

Regulatory Considerations for Ensuring Decommissioning & Other Lease Obligations



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Financial Assurance Storyline

- BOEM's mission and current financial assurance including general and additional bonds
- How the Supplemental Bonding NTL has changed over time
- Talk about concerns that led us to establishing a new risk management program
- BOEM's financial assurance goals
- Talk about proposed changes under current regulations and the release of a new supplemental bond NTL.

BOEM's Mission



BOEM's mission is to manage the development of the nation's offshore energy and mineral resources in an environmentally and economically responsible manner.



BOEM's role is to encourage oil and gas development activities on the OCS to increase the nation's energy independence and promote U.S. taxpayers' interests while simultaneously protecting natural resources and the environment.

BOEM-BSEE-ONRR Interactions

- BOEM is responsible for all OCS leasing activities including adjudication of lease ownership rights and transfers, exploration and development plans, resource and economic evaluation and requiring adequate financial assurance for OCS operations
- Program Management:
 - BOEM issues Leases, Rights of Use and Easement
 - BSEE issues pipeline Rights of Way
 - ONRR collects Rents, Royalties, Fees and Fines for OCS activities
- BOEM determines the appropriate amount of supplemental financial assurance required of all OCS operators, this considers:
 - BSEE decommissioning cost estimates,
 - ONRR rents and royalties
 - All other financial obligations except Oil Spill Financial Responsibility
- BOEM manages all business processes related to OCS financial assurance and liabilities and works collaboratively with BSEE and ONRR

BOEM Regulatory Authority

- The Outer Continental Shelf Lands Act provides the Secretary with the authority to require bonds or other forms of financial assurance on the OCS
- 30 CFR § 556 is the primary regulatory source regarding BOEM's financial assurance requirements

Current BOEM Bonding Guidelines

Two-stage Approach to Bonding

Stage 1: General lease surety bond

- Covers all types of lease obligations
- Extends beyond the end of lease (i.e., tail)
- Required by all lessees (no waivers)
- Lease-specific or area-wide bond amount based on lease activity:



<u>Lease activity amount</u>	<u>Lease-specific bond amount</u>	<u>Area-wide bond</u>
No approved operational activity	\$ 50,000	\$ 300,000
Exploration Plan	\$200,000	\$1,000,000
Development Production Plan	\$500,000	\$3,000,000
Pipeline – ROW	N/A	\$ 300,000

Current BOEM Bonding Guidelines

Stage 2: Supplemental bond

- Provides additional coverage for all types of lease obligations
- Cancelled after decommissioning completed/certified by BSEE and ONRR's clearance for outstanding payments
- Regional Directors currently set bond amount at BSEE-determined decommissioning liability
 - Estimated "routine" decommissioning liabilities in the GOMR are \$40 billion
 - Current amounts of financial assurance are outdated and inadequate

Adequacy of General Bonds

BOEM Viewpoint: The current general lease surety bond is too low to effectively cover any substantive offshore decommissioning costs, as necessary. Therefore, BOEM must ultimately rely on the sufficiency of its supplemental bond program for the purpose of assuring decommissioning performance.

Current BOEM Supplemental Bonding Procedures

- Under BOEM regulation, operating rights holders are jointly and severally responsible for decommissioning along with record title holders, with the provision that such decommissioning liability is limited to the BOEM approved operating rights area.
- It is BOEM's viewpoint that operating rights holders, where applicable, along with record title holders are equally responsible for supplemental bond compliance, and subject to BOEM and/or BSEE enforcement action pursuant to noncompliance.
- Historically, each company was not assessed its full cumulative decommissioning liability on any given lease, RUE or ROW

30 CFR §556.53 Additional bonds

(d) The Regional Director may determine that additional security (*i.e.*, security above the amounts prescribed in §§556.52(a) and 556.53(a) and (b) of this part) is necessary to ensure compliance with the obligations under your lease and the regulations in this chapter.

(1) The Regional Director's determination will be based on his/her evaluation of your ability to carry out present and future financial obligations demonstrated by:

(i) **Financial capacity** substantially in excess of existing and anticipated lease and other obligations, as evidenced by audited financial statements (including auditor's certificate, balance sheet, and profit and loss sheet);

(ii) Projected **financial strength** significantly in excess of existing and future lease obligations based on the estimated value of your existing OCS lease production and proven reserves of future production;

(iii) **Business stability** based on 5 years of continuous operation and production of oil and gas or sulphur in the OCS or in the onshore oil and gas industry;

(iv) **Reliability** in meeting obligations based on:

(A) Credit rating(s); or

(B) Trade references, including names and addresses of other lessees, drilling contractors, and suppliers with whom you have dealt

