

# An Update on BOEM's Financial Security Requirements for P&A and Decommissioning on OCS Leases: The 800 Pound Gorilla is Dormant . . . for now.

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# ***The Prequel Pre-2015: P&A and Decommissioning under MMS' NTL 2008-N07***

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- BOEM continues procedures and standards for supplemental bonds under Mineral Management Services (MMS) NTL No. 2008-N07:
  - Use BSEE or MMS cost estimates for P&A and decommissioning – sometimes after appeal based on engineering evidence
  - For non-sole liability properties, BOEM considers the financial strength/reliability of co-lessees in setting bond for each individual lessee
  - Waive bonds for lessees demonstrating sufficient financial strength
  - By 2015 GAO Report, BOEM and MMS had waived ~\$33 billion
- BSEE continues to use existing MMS data system dating from the mid-1990s for decommissioning liabilities
  - BSEE Regional Offices must manually enter decommissioning estimates to ensure accuracy
  - Otherwise, BSEE system calculates decommissioning liabilities based on shallow-water wells and platforms
  - As a practical matter, many cost estimates were
    - ~\$100,000 per well, regardless of type of well or depth
    - ~\$500,000 to \$2.5 million per platform – depending on type of fixed platform and not counting site clearance

# ***The Main Event: NTL 2016-N01 Implementation Timeline***

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- Sept 22, 2015** – BOEM makes “Proposed Guidance” available for review – sets out the procedures that BOEM will use to determine a lessee’s financial ability to carry out decommissioning liabilities. Will replace NTL No. 2008-N07
- Dec 4, 2015** – BSEE Final Rule initiating new P&A and Decomm cost estimation process by requiring operators to submit certified actual cost information
- Dec 18, 2015** – GAO Report on actions needed to protect against ~\$38 billion in federal exposure to OCS decommissioning liabilities
- July 14, 2016** – BOEM issues NTL 2016-N01, effective Sept 12, 2016
- Oct 20, 2016** – BOEM issues Proposal Letters giving affected operators the proposed amounts of additional security
- Dec 30, 2016** – BOEM issues Sole Liability Order Letters requiring that additional securities must be provided within 60 days
- Jan 6, 2017** – BOEM postpones issuance of Non-Sole Liability Order Letters for a period of six months
- Feb 17, 2017** – BOEM withdraws its Sole Liability Order Letters
- June 22, 2017** – BOEM extends NTL implementation timeline beyond June 30

# Sept 22, 2015 – BOEM announces “Proposed Guidance” for upcoming financial assurance procedures

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- Upcoming NTL would significantly revise current procedures for supplemental security bonds for P&A and decommissioning of OCS wells & platforms
- Intended to ensure U.S. taxpayers never pay to decommission an OCS facility
- Significantly revises BOEM’s criteria for supplemental security  
*by means of:*
  - A restricted self-insurance program instead of granting broad waivers:
    - Reduced maximum self-insurance level to 10% of tangible net worth from prior maximum limit of 50% of net worth
  - Decommissioning liability will no longer be spread among co-lessees:
    - Lessee’s decomm liability now 100% for every lease in which it holds an interest
    - BOEM no longer to consider combined financial strength/reliability of co-lessees
    - Co-lessees must determine among themselves how best to fulfill BOEM supplemental security requirements
  - Supplemental bonding over a 360-day phase-in period
  - BOEM to consider alternative forms of security a/k/a “Tailored Plans”

# Dec 3, 2015 – BSEE implements new cost estimation process

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- BSEE Final Rule — completed a rulemaking process to address decommissioning costs that began in 2009
- New rules to go into effect January 4, 2016
- Overhauls the P&A and Decomm cost estimation process
- After completing the specified decommissioning activities, OCS lessees and operators are required to submit certified summaries of actual P&A and decommissioning expenditures
- Intended to help BSEE better estimate and track future decommissioning costs related to OCS properties
- New processes and procedures intended to give BOEM the option to use BSEE's cost estimates to establish and require lessees/operators to provide the necessary additional financial assurances for OCS properties

