective emissions-reduction technologies and allows industry to account for the full cost of such technologies;
- Tracking and commenting on the draft ICR that EPA makes available for public comment (including through industry trade groups); and
- Engaging legal counsel and technical environmental consultants to consider the legal and technical/cost implications of proposed regulations for ongoing and future operations.

Additional costs for monitoring and reducing fugitive methane emissions could make existing wells economically nonviable. Participants in the oil and gas sector should engage early with EPA to make sure the agency understands the economic ramifications of installing advanced pollution control technology on existing oil and gas wells.

1 The proposed New Source Rule targets specific emission sources in the oil and gas sector and imposes distinct requirements for each type of source. Under the proposed New Source Rule, oil and gas companies will have to, among other things, limit emissions from new and modified pneumatic pumps, capture gas from the completion of fracked wells, find and repair leaks, and limit emissions from several types of equipment used at gas transmission compressor stations, including compressors and pneumatic controllers.

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Paul Tanaka
Kirkland & Ellis LLP
555 California Street
San Francisco, CA 94104
www.kirkland.com/ptanaka
+1 415 439 1451

Michael Saretsky
Kirkland & Ellis LLP
555 California Street
San Francisco, CA 94104
www.kirkland.com/msaretsky
+1 415 439 1419

Michael Mahoney
Kirkland & Ellis LLP
555 California Street
San Francisco, CA 94104
www.kirkland.com/mmahoney
+1 415 439 1453

This communication is distributed with the understanding that the author, publisher and distributor of this communication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, this communication may constitute Attorney Advertising.

© 2016 Kirkland & Ellis LLP. All rights reserved.

www.kirkland.com