30 CFR §556.53 *Additional bonds*

- (e) **The Regional Director will determine the amount of supplemental bond required to guarantee compliance.** The Regional Director will consider potential underpayment of royalty and cumulative obligations to abandon wells, remove platforms and facilities, and clear the seafloor of obstructions in the Regional Director's case-specific analysis.
- (f) If your cumulative potential obligations and liabilities either increase or decrease, the **Regional Director** may adjust the amount of supplemental bond required.
- (1) If the **Regional Director** proposes an adjustment, the **Regional Director will:**
- (i) Notify you and the surety of any proposed adjustment to the amount of bond required; and
 - (ii) Give you an opportunity to submit written or oral comment on the adjustment.
- (2) If you request a reduction of the amount of supplemental bond required, you must submit evidence to the Regional Director demonstrating that the projected amount of royalties due the Government and the estimated costs of lease abandonment and cleanup are less than the required bond amount. If the Regional Director finds that the evidence you submit is convincing, he/she may reduce the amount of supplemental bond required.

NTL 2008-N07

- August 2008
 - Net Worth equal to or greater than \$65M
 - 50% liability to net worth
 - Number of years in operation and production
 - Credit ratings, trade references, record of compliance, other indicator of financial strength

AND EITHER OF THE ITEMS BELOW

- Produce hydrocarbons in excess of an average 20,000 BOE/day
- Stockholder equity at least \$65M and meets the criteria in the table below

For lessees with stockholders' equity or net worth of:	If the lessee's cumulative decommissioning liability is ≤ 25 percent 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 decommissioning liability is >25 percent but ≤ 50 percent of stockholder's equity or net worth, the lessee's debt to equity ratio (total liabilities/net worth) must be:
\$65 Million to \$100 Million	≤ 2.5	≤ 2.0
Above \$100 Million	≤ 3.0	≤ 2.5

NTL Changes Through the Years

- October 1993
 - 25% liability to net worth
 - 500 employees
 - Minimum net worth of \$35M or gross O&G sales of \$45M
- December 1998
 - 25% liability to net worth
 - Number of years in operation and production
 - Credit ratings, trade references, record of compliance, other indicator of financial strength
 - Produce hydrocarbons in excess of an average 20,000BOE/day
 - Company demonstrates financial strength for present and future financial obligations

NTL Changes Through the Years

- June 2003
 - 50% liability to net worth
 - Number of years in operation and production
 - Credit ratings, trade references, record of compliance, other indicator of financial strength

AND EITHER OF THE ITEMS BELOW

- Produce hydrocarbons in excess of an average 20,000 BOE/day
- Stockholder equity at least \$50M and meets the criteria in the table below

For lessees with stockholders' equity or net worth of:

\$50 Million to
\$100 Million

Above \$100 Million

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:

≤ 2.5

≤ 3.0

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:

