Regulatory Considerations for Ensuring Decommissioning & Other Lease Obligations

Bureau of Ocean Energy Management
U.S. Department of the Interior

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Reminder of Underlying Causes of U.S. Offshore Financial Risk Management Concerns

1. Contingent liabilities on the Outer Continental Shelf (OCS) are large and increasing
    - Routine decommissioning related contingent liabilities in the Gulf of Mexico Region (GOMR), are estimated at $40 billion.

2. Existing infrastructure is aging
    - BSEE records indicate approximately 245 platforms currently fit “idle iron” criteria in the GOMR.

3. Characteristics of the types of companies operating on the OCS have changed
    - Large companies transfer sunset properties to smaller, less experienced companies including non-strategic players.

4. Technological advances are outpacing regulations, policies, and programs
    - Outdated bonding regulations (last published in 1993 and 1997)

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BOEM's Financial Assurance Goals

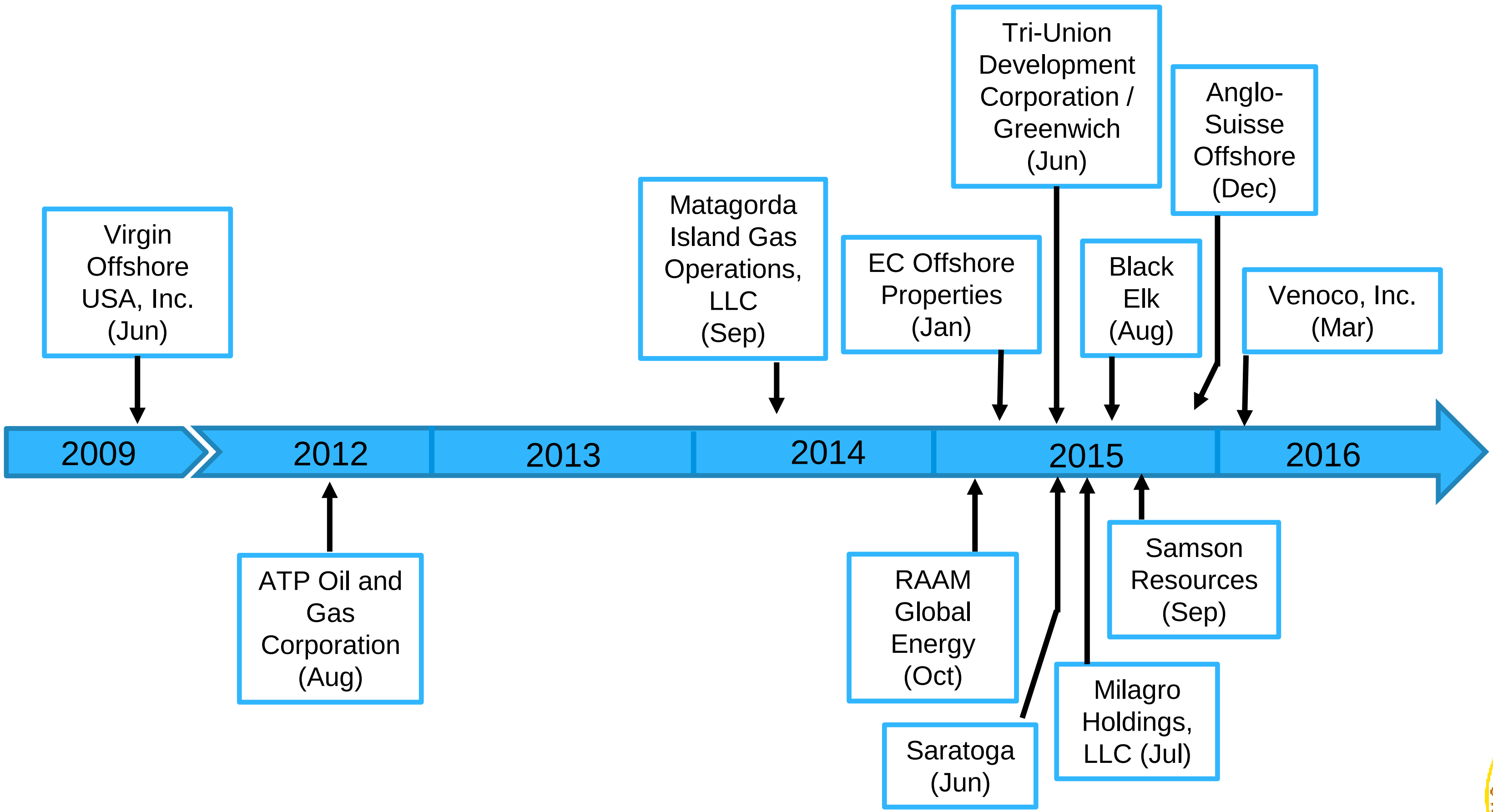
Protect the United States from financial loss or environmental damage when a leaseholder or operator is unable to pay rents and royalties or perform required decommissioning.

