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A Day Early and a Dollar Ahead – Unpacking BOEM’s Revised Financial Assurance Rule for Offshore Operations

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Historically, offshore oil and gas companies with operations in the United States have been providing base financial assurance in the form of surety bonds, decommissioning accounts or other guarantees to the Bureau of Ocean Energy Management (BOEM)—the agency within the Department of the Interior (DOI) responsible for managing the development of the nation’s offshore resources—to ensure performance of decommissioning obligations. The regulatorily prescribed amount of such assurance is based on the level of activity occurring on a specific lease or in an area.

Level of Activity	Lease-Specific Amount
No approved operational activity	\$50,000
Exploration Plan	\$200,000
Development Production Plan	\$500,000

Level of Activity	Area-Wide Amount
No approved operational activity	\$300,000
Exploration Plan	\$1,000,000
Development Production Plan	\$3,000,000
Pipeline – Right-of-Way	\$300,000
<i>[Effective June 24th] Right-of-Use and Easement</i>	\$500,000

BOEM is amending its risk management and financial assurance regulations and recently released a final **Risk Management and Financial Assurance for OCS Lease and Grant Obligations** rule¹, which will go into effect on June 24, 2024 and affect current and future offshore lessees, right-of-use and easement (RUE)² grant holders and pipeline right-of-way (ROW) grant holders. The rule finalizes these amendments that are intended, in part, to update existing regulations to address the increasing costs of facility decommissioning and other financial risks associated with the Outer Continental Shelf (OCS) development. The amendments are also expected to increase the total amount of financial assurance required from OCS lessees and grant holders. This alert provides a summary of the key provisions included in this final rule.

¹ The final Risk Management and Financial Assurance for OCS Lease and Grant Obligations rule can be found at the following link: <https://www.federalregister.gov/documents/2024/04/24/2024-08309/risk-management-and-financial-assurance-for-ocs-lease-and-grant-obligations>

² A Right-of-Use and Easement (RUE) is a right to use a portion of the seabed at an OCS site other than on a lease a grant holder owns, for the construction and/or use of artificial islands, facilities, installations, and other devices, established to support the exploration, development or production of oil and gas, mineral or energy resources from an OCS or state submerged lands lease.

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I. Stated Base Financial Assurance for RUE Grant Holders.

In the late 1990s, the Minerals Management Service, BOEM's predecessor, published the existing financial assurance requirements for RUE grants, which did not dictate a specific bond amount for a RUE, but did provide the agency the authority to require bonding from a RUE grant holder. Under BOEM's new rule, every OCS RUE grant holder must provide base financial assurance in an amount of \$500,000 for each OCS area in which the RUE holder owns one or more RUEs (regardless of whether the RUE serves a state or federal lease).

A lessee that has previously posted area-wide lease financial assurance may modify such assurance to cover any RUEs in the area owned by that lessee, provided that such assurance is in an amount large enough to cover the base financial assurance requirement for RUEs (*i.e.*, equal to or greater than \$500,000). For example, a lessee with a \$3,000,000 area-wide lease surety bond could satisfy the financial assurance requirements for RUEs that it owns in such area without having to post any additional base financial assurance, provided that the lessee modifies the terms of its area-wide lease surety bond to cover such RUEs. If an existing area-wide financial assurance is not modified, a lessee must satisfy the requirement by providing separate, new financial assurance to cover its RUEs.

II. Evaluation Criteria for Supplemental Financial Assurance.

The Regional Director for the Gulf of Mexico OCS Region may require a company to provide supplemental financial assurance above the base financial assurance required under the regulations. To determine whether supplemental financial assurance is required, BOEM will assess a company's financial risk by reviewing (1) the company's credit rating and (2) the ratio of the value of proved reserves on a particular lease to decommissioning liability associated with those reserves. A company with an investment grade credit rating or proxy credit rating, or a lessee or grant holder with at least one co-lessee or co-grant holder, respectively, that meets the investment grade credit rating threshold, will not be required to post supplemental financial assurance. Additionally, if a lessee satisfies a minimum proved reserves to decommissioning liability ratio of 3-to-1, then a lessee can avoid supplemental financial assurance demands with respect to the lease associated with such reserves and liability.

A company's supplemental financial assurance will be released after decommissioning is completed and certified by the Bureau of Safety and Environmental Enforcement (BSEE), and the Office of Natural Resources Revenue gives clearance for outstanding payments. Supplemental financial assurance does not, however, change or undermine the existing joint and several liability of companies operating in (or that previously operated in) the OCS. BOEM and BSEE retain their authority to pursue predecessor lessees and grant holders for the performance of decommissioning. A lessee or grant holder that transfers its interest to another party continues to be liable for any unperformed decommissioning obligations that accrued prior or during the time that lessee or grant holder owned an interest in the lease, RUE or ROW.