# December 2015 – GAO Report Identifies Flaws in BSEE Data and Estimating Procedures

- GAO issues extensive report to Congress that an outdated data system restricts BSEE's access to accurate data and its ability to record estimates of decommissioning costs
- BSEE stores its cost estimates of decommissioning liabilities in a system that uses algorithms developed in the 1990s
  - The system calculates the cost to plug a well as \$100,000, regardless of water depth or the type of well  
*while*
  - BSEE estimates the cost to plug a subsea well in deep water is ~\$21 million and must manually input such updated cost estimates
- BOEM without reasonable assurance that it is requiring sufficient amounts of financial assurance from lessees and operators based on BSEE's estimates
- Conclusion: less than 8% of decomm liabilities covered by financial assurances:
  - ~\$38.2 billion in total P&A and decommissioning liabilities in the Gulf
  - ~\$2.9 billion in bonds or other financials assurances held by BOEM
  - ~\$2.3 billion in liabilities may not be covered due to questionable data
  - ~\$33 billion in potential liabilities thus covered by BOEM waivers

## July 14, 2016 – BOEM issues NTL 2016-N01

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- Implements “Proposed Guidance” of Sept 2015 to modernize BOEM’s approach to ensure that U.S. taxpayers do not pay for the estimated \$40 billion of routine P&A and decommissioning liabilities in the OCS.
- Replaces current policies under existing NTL No. 2008-N07 in three areas:
  1. BOEM will no longer consider the combined financial strength of co-lessees when determining an individual lessee’s ability to meet its decommissioning liability financial assurance requirements.
    - Each co-lessee will be responsible for 100% of all accrued liabilities
    - Lessees will only be required to post security for their proportionate share of any accrued liability
  2. Establishes more rigorous criteria for determining capability of fulfilling obligations:
    - Each lessee and owner must demonstrate its own financial capacity, financial strength, stability, reliability and record of compliance.
  3. Replaces present waiver system with very limited self-insurance:
    - Lessees will no longer be granted waivers for supplemental bond obligations.
    - If deemed a financially stable, lessees will only be able to bond up to a maximum of 10% tangible net worth instead of 50% of net worth.

# Oct. 20, 2016 – BOEM issues “Proposal” letters to Operators

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- BOEM issued 232 “Proposal” letters to designated operators with new cost estimates for each lessee’s cumulative decommissioning costs for *all* leases, ROWs and RUEs
- Outlines the proposed amounts of additional security that will be required
- Some operators began developing tailored plans to provide new financial assurances to comply with the NTL



# Dec 30, 2016 – BOEM issues Sole Liability Order Letters

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- Based on its assessment that sole liability properties represent the greatest risk to taxpayers for default on P&A and decommissioning liabilities
- BOEM issued 112 order letters to sole liability owners and operators of 687 properties:
  - Ordered to provide additional securities within 60 calendar days
  - Additional securities estimated to cover \$2 billion in decommissioning liabilities
- BOEM anticipated sending Non-Sole Liability Order Letters in June of 2017 unless BOEM determined at an earlier date that there was a substantial risk of nonperformance of the interest holder's decommissioning liabilities

# Jan 6, 2017 – Six-month extension for non-sole liability properties to implement NTL 2016-01

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- BOEM delays implementation of NTL 2016-N01 by six months
- Delay intended to provide valuable time for OCS producers and operators to identify and distribute risk in complex multi-party business relationships
- Also allowed parties to develop plans to implement new decommissioning obligations
- Provided additional time for regulators to interface with the companies impacted to evaluate liability as between stakeholders
- During the delay, BOEM announced that it would focus on sole liability properties and properties where there is a substantial risk of nonperformance by the operator in regard to decommissioning liabilities

