

**UNITED STATES DEPARTMENT OF THE INTERIOR  
MINERALS MANAGEMENT SERVICE**

NTL No. 2003-N06  
Effective Date: June 17, 2003

**NOTICE TO LESSEES AND OPERATORS FEDERAL OIL, GAS, AND SULFUR  
LEASES IN THE OUTER CONTINENTAL SHELF**

**Supplemental Bond Procedures**

The Minerals Management Service (MMS) is issuing this NTL to update the criteria MMS uses to determine when a supplemental bond is required to cover potential lease abandonment liability. The NTL has been revised to: 1) increase the allowable cumulative lease abandonment liability amount of a lessee as a percentage of its net worth provided other financial criteria are met; 2) remove the current ratio from the criteria used to determine the financial strength of a lessee; 3) allow a lessee to request the MMS to consider a percentage of a lessee's proved producing reserves in the calculation of its net worth; 4) reduce the initial payment amount a lessee is required to contribute to a lease-specific abandonment escrow account; and 5) extend the time for a lessee to meet supplemental bond requirements after notice from the MMS. This NTL supersedes and replaces NTL No. 98-18N, effective December 28, 1998, and NTL No. 98-18N (Addendum 1), effective September 12, 2000, on this subject.

**Background**

For each OCS lease, 30 CFR 256.53(d) and (e) grant the Regional Director the authority to require additional security [i.e. security above the amounts prescribed in 30 CFR 256.52(a) and 256.53(a) and (b)] in the form of a supplemental bond, based upon a calculation of the potential lease abandonment liability and an evaluation of the lessee's ability to carry out present and future financial obligations. Each lease with lease abandonment liability must be covered by a supplemental bond unless at least one lessee demonstrates to the satisfaction of the MMS that it has the financial ability to ensure that wells and platforms can be abandoned and removed and the drilling and platform sites cleared of obstructions.

**I. General**

This NTL sets forth the procedures and criteria that all MMS OCS Regions will use to calculate lease abandonment liability, determine the risk that the lessee will be unable to carry out present and future financial obligations, and to specify the types and terms of the supplemental bonds or other additional security the MMS may require or accept. MMS reserves the right to vary from the procedures or criteria in this NTL on a case-by-case basis within the framework established in the governing regulations.

**II. Timing of Review of Potential Lease Abandonment Liability**

Generally, MMS will conduct an initial review of the potential lease abandonment liability when a lessee submits an Exploration Plan (EP) for approval.

1. Subsequent reviews will be conducted when a lessee requests approval of one of the following:
  - A. Assignment of a record title interest, or a portion thereof, in a lease.
  - B. Significant revision to an approved EP.
  - C. Development and Production Plan (DPP) or a significant revision to an approved DPP.
  - D. Development Operations Coordination Document (DOCD) or a significant revision to an approved DOCD.
  - E. Application for a pipeline right-of-way (ROW) or modification of an existing pipeline ROW.
  - F. Assignment of an interest in a pipeline ROW grant with platform amenities.
  - G. Significant revision to an approved pipeline installation plan for a pipeline having platform amenities.
2. MMS also may conduct reviews:
  - A. periodically;
  - B. when MMS becomes aware of information that indicates a change in the financial strength of the company or potential cumulative abandonment liability; or
  - C. when a Notice of an Incident of Noncompliance (INC) is issued related to safety, environment, non-payment of royalty, or other violations of MMS regulations.
3. If the lessee takes an action that causes MMS to initiate a review and then withdraws the action, at MMS's discretion, the review may continue and, if necessary, the submission of a supplemental bond may be required.

