



November 23, 2015

Department of the Interior
Bureau of Ocean Energy Management

Submitted via Risk.Management@BOEM.gov

Re: Updated Financial Assurance Criteria

To Whom It May Concern:

The American Petroleum Institute (API), the National Ocean Industries Association (NOIA), and the Offshore Operators Committee (OOC) (the Associations) offer the following feedback on the U.S. Department of Interior Bureau of Ocean Energy Management's (BOEM's) proposed updated criteria to determine the financial ability of lessees, operators, pipeline rights-of-way (ROW) holders, and rights-of-use and easement (RUE) holders to carry out their obligations on leases, ROWs, and RUEs issued on the Outer Continental Shelf (OCS) and the potential need for additional security as authorized in 30 CFR § 556.53 (d) –(f) to ensure performance of these obligations.

API is a national trade association that represents over 630 members involved in all aspects of the oil and natural gas industry, including exploring for and developing oil and natural gas resources in the OCS – a vital part of our nation's economy. The industry supports millions of American jobs and delivers billions of dollars in annual revenue to our government.

NOIA is the only national trade association representing all segments of the offshore industry with an interest in the exploration and production of both traditional and renewable energy resources on the U.S. OCS. The NOIA membership comprises more than 300 companies engaged in a variety of business activities, including production, drilling, engineering, marine and air transport, offshore construction, equipment manufacture and supply, telecommunications, finance and insurance, and renewable energy.

OOC is a non-profit organization comprised of any person, firm or corporation owning offshore leases and/or engaged in offshore activity as a drilling contractor, service company, supplier or other capacity that chooses to participate. The Committee's activities are focused supporting its member companies in operations that are protective of human health and the environment.

The Associations welcome the opportunity to provide input on the draft criteria that will presumably form the basis of a future Notice to Lessees (NTL) and modification to existing regulations. We recognize that BOEM has taken a number of the recommendations that industry

made in previous comments on the complex issues surrounding this topic. However, we remain concerned that BOEM has not provided a clear definition of the problem that the agency is trying to solve nor has there been justification provided as to the need for major changes the existing regulatory framework. Any changes should be designed so as not to undermine the current framework that encourages prudent operations or to introduce unintended and unnecessary consequences. We understand the complexity of these issues and look forward to continued collaboration with BOEM and the Bureau of Safety and Environmental Enforcement (BSEE), an agency that we believe also has a significant role to play in the financial assurance process for offshore operations.

I. Lack of Proper Rulemaking Procedures

Even though BOEM initiated an advanced notice of proposed rulemaking (ANPRM) on this issue last year, the agency has not proceeded with these changes through the next logical step in the rulemaking process, a notice of proposed rulemaking. The Associations are concerned about BOEM's practice of creating new binding requirements outside the rulemaking procedures of the Administrative Procedure Act (APA), including through the presumably contemplated NTL. For example, by setting a new maximum upper limit for self-insurance, the NTL would create a new constraint on the Regional Director and would restrict the set of options available to the regulated community. No such limitation is found in the existing regulations, which to the contrary provide the Regional Director with discretion "to determine the amount of supplement bond required to guarantee compliance" through a "case-specific analysis."¹ Similarly, as contemplated, the draft criteria describes a blanket prohibition on BOEM's ability to issue waivers or consider the combined financial strength and reliability of co-lessees or operating rights holders when determining a lessee's decommissioning liability, further restricting the Regional Director's discretion and the regulated community's options. Such binding norms should be promulgated as rules through the APA, not through a guidance document such as an NTL.

We also understand that BOEM is preparing a proposed rulemaking that may address a number of issues, including bonding amounts, financial assurance for RUEs, required filings, and financial assurance appeals. Any changes to the regulations on those topics could affect the impact of any new NTL. Accordingly, once those regulatory changes are finalized, BOEM should allow for additional comments on any NTL issued and should consider whether additional revisions to the NTL are necessary. API reserves its rights to provide new or revised comments on any issued NTL at that time.

In addition, we believe that BOEM has failed to recognize the tremendous burden the changes being contemplated will have on the offshore oil and natural gas and surety industries. One company estimates that the proposed changes could increase their compliance costs by up to \$20 million annually. We believe that under Executive Order 12866, any NTL including the proposed criteria would be an "economically significant regulatory action" that the Office of Information and Regulatory Affairs (OIRA) is required to review and that BOEM must provide

¹ 30 CFR § 556(e).

OIRA with an assessment of benefits, costs, and alternatives.² Also, given the potential that BOEM's implementation of the criteria could disrupt current production levels should lessees fail to timely comply with the new BOEM guidance, under Executive Order 13211, any NTL containing the criteria could be considered a "significant energy action," therefore triggering BOEM's obligation to also provide OIRA with a statement regarding adverse effects on energy supply and alternatives.