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 declining financial 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

Bankruptcy Trends

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



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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:

Lease activity amount	Lease-specific bond amount	Area-wide bond
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

Current BOEM Supplemental Bonding Procedures

- Under BOEM regulation, operating rights holders are jointly and severally responsible for decommissioning along with record title holders.

- 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 if not in compliance.

- Historically, each company was not assessed its full cumulative decommissioning liability on any given lease, RUE or ROW

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 $\leq$ 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 $\leq$ 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

OCS Decommissioning Estimates by Region

($ Billion)		GOM[1]	PAC[2]	AK[3]	Total
Contingent Decommissioning Liabilities	Active Leases	$30.9	$1.5	$0.8	$33.2
	Active RUEs	$0.3	-	-	$0.3
	Active ROWs	$1.7	-	-	$1.7
	Inactive Properties	$5.5	-	-	$5.5
	Total	**$38.4**	**$1.5**	**$0.8**	**$40.7**
Coverage on Decommissioning Liabilities	Supplemental Bonds	$2.2	$0.2	-	$2.4
	Indemnified	$8.7	-	-	$8.7
	Waived	$24.1	$1.3	$0.8	$26.2
	No Coverage	$3.4	-	-	$3.4
	Total	**$38.4**	**$1.5**	**$0.8**	**$40.7**
	% of Liability Bonded	**6%**	**14%**	**0%**	**6%**
	% of Uncollateralized Liability	**94%**	**86%**	**100%**	**94%**

1 Per TIMS database April 2016.

2 2014 PAC decommissioning study.

3 Based on submitted exploration plans.

Sufficiency of Supplemental Bonds

- BSEE is now in the process of reviewing and updating its decommissioning cost assumptions.

- BSEE is providing specific updated cost assessments for supplemental bond determinations under the current NTL.

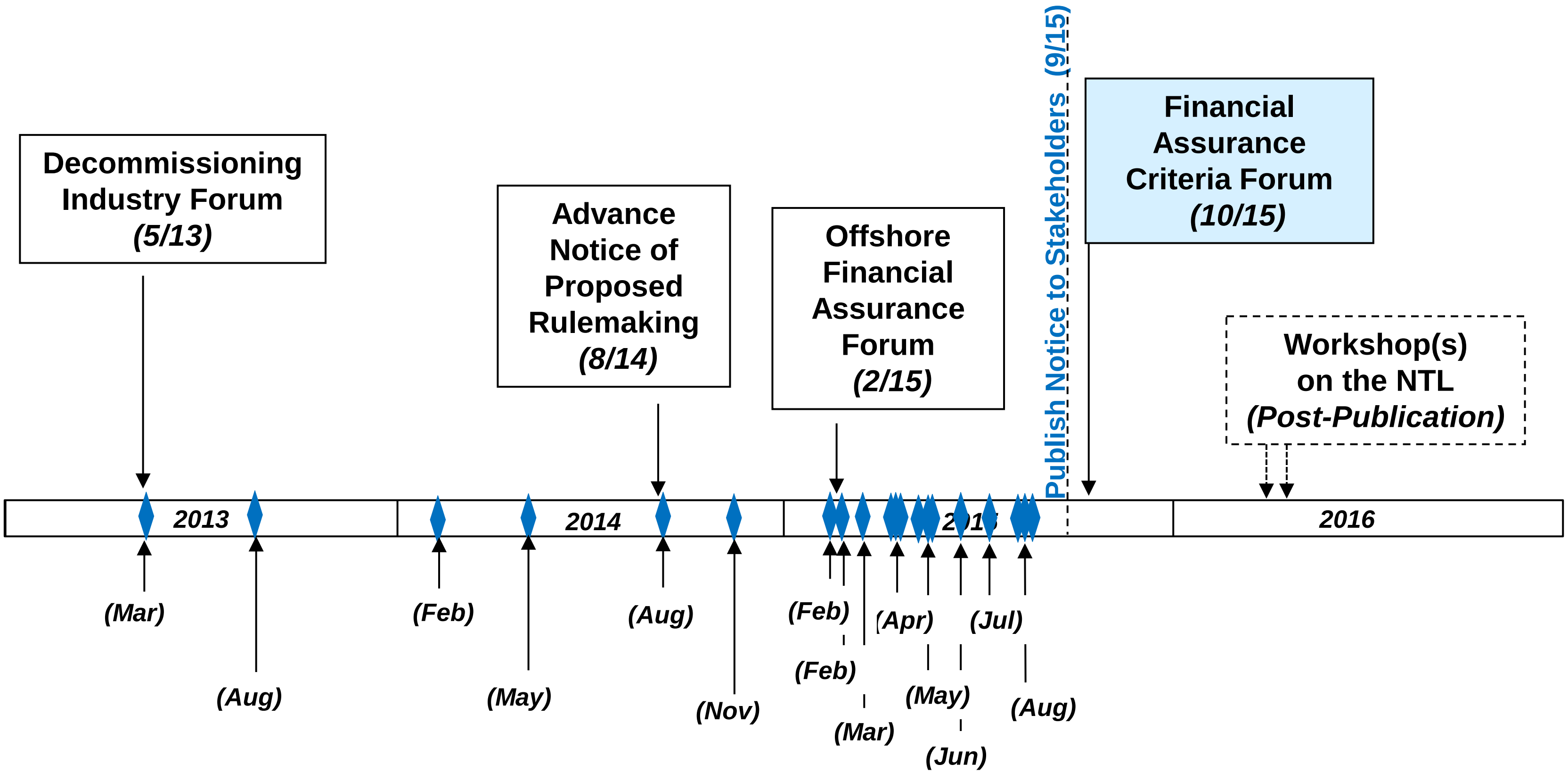
- BSEE expects to complete its update of the costs by this fall and BOEM will use them for supplemental bond determinations (across the board) with the new NTL.