≤ 2.0

≤ 2.5

Causes of Concern

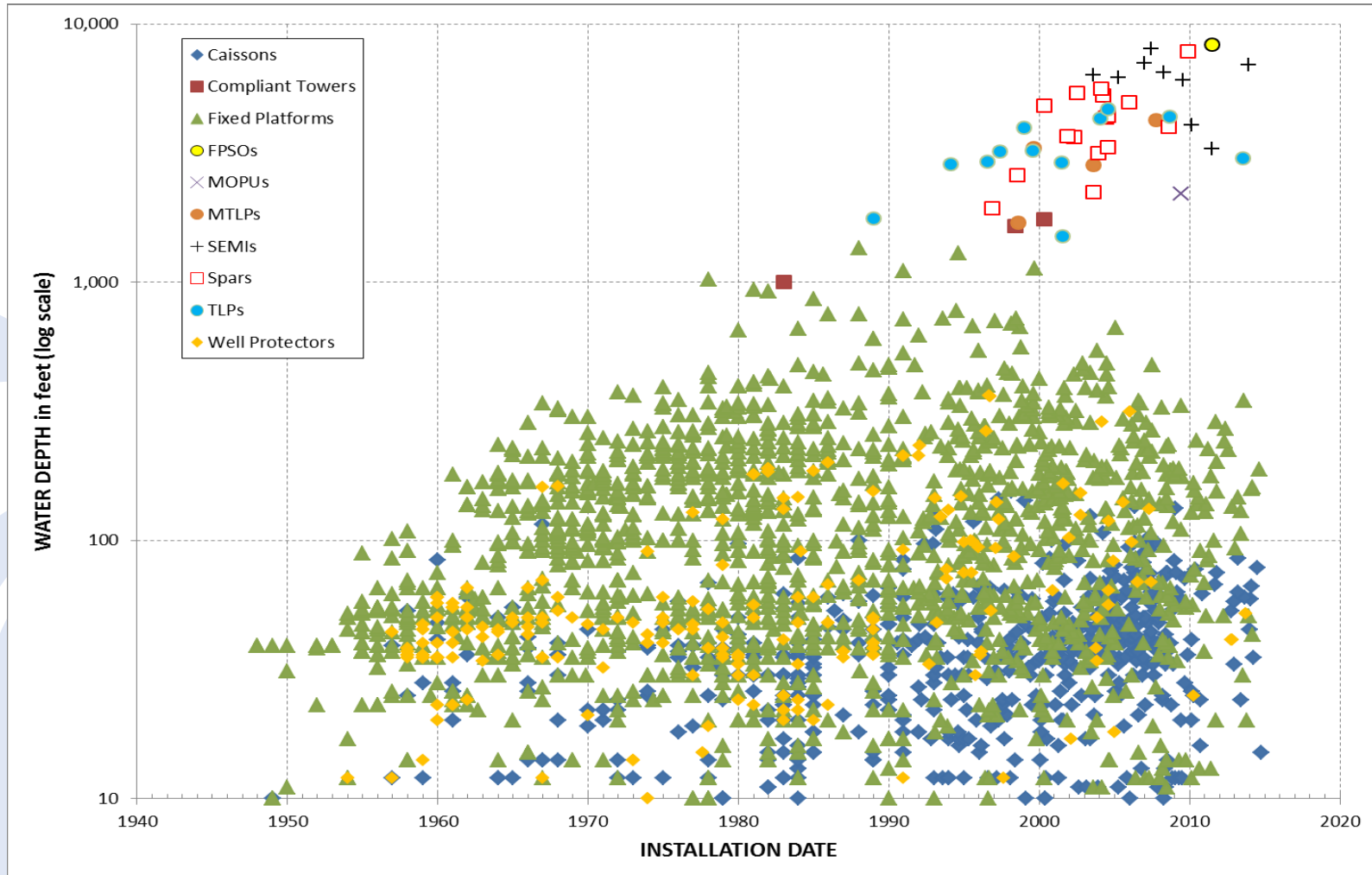
- “Routine” oil and gas facility decommissioning liability in Gulf of Mexico currently totals \$40 billion.
- An accident or hurricane event can result in a tenfold (or more) increase in “routine” decommissioning cost.
- Existing Pacific & Gulf of Mexico oil and infrastructure is aging. BSEE records indicate 245 GOM platforms currently fit idle iron criteria.
- Although Arctic infrastructure is in its infancy, it is important to get adequate decommissioning bonding policies in that area in