II. Increased Uncertainty Concerns

As we stated in our previous comments, there is consensus among our members that BOEM's current process of assessing a company's financial capability to meet its financial obligations works well and is simple and straight forward. We are concerned that the new framework being contemplated is overly complex, potentially unnecessary, and will reduce the certainty and predictability that companies need to have in an effort to continue to make profitable investment decisions and operate efficiently in the OCS. Depending on how BOEM intends to modify its existing regulations governing financial assurance, , the result could severely undermine the current regulatory, contractual and financial framework the industry has become accustomed to over decades of successful operations in the Gulf of Mexico.

BOEM has not indicated which of the five provisions of 30 CFR § 556.53(d) (1) (i-v) will be emphasized when the Regional Director is making the determination of a company's ability to carry out its obligations and industry would like BOEM to provide additional transparency regarding how this determination will be made. For instance, the unpredictable price of crude oil and its overwhelming impact on the financial snapshot afforded by a company's balance sheet and on the estimated value of lease production and proven reserves could result in an ever changing determination of a company's financial strength, potentially causing BOEM to make snap discretionary judgments on a company's financial capabilities. BOEM has indicated in discussions following the release of the new criteria that the financial capability of a company will be assessed on an annual basis unless major events occur potentially impacting a company's financial ability to meet future OCS liabilities. In case of major events impacting a company's financial stability, one or more reassessments during a calendar year could happen. We do not disagree with an annual assessment or more frequent assessments when extenuating circumstances arise that may warrant an immediate review. However, we believe companies should have the obligation to self-report changes such as corporate status (LLP, partnership, etc.), solvency ratio, litigation that threatens the financial viability of the company, etc. to trigger an assessment more frequently than annually.

In previous comments on last year's ANPRM, we said that the risk management, financial assurance and loss prevention programs implemented by BOEM should maintain simplicity and transparency, have clear minimum operational and financial standards, and be enforced across the entire industry. The proposed criteria accomplish part of this suggestion, but more work is needed. BOEM should consider weighting each of the financial standards against their potential effect on a party's ability to pay for their liabilities in a given year. For example,

² The Office of Management Budget made clear in a March 2009 memo that significant guidance documents are subject to EO 12866 review.

the tests involving liquidity should be given the greatest weight followed by the leverage tests and finally the profitability tests. BOEM should also consider establishing a range of acceptable values or minimum acceptable values for the financial criteria referenced (item 1).³ In addition, the financial criteria proposed by BOEM rely heavily on production and proved reserves, valuing such at point-in-time prices. By doing so, BOEM fails to recognize the value of substantial liquidity, other than through the Tangible Net Worth limitation on self-insurance, which is arbitrarily capped at 10%. Therefore, BOEM should consider alternative financial criteria for companies having substantial liquidity to meet all their financial obligations (including anticipated decommissioning liabilities) regardless of current levels of production, cash flow, earnings and proved reserves. The financial criteria quartile rankings that were provided for review with the draft (Table 1 and Table 2) provide no way for a company to determine whether its status is acceptable or not. With no established acceptable values, dividing the companies into quartiles is arbitrary and provides no guidance to the companies. In addition, the discretionary factors provided to the Regional Director to consider a company's operational history (Item 5) are overly broad, give no consideration to industry benchmarks, and includes items in subpart (d) that are not material to a company's ability to ensure compliance with the obligations under its lease. Those factors should not be considered in making a decision on operational capability.

How BOEM chooses to exercise its discretion in implementing the proposed policy changes greatly impacts a company's ability to operate on the OCS. Without clear guidance on what BOEM plans to emphasize in its decision making a company has no way of determining its "status", thus losing the predictability needed to effectively manage its business. In addition, there is no identified method of appeal for the decisions made by BOEM in the event that the proposed criteria are embodied in a new NTL. We understand that BOEM intends to address this issue through an upcoming rulemaking, but without such an appeals structure in place for failing to comply under the contemplated new NTL, there is no clear method for companies to file appeals or ensure that they are handled in a timely fashion.

III. Specific Areas of Concern

In reviewing the draft documents provided we came away with a number of specific areas of concern, mainly relating to implementation of this new framework, and suggestions for improvements to include the following (in no particular order of importance):

A. BOEM should develop clear and definitive guidelines and processes for managing financial assurance instruments (i.e., bonds and other forms of security). Expand the current model to include other potential categories other than independent vs. integrated, such as "growth", in order to capture flexibility to adequately measure a company's financial strength.

³ See Item I. above regarding need for proposed rulemaking should these values be established.