**III. Determination of Financial Strength and Reliability**

Generally, a supplemental bond will be required for the lease unless it is determined that at least one lessee meets the following conditions that demonstrate financial strength and reliability:

1. Cumulative lease abandonment liability is less than or equal to 50 % of the most recently available and independently audited calculation of net worth; MMS will use the procedure in section IV to calculate the cost of performing abandonment liability for each OCS lease for which the lessee owns a record title interest.
2. Demonstrates reliability as evidenced by the following:
  - A. number of years of successful operations and production of oil and gas or sulphur in the OCS or in the onshore oil and gas industry;
  - B. credit rating(s), trade references, and verified published sources;
  - C. a record of compliance with the current and previous governing laws, regulations, and lease terms; and
  - D. other items that indicate financial strength or reliability;

and, the lessee either:

3. Produces fluid hydrocarbons in excess of an average of 20,000 barrels of oil equivalent (BOE) per day from the OCS leases, based on calculations of production for the most recent 12 months for which data and information are available. [For the purposes of computing BOE for natural gas, 5.62 thousand cubic feet of natural gas equals 1 barrel of oil equivalent, as measured fully saturated at 14.73 psi and 60 degrees Fahrenheit according to 30 CFR 250.1203(b).] or
4. Has stockholders' equity or net worth of at least \$50 million and demonstrates meeting the criteria set forth in the table below by providing audited financial statements, (including an independent auditor's report, balance sheet, and profit and loss sheet).

For lessees with stockholders' equity or net worth of:	If the lessee's cumulative lease abandonment liability is $\leq$ 25% of stockholder's equity or net worth, the lessee's debt to equity ratio (total liabilities/net worth) must be:	If the lessee's cumulative potential lease abandonment liability is $>$ 25% but $\leq$ 50% of stockholder's equity or net worth, the lessee's debt to equity ratio (total liabilities/net worth) must be:
\$50 Million to \$100 Million	$\leq$ 2.5	$\leq$ 2.0
Above \$100 Million	$\leq$ 3.0	$\leq$ 2.5

5. The lessee may request that the MMS consider the value of proved producing reserves in the calculation of the lessee's net worth by providing the following information to the MMS for all OCS leases in which the lessee owns a record title interest or operating rights interest:
  - A. an independent third-party estimate of the total proved producing reserves. This third-party reserve report shall break down proved producing reserves on a lease, reservoir and well completion basis. It shall also include a cash flow spreadsheet to show anticipated production, expenses, and cash flow.
  - B. reservoir depth structure maps, net sand and oil/gas isopach maps;
  - C. production information for all producing wells for the last 12-month period;
  - D. well test information for the last 12-month period for all producing wells; and
  - E. reservoir bottom-hole pressure information (this data must include the well the pressure was recorded in, the date the pressure was recorded, the depth in MD and TVD of the recorded pressure and the calculated bottom-hole pressure corrected to reservoir datum depth).

Upon receipt of this information, MMS will determine the value of the proved producing reserves to be included in the net worth calculation. However, should the lessee wish the MMS to include the proved producing reserves for an operating rights interest, then the abandonment liability for such operating rights interest also will be included in the calculation of the lessee's cumulative lease abandonment liability. Based on potential risk associated with the reserves, MMS will include up to 50% of the reserve value in MMS's calculation of the lessee's net worth.

6. The determination of the lessee's financial strength is valid for 1 year. MMS will extend the determination for 1 year at a time if:
  - A. an independent accountant submits verification of the lessee's current financial capacity at least 60 days prior to the expiration of the determination; and
  - B. the lessee continues to meet the criteria established above.

#### IV. Determination of the Lease Abandonment Liability

When MMS requires the lessee to provide and maintain a supplemental bond, the amount of the supplemental bond for the lease will be determined as follows:

1. MMS will estimate the cost to plug and abandon wells, remove platforms and other facilities, and restore the lease to its original condition by clearing the obstructions from wells, platform sites, and pipeline ROW's. MMS assumes that the lessee will remove all facilities and abandon them onshore.
2. Costs will be estimated using available historical costs. The following calculation is drawn from historical data for 4-pile platforms in the Gulf of Mexico and includes costs for removing platforms from the lease and scrapping the platform onshore, plugging and abandoning wellbores according to the requirements of 30 CFR 250 Subpart G and Subpart Q, and clearing the site according to 30 CFR 250 Subpart I and Gulf of Mexico NTL No. 98-26. This estimate is based upon costs in the Gulf of Mexico and assumes that a lessee will use a rig to plug and abandon all wellbores. These figures will be adjusted when available information shows that the numbers are not accurate. Other OCS Regions will base estimates on the best available information. The lessee may provide additional information for consideration when MMS estimates the lease abandonment liability. When providing additional data, the lessee should explain the basis for the data.