place from the onset. Also, Arctic decommissioning costs rival GOM deepwater in magnitude.

Causes of Concern

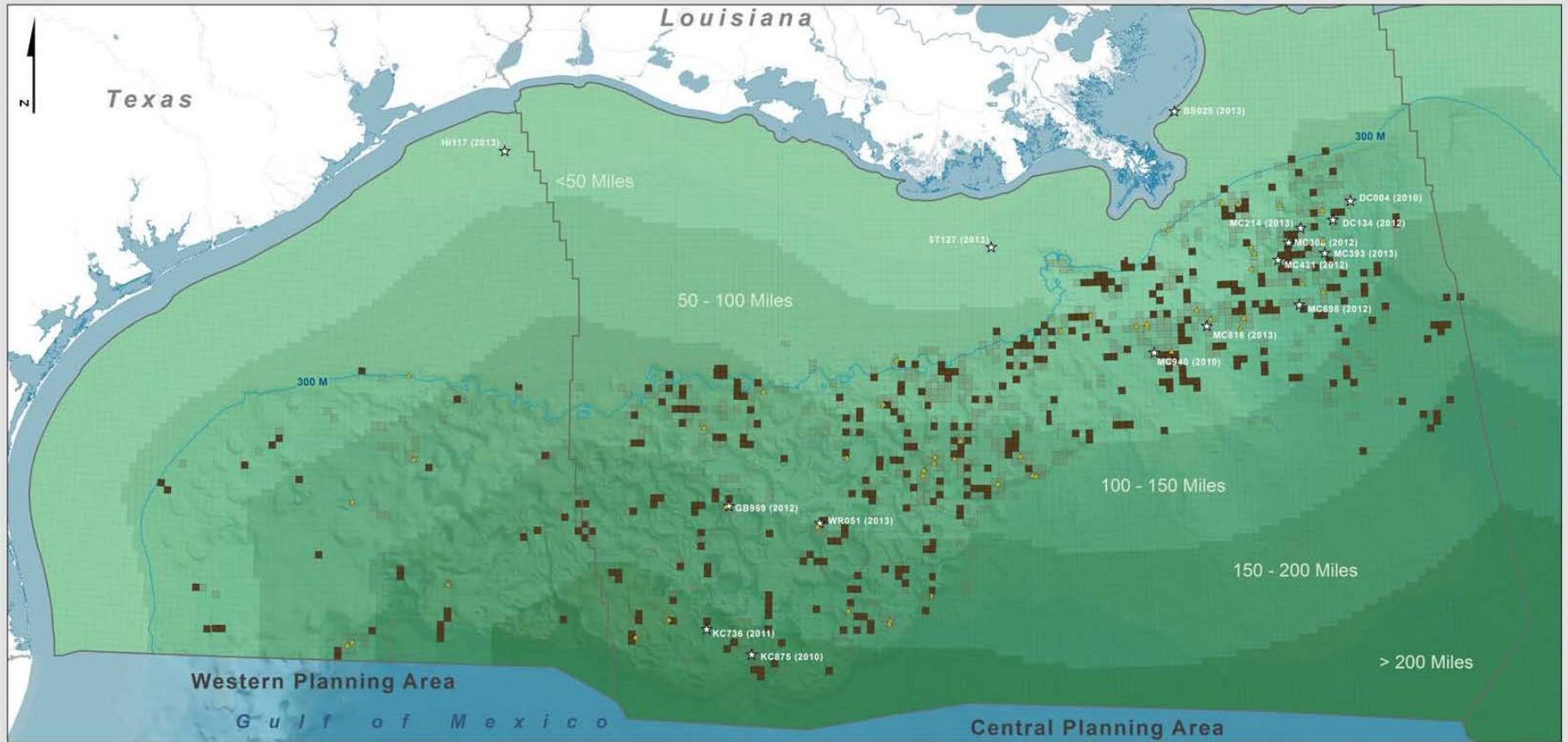
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- Characteristics of the types of companies operating in the Gulf of Mexico have changed. Most notably, large companies transfer sunset properties to smaller, less experienced companies.
- Technological advances are outpacing regulations, policies, and programs. For example there is a notable lack of industry and governmental expertise in subsea decommissioning.

