



BOEM Releases Proposed Rule on Supplemental Financial Assurance for OCS Lease and Grant Obligations

Update

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On June 29, 2023, the Department of Interior's Bureau of Ocean Energy Management (BOEM) published a proposed rule that, if adopted, would substantially revise the financial assurance requirements applicable to offshore oil and gas operations.^[1] The proposed rule is designed to address BOEM's concern that under its current financial assurance regulations, taxpayers are vulnerable to "bearing the cost of facility decommissioning and other financial risks" associated with oil and gas development on the Outer-Continental Shelf (OCS). The proposed rule would change the current criteria used to determine whether OCS lease and grant holders are required to secure supplemental financial assurance. If adopted, BOEM estimates that "the aggregate amount of supplemental financial assurance required of lessees and grant holders . . . would increase by an estimated \$9.2 billion over current levels."

BOEM's proposal signals the federal government's latest attempt to ensure operators possess adequate financial assurance to cover the decommissioning of oil and gas assets on the OCS. BOEM states that it "has opted to issue this new notice of proposed rulemaking to better protect the taxpayer from bearing the cost of facility decommissioning and other financial risks associated with OCS development, such as oil spill cleanup or other environmental remediation."^[2] Comments on the proposed rule are due by August 28, 2023.

The History of BOEM's Financial Assurance Regulations

BOEM's current financial assurance regulatory framework consists of two main parts: (1) base bonds, generally required in amounts prescribed in the regulations; and (2) supplemental financial assurance, which is an amount

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above the base bond that is required at the agency's discretion to ensure a lessee or grant holder can fulfill its contractual and regulatory obligations.

The existing supplemental financial assurance requirements imposed on lessees and grant holders are set out in 30 C.F.R. §§ 556.901(d)(1)(i)-(v). Under the current regulations, BOEM considers five criteria to assess whether a lessee or grant holder is required to obtain supplemental financial assurance: (1) financial capacity; (2) projected financial strength; (3) business stability; (4) reliability in meeting obligations based upon credit rating or trade references; and (5) record of compliance with laws, regulations, and lease terms. Additionally, BOEM provides further guidance on how it analyzes the five criteria through its issuance of Notices to Lessees (NTLs). In 2016, BOEM issued NTL 2016-N01 which aimed to remedy perceived weaknesses in its financial assurance regulatory framework in the wake of multiple bankruptcies across the oil and gas industry. The 2016 NTL sought to use net worth as a measure of a lessee's financial strength, and thus, as a key factor to determine whether a lessee needed to acquire supplemental financial assurance. BOEM ultimately rescinded the 2016 NTL before it was fully implemented and announced its plans to further develop supplemental financial assurance guidelines.

In 2020, BOEM and the Bureau of Safety and Environmental Enforcement (BSEE) issued a joint proposed rule, which set out to revise BOEM's financial assurance regulations and BSEE's policies concerning decommissioning orders. The 2020 proposed rule proposed that BOEM look to credit rating and valuations of proved reserves to assess whether supplemental financial assurance was necessary. The 2020 joint proposed rule proposed a credit rating threshold of BB from S&P Global Ratings (S&P) or Ba3 from Moody's Investor Service (Moody's) and contemplated waiving supplemental financial assurance for lessees when predecessors had strong credit ratings. After receiving substantial comments and input from the industry and other stakeholders, the agencies announced their intention to split the 2020 joint proposed rule into two separate rulemakings. BOEM declined to carry its portion of the 2020 joint proposed rule forward, while BSEE finalized its portion in a final rule published earlier this year.

BOEM's 2023 Proposed Rule

Like the 2020 joint proposed rule, BOEM's 2023 proposed rule proposes to assess whether an OCS lessee or grant holder is required to obtain supplemental financial assurance based on: (1) credit rating; and (2) valuations of proved oil reserves. Using these two criteria, BOEM would not require financial assurance in three cases: (1) where a lessee has an investment grade credit rating (i.e., a credit rating from an NRSRO that is greater than or equal to either BBB- from S&P or Baa3 from Moody's, or its equivalent); (2) where there

are multiple co-lessees on a lease and any one of those lessees meets the credit rating threshold; and (3) for any lease on which all lessees are rated below investment grade, where the value of the lease's proved oil and gas reserves is three times that of the decommissioning cost estimate.

- **Credit Rating:** BOEM proposes to accept two forms of credit ratings: (1) a credit rating from an NRSRO; or (2) a proxy credit rating that BOEM determines based on a company's audited financial statements. To determine proxy credit ratings, BOEM proposes to use S&P Global's Credit Analytics credit model. However, BOEM also proposes to reserve the right to use a different model if it believes that model will more accurately reflect the true credit rating. As a threshold, BOEM would not require a company to secure supplemental financial assurance if it has an investment grade credit rating (i.e., a credit rating from an NRSRO that is greater than or equal to either BBB- from S&P or Baa3 from Moody's, or its equivalent).
- **Valuations of Proved Oil and Gas Reserves:** BOEM proposes to use a reserve report determined under the SEC's accounting and reporting standards to provide the value of proved oil and gas reserves per lease. If BOEM determines that the "value of the reserves on any given lease exceeds three times the cost of the decommissioning estimate associated with the production of those reserves," then BOEM would not require that company to secure supplemental financial assurance. Additionally, BOEM would use BSEE's P70 decommissioning cost estimate (a value that BSEE determines to have a 70 percent chance of recovering the full decommissioning cost) as the figure to represent the decommissioning cost. BSEE's P70 decommissioning cost estimate will also be used to determine the amount of financial assurance that each company is to secure if it is required to do so.
- **Phased Compliance:** Since the proposed rule would mark a major revision of existing financial assurance regulation, BOEM proposes to phase in compliance over a three-year period. BOEM would initially require a company that receives a supplemental financial assurance demand to provide "one third of the total amount by the deadline listed on the demand letter." BOEM would then require a second one third "within 24 months of the receipt of the demand letter," and the final one third payment "within 36 months of the receipt of the demand letter."

BOEM's proposed rule would also make what the agency refers to as "less significant changes," including providing more specific bonding requirements for offshore rights-of-use and easements; removing restrictions on the use of third-party guarantees and providing lessees and grant holders with more flexibility to use third-party guarantees as supplemental financial assurance; and adding new criteria for the cancellation of third-party guarantees.

Comments on the proposed rule are due by August 28, 2023. Feel free to contact us with questions about how this may impact your business.

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**Bracewell summer associate Jacob Brandes provided invaluable assistance with this client alert.*

[1] Risk Management and Financial Assurance for OCS Lease and Grant Obligations, 88 Fed. Reg. 42136, 42176 (June 29, 2023).

[2] *Id.*