A. Credit Rating.

An "issuer credit rating", which provides a rating agency's opinion of an entity's ability to honor senior unsecured debt and debt-like obligations, shall be used to evaluate the financial health of OCS lessees and grant holders to ensure that they have the capacity to meet their financial and non-financial obligations. The credit rating must be from a Nationally Recognized Statistical Rating Organization (NRSRO), such as Standard and Poor's (S&P) Rating Services, Moody's Investors Service Incorporated and Fitch Ratings (or any of their subsidiaries). If different NRSROs provide different ratings for the same lessee or grant holder, BOEM will use the highest of the ratings.

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A company that does not have an NRSRO-issued credit rating may request that the Regional Director determine a proxy credit rating based on the company's audited financial information for the most recent fiscal year, including an income statement, a balance sheet, a statement of cash flows and the auditor's certificate. To obtain the proxy rating, BOEM will use the S&P Global Inc.'s Credit Analytics credit model to assess a company's probability of default on its financial obligations; provided, however, that BOEM retains the right to use a different model if it determines that a different model more accurately reflects the factors relevant to the financial evaluation of a company operating on the OCS. A company with an issuer credit rating threshold of BBB- (S&P and Fitch) and Baa3 (Moody's), an equivalent credit rating provided by another SEC-recognized NRSRO, or an equivalent proxy credit rating will not be required to provide supplemental financial assurance.

BOEM maintains the general practice of evaluating lessees, RUE grant holders and pipeline ROW grant holders for financial risk on at least an annual basis (typically corresponding with the release of audited financial statements). In addition, throughout the year, BOEM monitors company credit rating changes, market reports, trade press, articles in major news media and quarterly financial reports. Therefore, the amended regulations do not preclude a demand for supplemental financial assurance through the Regional Director's regulatory authority at any time.

Co-lessees are jointly and severally liable for the entirety of lease decommissioning obligations that accrue during, and prior to, their ownership. Therefore, BSEE may pursue full performance thereof from any individual, current co-lessee. BOEM's supplemental financial assurance evaluation process shall include an evaluation of the ability of a co-lessee to carry out present and future obligations, and BOEM will not require supplemental financial assurance from properties where at least one co-lessee meets the credit rating threshold. Similarly, BOEM will also consider the credit rating or proxy credit rating of RUE co-grant holders and ROW co-grant holders to determine if a grant holder must provide supplemental financial assurance. BOEM will not require supplemental financial assurance with respect to a RUE or ROW where at least one co-grant holder meets the credit rating threshold.

B. Valuing Proved Oil and Gas Reserves.

BOEM may also evaluate the financial health of an OCS lessee by considering the current value of the remaining proved reserves on a lease (using the U.S. Securities and Exchange Commission reserve pricing valuation) compared to the estimated cost of meeting decommissioning obligations. A company can avoid supplemental financial assurance demands with respect to such lease if, after submitting a reserve report for the proved oil and gas reserves located on a given lease, BOEM determines a company's lease area has sufficient proved reserves such that the company can satisfy a 3-to-1 ratio of the discounted value of the reserves (as determined by the regulations) to the proposed P70 decommissioning estimate (representing a 70% likelihood of covering the full cost of decommissioning a facility) associated with the production of those reserves. The 3:1 ratio provides BOEM a financial cushion to account for commodity price volatility, volumetric risk and interest rate risk when predicting which assets would have an attractive, positive net-present-value that would be marketable to other companies in the event of a bankruptcy. The 3-to-1 ratio exemption from supplemental financial assurance is not provided to RUE and ROW grant holders because neither a RUE nor a ROW grant entitles its holder to any interest in the underlying oil and gas reserves.

III. Determining the Amount of Supplemental Financial Assurance.

BSEE provides estimates to BOEM regarding the financial assurance likely needed to cover decommissioning costs, based on what the government would expect to pay if a company failed to perform decommissioning. BSEE has developed probabilistic estimates, which are based on industry-reported data and referred to as "P-values",

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for each OCS facility on any given lease. These estimates represent the likelihood that a company will cover the full cost of decommissioning a facility as a percentage. The P70 (*i.e.*, a 70% likelihood of covering decommissioning costs) decommissioning estimate value will be used to determine the amount of supplemental financial assurance required from a current lessee and grant holder.