History of Platform Installations in GOM



RECENT DISCOVERIES AND DRILLING ACTIVITY
U.S. Outer Continental Shelf, Gulf of Mexico



- Field Discovery ☆
- Rig on Location ▲
- 300 Meter Isobath ~
- OCS BOUNDARIES**
- Planning Area —
- Block —

- Plan Submitted Between 2010-2015 by OCS Block w/o API □
- Plan Submitted Between 2010-2015 by OCS Block w/ API ■

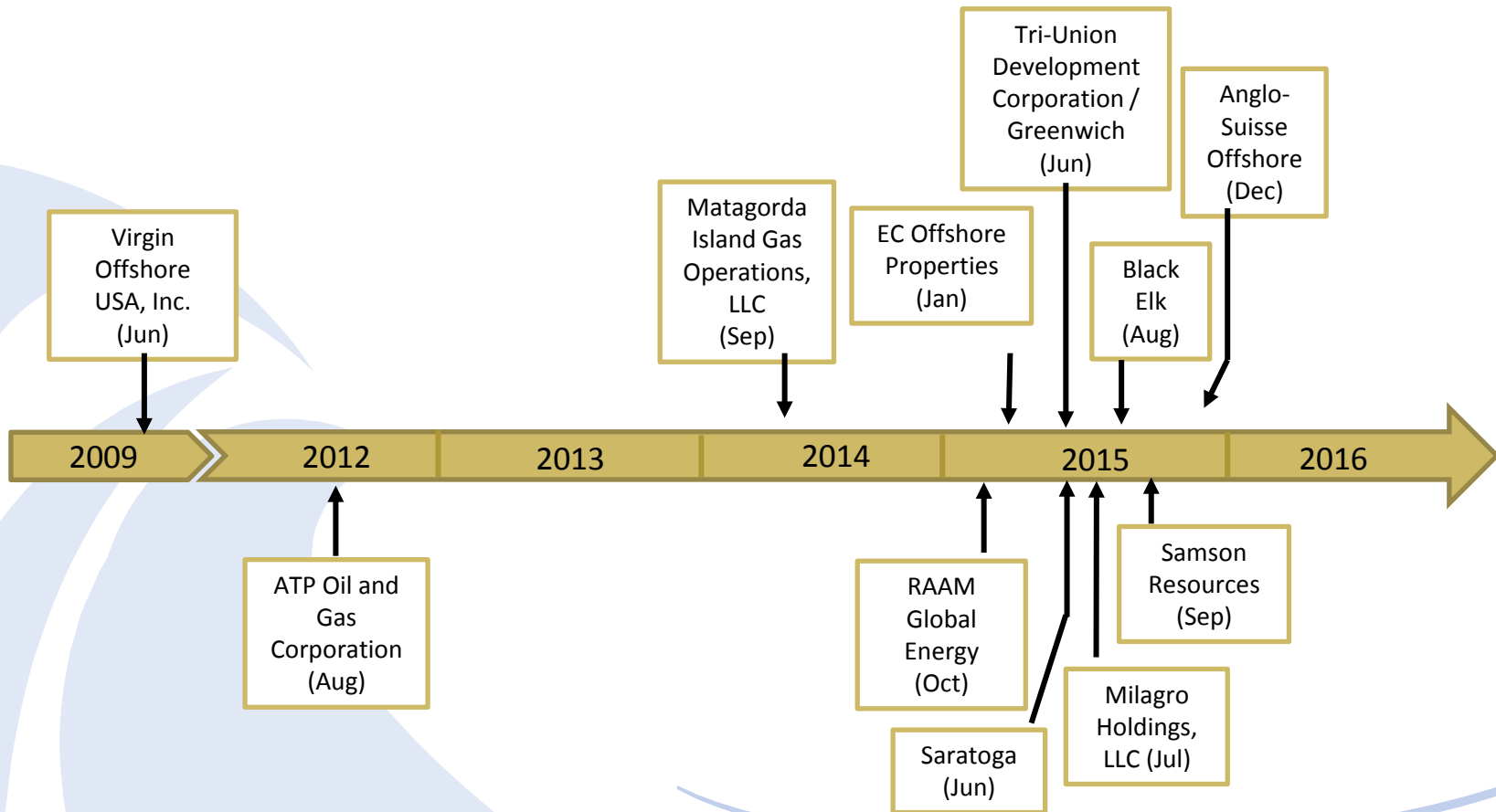
- DISTANCE BANDS FROM SHORE**
- 3 - 50 Miles □
 - 50 - 100 Miles □
 - 100 - 150 Miles □
 - 150 - 200 Miles □
 - > 200 Miles □