## Feb 17, 2017 – BOEM withdraws Sole Liability Orders

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- BOEM withdrew its Sole Liability Order Letters (Dec 2016), which required additional security to be provided for sole liability properties within 60 days
- The agency said its reason was to allow time for the new administration to review the complex financial assurance program
- BOEM reserved the right to re-issue the withdrawn orders if it determines there is a substantial risk of nonperformance of the interest-holder's decommissioning liabilities
- BOEM appears to have put the entire implementation of NTL 2016-N01 on hold pending its six month review of the requirements

# June 22, 2017 – BOEM indefinitely postpones implementation of NTL 2016-N01

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- On June 22, 2017, BOEM announced that it will extend the NTL implementation timeline beyond June 30
- Exception where there is a substantial risk of nonperformance of the interest holder's decommissioning liabilities
- BOEM states that:
  - it is in the final stages of its review
  - more time is necessary to interface with industry and other stakeholders to balance current economic realities with ensuring that American taxpayers are not on the hook for OCS decommissioning liabilities

# Future BOEM actions

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Future status unclear but may take any of 5 forms if and when BOEM re-engages in light of new Administration action:

1. *Status quo* extended with ad hoc actions for at-risk lessees and operators
  - Realistically, the question is how long BOEM maintains this *status quo*
2. BOEM implements NTL 2016-N01 with minor adjustments
  - BOEM aggressively implements current program for at-risk operators and leases
  - BOEM reinstates NTL 2016-N01 with refinements for all operators and leases
  - BSEE refines cost estimates, especially with new actual data, but significant fly-up in orders of magnitude remain for many leases
3. Current Industry-led initiatives:
  - Structured isolation of truly at-risk leases and operators
  - Realistic bond requirements for such
  - Only established at the time reasonably ahead of actual Decommissioning
  - Competing structures now being presented to BOEM

# Future BOEM actions, continued

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## 4. BOEM issues a new Financial Assurance NTL that will reflect Industry initiative to some degree

- Address the problems with Sole Liability properties including ROWs and RUEs?
- Focus enforcement on most at-risk lessees?
- Phase-in any new program to lessen impact on lessee implementation?
- Introduce an enhanced program before year's end?

## 5. Potential for newly developed Financial Vehicles

- Alternative to traditional bonds
- Accepted by BOEM under individual *Tailored Plan* concept
- Provide private contractual arrangements for funding
- Provide recognized assurance to BOEM

# The Impact on OCS World

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- *If and when BOEM resumes NTL 2016-N01:*
  - Impossible-to-satisfy demands for many operators and leases
  - Bankruptcies for many and immediate burdens for legacy lessees
  - Massive amounts of dead-capital held up in bonds and other security
  - Elimination of some independents
  - Barriers to entry by new independents
  - Collapse of the after-market for Majors' deep-water properties and for large independents' conventional Gulf properties
  
- *Even if BOEM resumes the past/stay continues indefinitely:*
  - BSSE new cost estimates and new methodologies will remain in place
  - Above concerns remain for:
    - At-risk operators and leases
    - New leases?
    - Future sales and assignments?

# The Impact on OCS World, continued

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- *If BOEM implements new Financial Assurance program:*
  - BSEE new cost estimates and new methodologies will remain in place
  - Otherwise, difficult to predict which of the above concerns remain:
  - Bond market issues remain
  - Probably greater focus on at-risk operators and leases
  - Hopefully some more realistic timing as to glide-path to actual decomm costs
  - New leases?
  - Future sales and assignments?
- ***The Real Issues, for each of these possible alternatives, remain:***
  - ***Whether and how the new BSEE estimates continue?***
  - ***Whether and how applied to new leases, sales and assignments?***



# The Impact on the World of Reserve Evaluation

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- How are the SEC reporting and evaluation requirements affected?
- Are reserve evaluations going to be affected by the massive fly-ups in BSEE decommissioning cost estimates?
- If so, how?
  - Shorter economic life when calculating reserves?
  - Fewer prospective targets coupled with overwhelming bonding requirements?
  - Can reserves be increased by pro-actively resolving P&A and Decommissioning liabilities?
  - Can there be different reserve evaluations depending on the bonding/financial security worthiness of a lessee/operator?

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