We will estimate costs as follows:

- A. Plugging and abandoning a wellbore will cost \$100,000 per wellbore for all water depths.
- B. Dismantling and abandoning a platform will vary with water depth as follows:

##### Estimated Costs of Removing a Platform and Scrapping it Onshore (According to Water Depth)

Water depths of 150 feet or less	Water depths between 151 and 200 feet	Water depths between 201 and 299 feet	Water depths of 300 feet or more
\$400,000	\$600,000	\$1,250,000	\$2,000,000+

- C.
- D. Site clearance will vary with water depth as follows:

##### Estimated Cost of Site Clearance (According to Water Depth)

Water depths of 150 feet or less	Water depths between 151 and 249 feet	Water depths of 250 feet and greater
\$300,000	\$400,000	\$500,000+

3. The following procedure will be used to estimate the need for and amount of supplemental bonds for all companies that have provided a general bond for one or more leases:

- A. Determine the abandonment liability for all leases for which the lessee owns a record title interest (and the abandonment liability associated with the lessee's operating rights interest where the lessee has requested the MMS to include proved producing reserves for such operating rights interest in the calculation of its net worth as provided above).
  - B. Apply lease-specific bonds (i.e., lease-specific general bonds, lease-specific supplemental bonds, and lease-specific guarantees) to identified leases.
  - C. Exclude from the lessee's abandonment liability calculation, for the purpose of supplemental bond determination, the full amount of the abandonment liability for any lease(s) for which MMS has determined that one or more co-lessees have sufficient financial strength such that it is not necessary to require a supplemental bond. MMS will exclude less than the full amount of the abandonment liability when it is determined that additional security is needed based upon the financial or operational history of the companies involved.
  - D. Deduct a reserve account for the Minerals Revenue Management from the general bonds on file. This account will be credited \$50,000 per lease or \$300,000 per area-wide bond on file.
  - E. After calculating the remaining potential liability, the financial strength and reliability of the company will be evaluated using the procedures above. MMS will then determine the need for a supplemental bond and the amount.
  - F. Request lease-specific supplemental bonds through the designated operator who coordinates the submittal with the lessees.
4. The lessee may facilitate the review and approval of the request by providing detailed information on existing leasehold facilities. The lessee may provide evidence to support an adjustment in the estimate of the cumulative potential abandonment liability. This evidence may include:
- A. the itemized data and information by lease used as a basis for the estimate of the cumulative potential abandonment liability represented by wells and facilities on the lease(s), and
  - B. the itemized data and information by lease on which a third party bases its estimate of cumulative potential lease abandonment liability.
5. When conducting a subsequent review of the need for a supplemental bond, MMS will consider the number of wells drilled or plugged and abandoned in the time that has elapsed since the last review of the lessee's cumulative potential abandonment liability, the number of platform installations or removals since the last review, changes in the amount and value of reserves being produced, the projected rates of oil and gas production, inflation, and other changes in the market conditions. The objective of the review and analysis will be to ensure that the supplemental bond coverage or alternate form of security provided is not less than the amount established based upon the lessee's cumulative potential lease abandonment liability.