USA Contiguous Lambert Conformal Cone
 Projection: Lambert Conformal Cone
 Datum: North American 1983
 False Easting: 0.0000
 False Northing: 0.0000
 Central Meridian: -91.3533
 Standard Parallel 1: 28.1667
 Standard Parallel 2: 27.8333
 Latitude Of Origin: 29.4670
 Units: Foot US
 Map Scale = 1:1,230,000
 0 12.5 25 50 Miles
 0 12.5 25 50 Nautical Miles



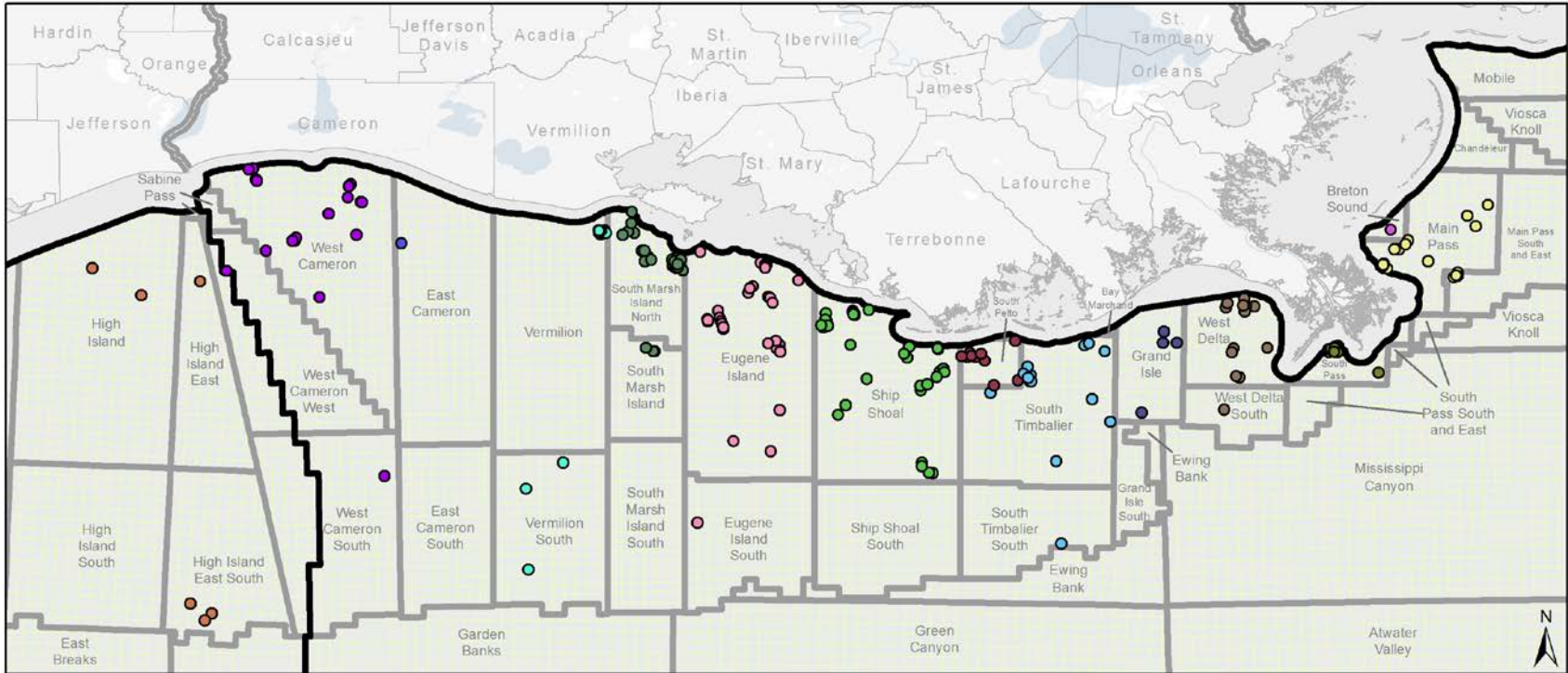
Bankruptcy Trends

Significant increase in companies operating in the OCS experiencing financial distress/bankruptcy in the past year, which is expected to continue.



Existing Idle Iron Structures as of January, 2016

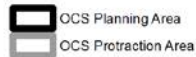
Gulf of Mexico



Idle Iron Structures - 245 Total

Count by Protraction Area

- | | |
|---------------------------------|--------------------------------------|
| ● Breton Sound - 1 Structure | ● South Marsh Island - 31 Structures |
| ● East Cameron - 1 Structure | ● South Pass - 26 Structures |
| ● Eugene Island - 40 Structures | ● Ship Shoal - 35 Structures |
| ● Grand Isle - 4 Structures | ● South Timbalier - 17 Structures |
| ● High Island - 6 Structures | ● Vermilion - 11 Structures |
| ● Main Pass - 19 Structures | ● West Cameron - 21 Structures |
| ● South Pelto - 18 Structures | ● West Delta - 13 Structures |



Coordinate System: GCS North American 1983
Datum: North American 1983
Units: Degree

DISCLAIMER:
This is a product of the Bureau of Ocean Energy Management (BOEM), Gulf of Mexico, Outer Continental Shelf (OCS) Region, Office of Leasing and Plans. The data used in this product is dynamic and therefore may not agree with data from other sources or time frames.

Map prepared January, 2016 by
Bureau of Ocean Energy Management
Gulf of Mexico OCS Region
Leasing and Plans
Mapping and Information Section
Map ID: 84502180934

Sufficiency of Supplemental Bonds

- BSEE is now in the process of reviewing and updating its decommissioning cost assumptions and BOEM is in the process of using those updated cost assessments for supplemental bond demands on a case by case basis.
- However, it is BOEM and BSEE's intention to fully implement the higher cost assessments and related supplemental bond determinations (across the board) as soon as reasonable.

OCS Decommissioning Estimates by Region

		GOM ¹	PAC ²	AK ³	Total
Contingent Decommissioning Liabilities	Active Leases	\$31.94	\$1.46		\$33.40
	Active RUEs	\$0.32	\$0.00		\$0.32
	Active ROWs	\$1.79	\$0.00		\$1.79
	Inactive Properties	\$5.44	\$0.00		\$5.44
	Total	\$39.49	\$1.46	\$0.79	\$41.74
Coverage on Decommissioning Liabilities	Sup. Bonds	\$2.91	\$0.20	\$0.00	\$3.11
	Indemnified	\$8.64		\$0.00	\$8.64
	Waived 1	\$7.67	\$1.26	\$0.79	\$9.72
	Waived 2+	\$18.43	\$0.00	\$0.00	\$18.43
	No Coverage	\$2.59		\$0.00	\$2.59
	Over Guaranteed/Bonded	-0.75			-0.75
	Total	\$39.49	\$1.46	\$0.79	\$41.74
% of Liability Bonded		7.37%	13.70%	0.00%	7.45%
% of Uncollateralized Liability		92.63%	86.30%	100.0%	92.55%

¹ Per TIMS database January 2016.

² 2014 PAC decommissioning study.