B. In addition to the steps taken by BOEM to reduce the need for “double bonding”, the Associations support granting rights of subrogation to all parties in the chain of title, including BOEM, to reduce the need for redundant bonds covering the same decommissioning liabilities.

C. BOEM should take proactive steps to include in the regulatory framework the “co-obligee” concept on existing and future decommissioning related bonds or other forms of decommissioning security.

D. BOEM should assess the owners of operating rights separately from the owners of record titles, while applying the same requirements to both. This approach will recognize the difference between the estates while also avoiding the possibility of a “free ride” for operating rights owners.

E. In addition, the new regulatory framework should require that all private security instruments be posted in the non-required filings section in the Adjudication Unit and give BOEM the ability to work with industry to jointly access these instruments within the overall framework of securing decommissioning liabilities for the government and prior lessees in the chain of title. The industry does not want BOEM to introduce any need for “double bonding” and every lease holder should provide support for their working interest share of the lease so that as a whole 100% of the lease is covered.

F. BOEM needs to revisit the need to fully account for all potential financial liabilities associated with an Exploration Plan. Exploration Plans include multiple, alternative well site options for drilling an initial exploration well, as well as potential locations for future exploration or appraisal wells, depending upon the results and learnings from the initial exploration well. Requiring bonding for all “potential, alternative” well sites grossly overstates the actual exposure. There is no risk of loss associated with plugging a well that has never been and may never be drilled. Risk of loss associated with plugging a well arises only when a well is actually drilled. As such, a liability should not be accrued until the drilling permitting phase for the well or wells being permitted to drill.

G. BOEM should also consider when operational risks arise when determining the amount of security required. For example, is there a need to require the full bonding amount at the time of platform installation when the platform has an expected life of 10 to 20 years? BOEM could instead apply a present value to such decommission liability.

H. When determining a company’s financial ability to cover future decommissioning liability, BOEM could recognize that general accounting principles already subtract from a company’s net worth the cost of abandoning wells and removing platforms. The “asset retirement obligations” (“AROs”) are not included by BOEM in their assessment, and therefore effectively double counts the costs of removal by subtracting its own estimates of removal liability from a self- insurance limit based on a line of credit. Therefore, the 10% of tangible net worth maximum limit for self-insurance amount needs to be increased to at least 25%. Limiting credit given for a strong balance sheet to 10% of the value of that balance sheet is arbitrary and fails to give proper consideration to the very thing that is required to meet decommissioning

liabilities – assets, in excess of liabilities. Companies who have positioned themselves well to meet their current and future liabilities are not adequately differentiated. Regardless of the strength of the financial position demonstrated, credit for that position is limited to a small fraction of its value.

I. As part of self-insurance, companies should also be allowed to use a captive insurance company to fulfill the decommissioning security requirement.

J. The Phased-in Timetable for Compliance needs to be greatly extended to allow industry to work out financial assurance obligation details not currently covered in Joint Operating Agreements (JOAs). The proposed 90-120 days is not enough time if operators are required to negotiate new JOAs, amend existing JOAs or execute other documents with joint owners as well as reconcile individual company AROs with BSEE calculated decommissioning liabilities to secure the proportionate liability prior to submitting a plan for compliance with the new regulatory framework. We suggest the NTL become effective 180 days after it is issued with lessees granted three consecutive 180 day periods to comply with the new guidelines (1/3rd compliance by the end of each 180 day period)

K. BOEM should provide some form of consequences for companies that either do not provide their portion of the financial assurance obligation or fail to do so in a timely manner.

L. Concerning Decommissioning Security Trust Agreements, BOEM should establish guidelines for how and when the trust must be funded, acceptable financial instruments, whether the trust can be funded over time and drawn from over time to perform abandonment activities, etc.

M. Encourage the adoption of a standard method for the calculation of decommissioning liabilities in accordance with acceptable financial accounting methods (IFRS or GAAP). The AROs that are part of a company's audited financials submitted to BOEM follow one of these standard methods.

The associations appreciate the opportunity to provide input to the Bureau on this very important issue to the industry. Should you have any questions on these comments, please contact Andy Radford at 202-682-8584 or at radforda@api.org.

Sincerely,



Andy Radford
American Petroleum Institute

A handwritten signature in black ink, appearing to read "Randall Luthi". The signature is fluid and cursive, with a large initial "R" and a long, sweeping underline.

Randall Luthi
National Ocean Industries Association

A handwritten signature in black ink, appearing to read "Evan Zimmerman". The signature is more compact and stylized than the one above, with a large initial "E" and a horizontal stroke at the end.

Evan Zimmerman
Offshore Operators Committee