The decommissioning cost estimates are based on actual decommissioning expenditure data received from OCS operators. The data is available based on a lease, RUE or ROW basis and contains details on a well, platform, pipeline and site clearance level, but does not consider which companies are jointly and severally liable for meeting decommissioning obligations. If a probabilistic estimate is not available, BOEM will use the deterministic value—a single, algorithm-based estimate for OCS facilities for determining decommissioning cost estimates—to determine the amount of supplemental assurance.

It is worth noting that BOEM plans to evaluate the specific values of base financial assurances for leases, RUEs and ROWs in future rulemaking, in part, because the current rates were determined in the 1990s, were based on costs in relatively shallow waters (as opposed to the deeper waters that companies now more frequently operate in) and do not consider the significant inflation that has occurred since the last revision.

IV. Reduction in, Appeal of, and Compliance with a Supplemental Financial Assurance Request.

A company may submit data, such as an existing contract for decommissioning activities, to the Regional Director demonstrating that the company's actual decommissioning costs are below BSEE's estimates so that the Regional Director may consider a reduction in the company's supplemental financial assurance demand. BOEM will consult with BSEE on the information received when determining whether to reduce such company's required amount of supplemental financial assurance.

Any company seeking to stay a supplemental financial assurance demand pending appeal must, as a condition of obtaining a stay of the order, post an appeal bond in the amount of supplemental financial assurance required. If the appeal is partially successful, the amount of the appeal bond exceeding the amount of any supplemental financial assurance determined to be required would be returned to the appropriate party. If the appeal is unsuccessful, the appeal bond could be replaced with, or converted into, bonds or other forms of financial assurance to cover the supplemental financial assurance demand. If an appellant wins its appeal, and no financial assurance is required, the appeal bond will be cancelled.

During approximately the first three years following the effectiveness of the rule, current lessees and grant holders may, upon receipt of a demand letter for supplemental financial assurance, request that the Regional Director allow the requesting party to provide, in three equal installments, the full amount of supplemental financial assurance required. If the Regional Director allows such requesting party to provide the amount required on such a phased basis, the company must provide to BOEM (i) the initial one-third of the total supplemental financial assurance required within the timeframe specified in the demand letter or, if no timeframe is specified, within 60 calendar days of the date of receipt of the demand letter, (ii) the second one-third of the required supplemental financial assurance within 24 months of the date of receipt of the demand letter and (iii) the final one-third of the required supplemental financial assurance within 36 months of the date of receipt of the demand letter. If a company fails to timely provide the required supplemental financial assurance to BOEM under the phased compliance approach, the entirety of the remaining supplemental financial assurance amount will become due ten calendar days after the company receives a notice of such failure from the Regional Director.

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V. Other Types of Supplemental Financial Assurance.

A. Third-Party Guarantees.

To allow more flexibility in the use of third-party guarantees, the final rule provides that a third-party guarantee (from a guarantor with an investment grade credit rating or proxy credit rating) may be used as supplemental financial assurance for the benefit of an OCS lessee and/or grant holder, and such guarantee may be limited to a specific amount or limited one or more specific lease obligations, rather than guaranteeing compliance with all decommissioning obligations associated with a supplemental financial assurance request. If a limited guarantee is approved by BOEM, the guaranteed party will be required to provide other supplemental financial assurance with respect to any of its liabilities left uncovered by the limited guarantee. BOEM may cancel a third-party guarantee under the same terms and conditions that apply to cancellation of other types of financial assurance as provided in the regulations.

B. Decommissioning Accounts.

The amendments rename the “lease-specific abandonment accounts” as “decommissioning accounts” to remove any perceived limitation that this type of account only applies to a single lease. Decommissioning accounts may be used to ensure compliance with supplemental financial assurance requirements for a RUE and ROW grant, as well as a lease. To make these accounts more attractive to parties who may desire to use this method of providing supplemental financial assurance, the amendments also remove the requirement of a company to pledge Treasury securities to fund a decommissioning account before the funds held therein equal the maximum amount insurable by the Federal Deposit Insurance Corporation (FDIC) and Federal Savings and Loan Insurance Corporation (FSLIC), for which insurance is currently capped at \$250,000.

VI. Transfers.

The amendments clarify that BOEM may withhold approval of the transfer of a lease interest, whether a record title interest or an operating right interest, until the transferee complies with all applicable regulations and orders, including financial assurance requirements. Therefore, BOEM may withhold approval of any new transfer or assignment of any lease interest unless and until financial assurance demands have been satisfied. Additionally, BOEM may disapprove an assignment of an interest in a RUE if the assignee does not meet the applicable financial assurance requirements or has not complied with a BOEM or BSEE order. When a company attempts to assign a ROW grant, it must furnish and maintain \$300,000 of area-wide financial assurance that guarantees compliance with the regulations and the terms and conditions of the ROW grant.