#### **V. Acceptable Forms of Supplemental Bonds**

Within 45 days following MMS written notification, the lessee must submit one of the following to meet the supplemental bond obligation:

- 1. A lease-specific supplemental bond, United States Treasury Securities, or an alternate form of supplemental security approved by us, in the full amount required. If the value of the lessee's security falls below this amount, or if the U.S. Treasury no longer certifies that the company that issued the bond is acceptable, the lessee must notify us within 15 days and take necessary action to meet the supplemental bond obligation.
- 2. A plan to MMS for review and approval whereby the lessee commits to fully fund a lease-specific abandonment escrow account according to 30 CFR 256.56. Generally, the lessee must fully fund a lease-specific abandonment account within four (4) years or by the beginning of the year in which it is projected that 80 percent of the originally recoverable reserves have been produced, whichever is earlier. The plan must include the following:
  - A. An initial payment into the lease-specific abandonment escrow account equal to or greater than 50 percent of the estimate of the cumulative potential lease abandonment liability. At the lessee's request, the MMS may approve an initial payment of less than 50 percent following the review of a third-party estimate of the proved producing reserves for the lease, if MMS determines that the lesser amount doesn't create a risk to the Government.
  - B. A prescribed time schedule for making specified incremental payments (e.g., monthly payments) in amounts that will ensure that the amount in the lease abandonment account will increase at a faster rate than the rate at which the originally recoverable reserves are being produced from the lease.

- C. A commitment by the financial institution in which the lessee established the lease-specific abandonment account to notify us of the date and amount of the initial deposit and of each incremental payment into the account.
- D. A risk insurance policy for the benefit of MMS that covers the residual liability in the event of any catastrophic failure that prevented the completion of the remaining payments. This requirement has been met, in the past, by including MMS as a beneficiary on existing policies.

MMS will review the above-described information and will approve it either as submitted or request specific revisions. For example, MMS will analyze both the initial payment amount as well as the time schedule for making specified incremental payments based on an analysis of current, past, and projected rates of production from the leasehold(s), or cash flow for facilities utilized by ROW, characteristics of the producing reservoir(s), plugging and abandonment information available in MMS's databases, and/or other information provided.

The lessee must immediately submit, and subsequently maintain, a supplemental bond in an amount equal to the remaining portion of the estimate of the amount of the lessee's cumulative potential lease abandonment liability in the event the lessee fails to:

- E. make the initial payment into a MMS approved lease-specific abandonment; or
  - F. pay on the date due an incremental payment into the MMS-approved lease-specific abandonment account in the amount agreed.
- The following table provides an example of an incremental payment schedule for a lease-specific abandonment escrow account.

The following is an example of a lease-specific abandonment account, the time schedule prescribed, and the amount of each incremental payment, to fund the account over a four-year period. This example describes a situation in which, based on our estimate of your cumulative potential lease abandonment liability, we required a \$5 million supplemental bond.

Year	Percent of Recoverable Reserves Produced at End of Year as a Percentage of Originally Recoverable Reserves	Dollar Amount (Security) Required at Start of Year	Quarterly Payment During Year
2	40%	\$3,125,000	\$156,250
3	60%	\$3,750,000	\$156,250
4	80%	\$4,375,000	\$156,250

1. Total Supplemental Bond Amount: \$5,000,000

2. The amount of the initial payment is 50 percent of the cumulative potential lease abandonment liability since 50 percent is greater than the percentage of the originally recoverable reserves projected to be produced by the end of Year 1.

3. By the end of Year 3, MMS projects that 60 percent of the originally recoverable reserves will have been produced. Therefore, the lessee will need to fund at least 60 percent of the total

supplemental bond (\$3,000,000 = 60% x \$5,000,000) by the start of Year 3.

4. By the end of Year 4, MMS projects that the lease will have produced over 80 percent of the originally recoverable reserves. Therefore, the lessee will need to fund the entire \$5,000,000 by the end of Year 4. Quarterly payments of \$156,250 during the 4-year period will increase the fund to \$5,000,000 by the end of Year 4.

#### **VI. Using a Third-Party Guarantee In Lieu of a Supplemental Bond**

The lessee may submit a third-party guarantee in lieu of a supplemental bond. The guarantee must be provided by a third party (guarantor) who will guarantee compliance with all lease obligations. The guarantor must also comply with all requirements in 30 CFR 256.57. MMS will accept a third-party guarantee only if the guarantor and the indemnity agreement meet all of the criteria below.

