

BOEM Issues NTL Implementing Major Changes to its Financial Security Requirements for the OCS

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JULY 15, 2016

On July 14, 2016, the Bureau of Ocean Energy Management (BOEM) published a long-awaited Notice to Lessees and Operators (NTL) implementing new financial security requirements (NTL No. 2016-N01 dated July 12, 2016). The NTL was issued to “clarify the procedures and criteria that BOEM Regional Directors use to determine if and when additional security ... may be required for Outer Continental Shelf (OCS) leases, pipeline rights-of-way (ROW), and rights-of-use and easement (RUE).” The NTL will become effective on September 12, 2016 and will do away with the past practice of “waiver” of certain OCS decommissioning obligations.

Determining Financial Strength and Reliability:

BOEM determined that “its previously utilized formulas for determining financial strength and reliability are outdated and no longer provide sufficient protection for liabilities incurred during OCS operations.” As a result, each company (which includes owners of record title, owners of operating rights, pipeline ROW holders and RUE holders) will now be responsible for ensuring that all obligations, including decommissioning and abandonment, are satisfied for every lease, ROW or RUE in which the company has an ownership interest or for which a company provides a guarantee.

The Regional Director will determine the financial capacity of each company to carry out its abandonment obligations taking into consideration the company's:

1. Financial Capacity – financial capacity must be substantially in excess of existing and anticipated lease and other obligations, based upon audited financials and other information (as detailed here).

2. Projected Financial Strength – projected financial strength must be substantially in excess of existing and anticipated lease and other obligations taking into consideration both existing production and proven reserves of future production.
3. Business Stability – business stability is based upon five years of continuous operation and production on the OCS or onshore.
4. Reliability – reliability is based upon the company's credit rating from Moody's or Standard and Poor's, or trade references.
5. Record of Compliance – record of compliance applies to the company and any of its affiliates or subsidiaries and takes into account any assessment of civil penalties by BSEE or BOEM, findings or citations of noncompliance by BSEE, BOEM or other agencies, and citations for non-payments or under-payments that have been referred to the U.S. Treasury.

In this determination, BOEM will consider 100% of the decommissioning liability for every lease, ROW and RUE in which a company holds an interest. In the event a company's abandonment obligations exceed its financial capacity as determined by BOEM, then the company will be required to provide additional security.

Determining the Amount of Additional Security:

If the Regional Director determines additional security is required, the Regional Director will either:

1. propose an amount of additional security required, and give the company the opportunity to meet with BOEM, within a specified period of time, to discuss this amount; or
2. order that within a specified period of time, the company provide the required additional security or present to BOEM a tailored plan to meet the additional security requirement.

For sole liability properties, additional security will not be permitted to be phased in. The designated operator is required to coordinate with lessees to provide the amount of additional security required for each lease. The RUE holder-of-record and the ROW holder-of-record are required to provide the amount of additional security required for each RUE and ROW, respectively.

A company has 30 days from receipt of the Regional Director's proposal of the amount of additional security to notify BOEM in writing of any dispute. If no notice of dispute is made within the 30-day period, the Regional Director will issue an order to provide additional security or to present BOEM with a tailored plan to meet the additional security requirement. Additional security must be provided within 60 days of receipt of the order for sole liability properties and

within 120 days of receipt of the order for all other properties (unless notification is provided to BOEM of an intent to submit a tailored plan or as otherwise specified in the order).

Acceptable Forms of Additional Security:

One or more of the following are acceptable to meet the requirement of additional security:

1. Surety Bond(s).
2. Pledge of U.S. Treasury Security(ies).
3. Tailored Financial Plan.

A tailored financial plan may include surety bonds, pledge of U.S. Treasury securities, abandonment accounts, third-party guarantees, any other form of security approved by the Regional Director or a combination of any of the above. BOEM will provide guidance in putting together a tailored plan, if requested. Notice of intent to provide a tailored plan must be provided to BOEM within 10 days of receipt of an order to provide additional security and the plan itself must be submitted for approval within 120 days of receipt of the order (or such other time period as specified in the order).

Self-Insurance:

If additional security is required, the same five categories set out above will be used by the Regional Director to determine whether the company will be permitted to self-insure all or part of the additional security obligations. Self-insurance (which was capped at 50% of a company's net worth) will be a maximum of 10% of tangible net worth. Given the significant recent decline in the price of oil and the resulting decline in the net worth of many oil companies, the new 10% cap could significantly reduce the number of companies that will have the ability to self-insure. The Regional Director may determine, based on a company's credit rating, that the company cannot apply self-insurance to sole liability properties.

For a company to meet all or a portion of its additional security, it may be possible for the company to make arrangements to rely upon financially strong co-lessees or co-owners who agree to allocate self-insurance to the co-owned lease, ROW or RUE.

Timing for Compliance with Additional Security Requirement:

As part of a tailored plan approved by BSEE, it is possible to phase in additional security according to the following schedule (unless varied by the Regional Director):

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

When the Regional Director will Evaluate Financial Ability:

The Regional Director will evaluate companies annually to determine whether additional security is required based upon a company's financial ability to carry out present and future obligations.

In addition, the Regional Director, in his or her discretion, may at any time review a company's financial ability. Per the NTL, the following events will likely trigger such a review:

- Material or adverse change in a company's financial strength or OCS obligations;
- Performance deficiencies, such as incidents of noncompliance, civil penalties or failure to adhere to any term or condition of, or obligation imposed by, a lease, exploration or development and production plan, development operations coordination document, or permit;
- Change in operator or ownership; or
- Violation of Department of the Interior or other applicable regulations.

When the NTL becomes effective on September 12, 2016, it will replace and supersede the current supplemental bonding regime, as detailed in NTL No. 2008-N07. The NTL will apply to all BOEM regions. As we noted in blog posts last fall and last spring, this NTL follows the February 2015 BOEM Financial Assurance Forum and a March 2015 meeting between BOEM staff and several lawyers who focus on OCS regulatory matters, including Gordon Arata Montgomery Barnett attorneys. If you have any questions about this NTL, please contact Cynthia Nicholson, Peck Hayne or Peggy Welsh.