Fundamental 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?

BOEM's On-going Outreach Efforts



BOEM has engaged and will continue to engage industry as it moves forward

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

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Industry Feedback

The use of industry standard metrics to determine financial ability to carry out obligations

Eliminate the concept of other exempt partners in the lease

To self-insure while at the same time employing non-size biased criteria

Use the net liability for each company as opposed to 100% of the liability

Provide for the timely release of bonds

Avoid double-bonding or "redundant bonding"

Increase the number of financial instruments that can be used to provide financial assurance

Although industry's concerns vary depending mainly on the size of the company, there are some common themes.

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Upcoming NTL refers to the Bonding Regulations

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	• Ratings by Moody's or Standard and Poor's; Trade references
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; INCs; Cancelation of Leases; Non-payment/under-payment

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

Financial Assurance Approach

- Financial capacity will be evaluated based on select financial metrics. This will assist in determining if a company is allowed self-insurance, which will not exceed 10% of their tangible net worth.

- The metrics will evaluate
  - Liquidity
  - Coverage
  - Leverage
  - Performance

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Key Proposed Changes to Guideline (NTL)

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 to Guideline (NTL)

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. • BOEM will work with lessees on solutions to reduce "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.

Tailored Plans

- Companies will be able to utilize multiple types of financial assurance to create a tailored plan to meet their additional security requirements.
  - Types of financial assurance set forth in the regulations.
  - Other types of financial assurance permitted through the discretion vested in the Regional Director.
    - Surety bonds
    - U.S. Treasury securities
    - Lease-specific abandonment accounts
    - Third-party indemnity & guarantees
    - Trust agreements
    - Multi-party bonds
    - Letters of Credit
    - Parent guarantee
    - Certificates of deposit
    - Escrow accounts
    - Insurance
    - Other instrument(s) suggested by industry
- Tailored plans will be submitted to BOEM for review and approval by the Regional Director.
- Companies will be encouraged to work with the BOEM while developing their tailored plan.

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 (have predecessors)
   a) Inactive Properties
   b) Active Properties

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

Phased–In Timetable

Upon publication of the updated Supplemental Financial Assurance NTL, if it is determined that additional financial assurance is required, companies will be able to phase-in compliance. A BOEM approved tailored plan may be allowed to be phased in according the following schedule:

- Within 120 calendar days from the date of approval, provide at least one-third (1/3) of the required additional security;
- Within 240 calendar days from the date of approval, provide at least two-thirds (2/3) of the required additional security, and;
- Within 360 calendar days from the date of approval, provide the full amount of the required additional security.

Next Steps – NTL Implementation

BOEM anticipates a lag in implementation of 60-120 days from date of issuance

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

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

Questions