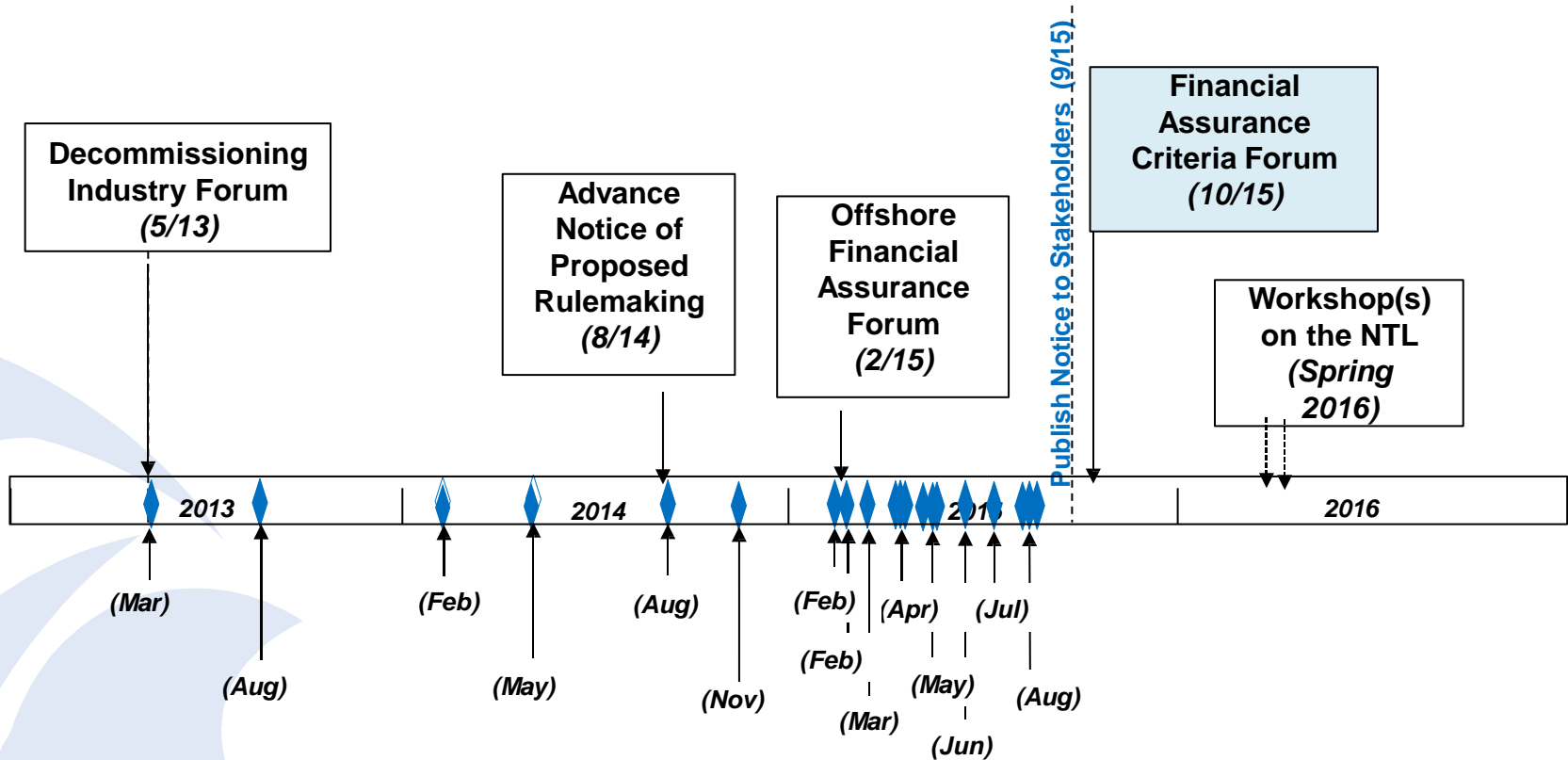
³ Based on submitted exploration plans.

⁴ \$302 million Over-bonded on lease/rue/row specific bonds can not be used, \$450 million Over-Guaranteed

Financial Risk Management Program

- An effective risk management program is particularly important, because potential costs and liabilities of financial uncertainty, credit risk, project failures, legal liability, accidents, and natural disasters are far easier to manage than to remediate in the high risk offshore environment
- A DOI led comprehensive risk management solution benefits taxpayers by reducing potential OCS liability and operators by negotiated adaptive solutions and improved business certainty. Implementation of the program is win-win and places DOI in the forefront of offshore risk transfer solutions

Addressing Concerns with Industry



- Indicates speech or presentation by BOEM's Director or Deputy Director where Risk Management was addressed

BOEM's Financial Assurance Goals

Protect the United States from financial loss or environmental damage when a leaseholder or operator is unable to pay rents and royalties or perform required decommissioning.

Protect the U.S. Taxpayer from exposure to financial obligations and liabilities associated with OCS exploration and development.

- Incorporate front end risk management tools that provide a fair, equitable and transparent approach to financial assurance and loss prevention
- Monitoring company financial data and developing criteria to detect poor performance
- Develop and implement comprehensive financial assurance practices that mitigate exposure to liabilities
- Use financial criteria that are aligned with banking protocols
- Consider additional forms of financial assurance
- Update our regulations while balancing the need for economic growth with the responsibility to protect our natural resources

Resulting Overall Questions for Risk Management Program

What is the best way to assess the financial wherewithal of an individual company to meet its offshore oil and gas decommissioning responsibility, especially in light of recent applicable industry trends and factors?

In situations where BOEM has determined that the financial risk profile of an individual company threatens its ability to meet its decommissioning responsibility, what are appropriate available options for that company to provide necessary financial assurance to BOEM?