1. The guarantor must:
  - A. meet the qualifications for a lessee in 30 CFR 256.35(b);
  - B. demonstrate satisfactory levels of financial strength and business history that exceed financial and production thresholds in Section III; and
  - C. not have total outstanding and proposed guarantees that exceed 25 percent of its unencumbered net worth in the United States.
2. MMS will review the financial information that the lessee or the guarantor submit to determine a guarantor's financial strength, business history, and compliance with current financial and production thresholds. The lessee or the guarantor will provide information MMS determines is necessary including the guarantor's:
  - A. current rating for its most recent bond issuance by either Moody's Investor Service or Standard and Poor's Corporation;
  - B. net worth, taking into account potential liabilities under its guarantee of compliance with all the terms and conditions of the lease, MMS regulations, and any other existing guarantees to the MMS;
  - C. ratio of current assets to current liabilities, taking into account potential liabilities under its guarantee of compliance with all the terms and conditions of the lease, MMS regulations, and any existing guaranties to MMS; and
  - D. unencumbered fixed assets in the United States.
3. If the guarantor's financial data are not publicly available, MMS will review the following financial information that the lessee or the guarantor submits and that an officer of the company certifies as correct:
  - A. Financial statements for the most recently completed fiscal year verified by an independent certified public accountant (CPA) using generally accepted accounting principles and containing no adverse opinions by the CPA.
  - B. Yearly updates of the financial statements submitted 90 days before the end of the guarantor's fiscal year or an annual date MMS sets.
4. An evaluation will be based on of the stability of the guarantor In part on the length of time that the guarantor has been in continuous operation. A guarantor's continuous operation:
  - A. is the time immediately before submission of a guarantee; and
  - B. does not include periods of interruption of operations not within guarantor's control and that do not affect the likelihood of the guarantor remaining in business during the lessee's exploration, development, production, plugging, removal, and clearance operations on the lease.
5. The guarantor must meet the criteria in Section III for financial strength and reliability.
6. The guarantor must submit an indemnity agreement providing for compliance with all lease obligations, the obligations of all operating rights owners, and the obligations of all operators on the lease. A third-party guarantee must contain each of the following provisions:

- A. If the lessee, the operator, or an operating rights owner fails to comply with any lease term or regulation, the guarantor must take corrective action or provide within seven (7) calendar days sufficient funds for us to complete corrective action.
  - B. If the guarantor takes corrective action to bring a lease into compliance with MMS requirements or provides funds for us to bring the lease into compliance, these actions do not reduce the guarantor's liability.
7. If a guarantor wishes to terminate the period of liability under its guarantee, it must:
- A. Notify the lessee and us at least 90 days before the proposed termination date;
  - B. Obtain MMS approval for the termination of the period of liability for all or a specified portion of the guarantor's guarantee; and
  - C. Remain liable for all obligations accrued during the period that the guarantor's guarantee is in effect.
8. If MMS approves the third-party guarantee, the guarantor must submit an indemnity agreement that meets the following criteria, (see Attachment 1 for Example Agreement):
- A. The indemnity agreement must be executed by the guarantor and all persons and parties bound by the agreement.
  - B. The indemnity agreement must bind each person and party executing the agreement jointly and severally.
  - C. When a person or party bound by the indemnity agreement is a corporate entity, two corporate officers who are authorized to bind the corporation must sign the indemnity agreement.
  - D. The guarantor and the other corporate entities bound by the indemnity agreement must provide us copies of:
    - 1. the authorization of the signatory corporate officials to bind their respective corporations;
    - 2. an affidavit certifying that the agreement is valid under all applicable laws; and
    - 3. each corporation's corporate authorization to execute the indemnity agreement.
  - E. If the third-party guarantor or another party bound by the indemnity agreement is a partnership, joint venture, or syndicate, the indemnity agreement must bind each party who has a beneficial interest in the guarantor; and provide that, upon MMS demand under the third-party guarantee, each party is jointly and severally liable for compliance with all terms and conditions of the lease.
  - F. The indemnity agreement must provide that, within seven (7) calendar days of a demand for forfeiture under 30 CFR 256.59, the guarantor will either commit itself to take all necessary corrective action or provide sufficient funds for us to take corrective action.
  - G. The indemnity agreement must contain a confession of judgment. It must provide that, if it is determined that the lessee, the operator, or an operating rights owner is in default of the terms of the lease or in violation of the OCS Lands Act (OCSLA) or its implementing regulations, the guarantor will not challenge the determination and will remedy the default.
9. Each indemnity agreement is deemed to contain all terms and conditions above, even if the guarantor has omitted them.

