

## Bureau of Ocean Energy Management Implements New Bonding Procedures for Plugging and Abandoning and Decommissioning on the Outer Continental Shelf

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**PRACTICES** Energy, Power and Natural Resources, Environmental

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Nearly one year after proposing to do so, on July 14, 2016, the Bureau of Ocean Energy Management (“**BOEM**”) issued Notice to Lessees and Operators NTL No. 2016-N01 (“**NTL 2016-N01**”) that, effective September 12, 2016, establishes new procedures in connection with requiring additional security in the form of supplemental bonds for plugging, abandoning, and decommissioning Outer Continental Shelf (“**OCS**”) wells, platforms and other facilities. Following in lock-step with BOEM’s proposal in September, 2015, the new NTL No. 2016-N01 discontinues and materially supplants the current policies under the existing NTL No. 2008-N07 in three areas: (1) ending the practice of excusing lessees or operators from providing additional security where co-lessees or co-operators had sufficient financial strength and reliability to meet such obligations; (2) establishing new criteria for determining financial strength and reliability; and (3) replacing the present waiver system with one of self-insurance. Asserting that its present policies are outdated and provide inadequate protection, BOEM claims that it has modernized its approach to ensure that U.S. taxpayers do not pay for the estimated \$40 billion of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.

Notably, this major substantive regulatory action was not implemented as a regulation, after formal rulemaking, but rather issued as an NTL that, although it followed a self-described “45 day review period” and several workshops with industry, did not formally solicit or follow public comment procedures. Given the new procedures and standards under NTL 2016-N01 and the size of the total estimated P&A and decommissioning liability, the industry must anticipate that many lessees and operators will soon be required to provide additional financial security unless they can self-insure after meeting the new rigorous metrics for financial strength. However, current oil and gas prices and liquidity conditions in the surety bond market may make obtaining such bonds costly to individual lessees and operators and compromise their ability to present tailored plans to otherwise demonstrate financial security for P&A and decommissioning liabilities even with the phase-in promised under the new procedures.

In contrast to the current policy of providing waivers to co-lessees and co-operators where BOEM has determined that other co-lessees or co-operators have sufficient financial strength and reliability to satisfy decommissioning liabilities for joint properties, under the new NTL 2016-N01, BOEM will no longer exclude a lessee or operator’s share from its full amount of the decommissioning liability on OCS leases, pipeline rights-of-way (“**ROWS**”), and rights-of-use and easement (“**RUEs**”). Instead, each co-lessee and co-operator will be responsible for 100 percent of its own decommissioning liabilities. BOEM states that it is willing to allow co-lessees and co-operators to make arrangements among themselves, such that, in certain circumstances, smaller and mid-size operators may rely upon financially strong co-lessees or co-owners that agree to allocate BOEM-determined self-insurance to a particular lease, ROW or RUE.

NTL 2016-N01 will implement significantly expanded and more rigorous criteria to evaluate whether, and to what extent, an entity is capable of fulfilling present and future obligations. Lessees and owners will need to provide information to BOEM demonstrating that entity's financial capacity, financial strength, stability, reliability and record of compliance. In brief, BOEM will evaluate:

1. Financial Capacity. BOEM has established minimum thresholds, including but not limited to total debt/equity and total EBITDA, which must be exceeded for BOEM to find that the entity has the financial capacity substantially in excess of existing and anticipated lease and other obligations.
2. Projected Financial Strength. BOEM will examine the estimated value of an entity's OCS lease production and proven reserves of future production.
3. Business Stability. BOEM will base its determination on an entity's five-year record of continuous operation and production on the OCS or onshore.
4. Reliability. BOEM will look to an entity's credit rating from Moody's or Standard & Poor's, or an entity's trade references.
5. Record of Compliance. Finally, BOEM will examine, among other things, whether an entity, its affiliates or subsidiaries, have been assessed civil penalties or citations by agencies with jurisdiction or have been found by BOEM and/or the Bureau of Safety and Environmental Enforcement ("**BSEE**") to be non-compliant with any lease, plan, or permit term or condition.

NTL 2016-N01 eliminates the current program that enables Regional Directors to waive the supplemental bond requirement and replaces it with a policy whereby financially stable entities can self-insure. BOEM will base its determination on the above criteria and other relevant information. In such circumstances, the entity must notify BOEM of the amount of self-insurance, not to exceed 10 percent of its tangible net worth, which the entity will allocate to each lease, ROW, or RUE. For sole liability properties, BOEM will publish on its website the minimum credit rating that an entity must have to be able to self-insure.

Where additional security is required, the burden is on the designated operator to coordinate with lessees to provide the amount of additional security required for each lease. Likewise, the holder-of-record for a RUE or a ROW is required to provide the amount of additional security required for each RUE and ROW, respectively. Parties can provide additional security in the form of surety bonds, a pledge of U.S. Treasury Securities or a tailored financial plan that is approved by BOEM.

Upon receipt of an order to provide a specified amount of additional security, an entity that is solely liable for a property must provide such security within 60 days. For co-lessees and co-owners, additional security must be provided within 120 days of the receipt of an order or as otherwise provided. Under limited circumstances, BOEM may approve a plan that phases-in compliance with the additional security requirement. Under such a tailored plan, lessees and operators would have 360 days to provide the full amount of the required additional security according to a fixed schedule that requires at least one-third (1/3) of the remaining required additional security within three consecutive 120-day intervals. To request the phased-in provision, lessees or operators must submit their proposal as part of a tailored plan.

This NTL applies to all BOEM regions and planning areas. BOEM is giving a sixty day grace period before the NTL will be implemented on September 12, 2016.

Remarkably, BOEM does not indicate that it took into account the continuing liability on the part of all lessees in a lease's chain of title for any P&A and decommissioning liability for wells and facilities installed on that lessee's watch, which has proven in the past to be a fundamental bulwark against public funding of such liabilities.

Many smaller and mid-sized offshore operators may encounter difficulties in providing additional security in compliance with NTL No. 2016-N01, given the economic factors influencing the offshore industry, not least of which are low commodity prices, the current state of the bonding market, and the significantly increased burdens of the current estimates for the costs of P&A and decommissioning. It is noteworthy that this major substantive regulatory action was issued in the form of a purported policy without formal rulemaking and not as a published regulation, as required, in Title 30 of the CFR.

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