Financial Ability to Carry Out Obligations

Financial Ability will continue to be determined using the following criteria:

Financial Capacity

- Based on the most recent (not more than 12 months old) independently audited financials.

Projected Strength

- Estimated value of existing OCS lease production and proven reserves of future production.

Business Stability

- Five years of continuous operation and production on the OCS or onshore.

Reliability

- Moody's, Standard and Poor's or Dun and Bradstreet rating review.

Record of Compliance

- Based on record of compliance with laws, regulation and lease terms including but not limited to:
 - Civil penalties
 - Revocation of Ownership
 - Debarment
 - Cancellation of Leases
 - Non-payment/under-payment

The criteria cited above are established in 30 CFR § 556.53(d).

Key Proposed Changes

Waiver

- Lessees will no longer be granted waivers for their supplemental bond obligations.

Minimum Net Worth

- Lessees will be able to apply for self-insurance *regardless* of their Net Worth.

Self-Insurance

- Will change from 50% of **Net Worth** to a maximum of 10% of **Tangible Net Worth**.
- If eligible, the amount of self-insurance will range from 1% to 10% of Tangible Net Worth, based in part, on its financial strength as assessed from the proposed financial criteria.

Decommissioning Liabilities

- BOEM will consider 100% of each lessee's decommissioning liability for every lease, ROW and RUE in which the lessee holds an interest.

Key Proposed Changes

Co-lessees

- No longer consider the combined financial strength of co-lessees when determining a lessee's ability to meet its decommissioning liability financial assurance requirements.
- With multiple co-lessees, it will be up to the co-lessees to determine how best to fulfill BOEM's requirement for 100% assurance of OCS decommissioning liabilities.

Redundant Bonding

- It is not the Bureau's intent to double bond.
- We will work with lessees on solutions to "Redundant Bonding" through mechanisms such as "Multi Party" bonds.

Tailored Plans

- BOEM may consider alternative forms of financial assurance to provide additional flexibility.

Phased-in Approach

- There will be a phase-in period for compliance.

Forms of Financial Assurance for Possible Consideration

- Payment Bonds
- Performance Bonds
- Letters of Credit
- Insurance
- Captive Offshore Insurance
- Third Party Guarantees
- U.S. Treasury Notes
- Decommissioning Trust Agreements
- Risk Pooling
- Signed Decommissioning Contracts
- Packaged Financial Assurance



Bonding Priorities in a Tailored Plan

- 1) Sole Uncovered Properties
 - a) Inactive (Relinquished, Terminated or Expired) properties
 - b) Active (Not Relinquished, Terminated or Expired) properties

- 2) Properties with No Active Co-lessees (may have predecessors)
 - a) Inactive Properties
 - b) Active Properties

- 3) Properties with Active Co-lessees
 - a) Inactive Properties
 - b) Active Properties

In Response to Comments on the Proposed Rule AND Lessons Learned

In the tailored Financial Plan BOEM will consider deferring supplemental bonding

Decommissioning Assessment

- For disputed BSEE decommissioning assessments, BOEM will require supplemental bonding but may defer the disputed difference. You will be allotted an adequate time to reconcile the assessment with BSEE.

In Response to Comments on the Proposed Rule AND Lessons Learned

BOEM will consider deferring supplemental bonding

Exploration Plans

- BOEM can conditionally approve a plan deferring supplemental bonding on the plan until 60 days prior to the first permit application
- BOEM will work on technology upgrades to further defer supplemental bonding to prior to approval of each well permit application

Next Steps – NTL Issuance



BOEM continues its outreach

BOEM will finalize the Supplemental NTL

BOEM anticipates issuing the revised NTL in Spring 2016

Next Steps – NTL Implementation



BOEM anticipates a lag in implementation from date of issuance

BOEM will conduct a workshop(s) to instruct lessees on its process and details associated with the phased implementation

BOEM invites lessees who have questions to contact its Risk Management Operation Group

BOEM Regulatory Changes

AD83 Rulemaking Status

The Advanced Notice of Proposed Rulemaking (ANPR) on Risk Management, Financial Assurance and Loss Prevention, was published in the Federal Register on August 19, 2014, with a 60 day comment period. An extension was requested and the comment period was extended until November 17, 2014. The ANPR was comprised of 54 questions grouped in the following four topic areas:

- Identification of Pertinent Risks/Liabilities
- Risk Monitoring and Risk Management
- Demonstrating Financial Assurance Over Project Lifecycles
- Financial Assurance, Bonding Levels and Requirements

BOEM received 35 responses to the ANPR from Industry, Trade Groups, and other interested parties. Few of the received responses answered all 54 questions, while the majority focused on broadly addressing the four topic areas.

In Conclusion...

- BOEM and industry need to work together to identify mutually satisfactory solutions



- BOEM strives to ensure appropriate procedural and operational safeguards without unduly discouraging exploration and development



Questions?