**VII. Termination of Supplemental Bond or Third-Party Guarantee, or Determination that a Supplemental Bond is Not Necessary**

MMS reserves the right to deny the lessee's request for a finding that a supplemental bond is not necessary, even though an independent accountant provides an audit and certification that the lessee meets the financial strength and performance criteria described herein. Normally, such a denial or revocation of a previous finding will be based on a review of independently audited information that indicates that recent or anticipated future events may adversely affect the lessee's ability to comply with current and/or future lease abandonment obligations. MMS may also require a supplemental bond on any lease, regardless of any prior determination under these requirements, if it is determined that the designated operator has not fully and consistently complied with MMS regulations.

- 1. When any of the following occur, the lessee must take necessary action immediately to meet these requirements. If the lessee does not, MMS may issue a civil penalty, stop operations on the lease, or take any other action authorized by the OCSLA or the implementing regulations.
  - A. MMS requires the lessee to provide a supplemental bond when it was previously determined that the lessee's financial strength was sufficient such that a bond was not required. In such cases, the lessee will have a minimum of 40 days notice before the lessee must furnish a supplemental bond.

- B. The lessee's third-party guarantor ends the period of the guarantee.
  - C. The lessee's bonding company ends the period of bond protection.
  - D. The value of the lessee's security falls below the required amount of the supplemental bond
  - E. The U.S. Treasury no longer certifies that the company that issued the bond is acceptable.
2. If the lessee chooses to provide a lease specific abandonment escrow account instead of providing a bond, the lessee may be allowed up to an additional 70 days to prepare and allow MMS to review a plan for incremental payments and to contribute funds to the account, according to the plan.

#### **VIII. Addresses**

Use the following addresses to obtain further information or to submit information:

##### Alaska OCS:

Minerals Management Service  
Alaska OCS Region  
Attn: Jeffrey Walker, RS/FO  
949 East 36th Avenue, Third Floor  
Anchorage, AK 99508-4302  
Jeffrey.Walker@mms.gov  
(907) 271-6190

##### Gulf of Mexico OCS or Atlantic OCS:

Minerals Management Service  
Gulf of Mexico OCS Region  
Attn: Carrol Williams, MS 5421  
1201 Elmwood Park Boulevard  
New Orleans, LA 70123-2394  
Carrol.Williams@mms.gov  
(504) 736-2803

##### Pacific OCS:

Minerals Management Service  
Pacific OCS Region  
Attn: Frederick L. White, MS 7300  
770 Paseo Camarillo  
Camarillo, CA 93010-6064  
Frederick.white@mms.gov  
(805) 389-7830

#### **Paperwork Reduction Act of 1995 (PRA) Statement**

The information collection referred to in this NTL provides clarification, description, or interpretation of requirements in 30 CFR 256. The Office of Management and Budget (OMB) has approved the information collection requirements in these regulations and assigned OMB control number 1010 0006. This NTL also refers to approved information collection requirements in 30 CFR 250, subparts B, Q, and I. The respective OMB control numbers are 1010 0049, 1010 00142, and 1010 0058. This NTL does not impose additional information collection requirements subject to the PRA.

#### **Contact**

Please contact Mr. Carrol Williams at (504) 736-2803 or [Carrol.Williams@mms.gov](mailto:Carrol.Williams@mms.gov) if you have any questions regarding this NTL.

[signed] Thomas A. Readinger  
Thomas A. Readinger  
Associate Director for  
Offshore Minerals Management

Attachments:

1. Model form for "Third Party Indemnity Agreement"
2. Internet web sites and information