

# OPERATORS LOOKING FOR CLARITY ON NEW GULF OF MEXICO REGULATIONS

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## **There is tension between Gulf of Mexico operators and the U.S. Department of Interior's two offshore governing bodies following the recent modifications to cost-reporting and financial-assurance regulations.**

The Bureau of Safety and Environmental Enforcement (BSEE) and Bureau of Ocean Energy Management (BOEM) have tightened their rules in an effort to protect federal taxpayers from footing an estimated \$33 billion in future decommissioning costs. Under regulation 30 CFR § 250.1704 (i), effective from January 2016, BSEE is requiring asset owners to submit all decommissioning-related expenditure, including plugged wells, platforms removed, or sites cleared, within 120 days of completion. Over time, BSEE intend to use the data gathered to adjust their assigned decommissioning obligation estimates for the purpose of BOEM financial liability enforcement.

BOEM previously granted exemptions for lessee requirements to provide supplementary assurance in the form of bonds, letters of credit, third-party guarantees and other alternative forms of collateral based on sufficient company net worth and financial strength. The old rule that often presumed the financial health of larger players allowed them to receive supplementary bonding exemptions that helped them to avoid often costly methods of external collateral. The exemptions were applicable to any lessee with a net worth greater than or equal to \$65 million or with a decommissioning liability less than 50% of net worth. Under NTL 2016-N01, effective since September 12, 2016, BOEM will require all operators to seek supplementary bonding to cover decommissioning debts, regardless of net worth. It has also reduced the self-insurance contribution toward decommissioning liability from 50% of 'tangible' net worth to a theoretical limit of 10%, but in practice adjusted lower via credit rating. The remaining 90% of the total assigned liability formulated using BSEE estimates will need to be topped up with available forms of supplemental bonding to cover 100% of the cost.

Gary Siems, Vice President of Decommissioning at Montco Oilfield Contractors believes the BSEE and BOEM regulations add financial and bureaucratic pressure on already strained operator resources. Since the BOEM notice to lessees (NTL) was announced in July, Siems says the industry has been scrambling to put up assurances in time for next September, when all lessees must be compliant. Many have questioned the timing of such regulations at a time when the market is struggling. The long-term impact on exploration and production in the GoM is a key concern, as is a heightened risk of insolvency caused by needing to provide assurances upfront. Opportune LLP, an energy-focused management consultancy, has calculated that the offshore and oilfield-services industry could lose about \$9 billion in future revenues as a direct result of the NTL. John Sherman, a partner at the firm, has called it "an overreaching regulation that attempts to solve a non-existent problem".

## Issues with privacy and Paperwork

Another concern for the industry is protection of private and confidential information. By having to submit expenditures, it is feared that trade secrets between operators and contractors may be exposed – and strip certain operators of their competitive advantage.

BSEE has addressed these concerns by stating that all information will be handled in accordance with the Freedom of Information Act (FOIA). However, Glenn Legge, Partner at Legge Farrow Kimmitt Mcgrath & Brown, says the FOIA has limitations. “Unfortunately, our FOIA is not an impermeable barrier to third parties making requests for additional information not present in the public record,” Legge said. In the event that certain information may be helpful for making future bids, he added, the FOIA is not an absolute guarantee against information discovered by parties filing requests under the same act. BSEE’s pledge to protect confidential cost data provided in summaries under the FOIA was not explicitly stated to also protect the private information provided by additional supporting documents, he further argued.

Another key concern is the additional manpower and administrative effort required to compile and submit all expenditure summaries within four months of completing decommissioning activity. Legge says the financial cost of increased administration should be insignificant so long as the operator already has good financial-accounting practices and that its departments are equipped to take on the extra load.

BSEE has equated the act of submitting expenditure summaries to an additional burden of one hour per decommissioning activity and a total of 500 additional hours per year. It did not include in this estimate the time required to contest BSEE’s decision, which could involve several months of negotiations between the operator and the regulator.

A further concern raised by Legge on behalf of GoM operators is a potential inconsistency in the submissions from company to company. The NTL did not prescribe a type and format of acceptable submissions, meaning that frequent requests for additional supporting documentation is likely – again posing a strain on time and internal resources.

## Determining accuracy of estimates

One thing regulators and operators could both benefit from is clarity around decommissioning costs. Until now, Legge says, cost estimates have largely come from private-sector consultancies. The question of accuracy has always been a concern for players, particularly as there have been very few cases of deep water decommissioning to base these estimates on.

According to Larry Johnson, Principle Global Decommissioning Engineer at BHP Billiton, BSEE revealed its estimation methodology at an operator workshop in July and August. BSEE clarified how and why it assigns a higher liability estimate than operators carry for internal provisions, Johnson said. For example, he explained that BSEE assumes standalone costs for each and every well and pipeline segment submitted by operators, including future wells and lines that were submitted but never installed. BSEE also estimates that wells are plugged on a well-by-well basis, whereas operators plan for abandonment by campaign, with mobilization and demobilization of shared vessels.

BSEE will need to put in considerable time and effort to gather enough of the actual costs from operators under the NTL to enable it to adjust its current assigned cost per well and pipeline segment, Johnson commented. He proposes that operators assist BSEE by providing duration estimates for activities by common component type and by including information on their planned internal methods. BSEE could then adjust contingencies to those activity durations and assign third-party pricing to arrive at its “bankruptcy” liability estimate, he says. Johnson recently met with BSEE’s Pipeline Section, and he was advised that BSEE would welcome operator estimates by pipeline segment type. BSEE’s existing estimation algorithm is based solely on physical length, diameter, and distance from shore; it does not account for the different decommissioning activities between risers from host to seabed, and other segments already on the seabed. According to Johnson, not assigning standard unit costs to segments left in-situ, or to future segments that were never installed, could materially reduce assigned pipeline liabilities. BSEE also reminded operators that in addition to removing hydrocarbons, umbilicals should be abandoned after flushing certain fluids injected into wells, Johnson said.

In the short term, estimates and actual costs are likely to differ due to a lack of deepwater decommissioning experience in the GoM. As more decommissioning work is completed and more costs are declared, the accuracy of estimates will improve over time, Legge said, resulting in future estimates that more closely resemble the actual cost of abandonment work left to be performed in the basin. “This will be a dynamic learning process for both industry and regulators as estimates will be formed as work proceeds,” he noted.

Another point to note is that estimates made today may not reflect cost-reducing technologies that are introduced in future. Michael Celata, BOEM’s Regional Director for the Gulf of Mexico, acknowledged in a recent presentation that “technological advances are outpacing regulations, policies and programs.”

Legge, in defence of BSEE, said that requesting expenditure summaries is the most effective path to calculating true cost estimates. He also commented that BOEM and BSEE are open to communicating with industry players, as demonstrated by a recent forum on cost accuracy. BOEM has encouraged players to challenge assigned liabilities within 30 days of receipt of notice. Furthermore, it has expressed a willingness to assess what is working well and what is not as the regulations are enforced over the coming years.

### Tailored plans offer way forward

The recent regulations present stumbling blocks for smaller or cash-strapped operators. Should a small company have a parent company that is financially competent, they are able to request leverage from them in the form of third-party guarantees in place of their own inability to self-insure. But without that form of protection, smaller operators will be at risk of being unable to pay for supplementary bonds and of defaulting on their obligation. For parent companies, providing these guarantees will affect their own debt ratio and borrowing power. As this shows up on annual company reports, there could be significant consequences as far as shareholders are concerned. Legge said the regulators are somewhat cautious about third-party guarantees as they may ultimately lead back to an unstable entity offering questionable financial support or liquidity.

BOEM are accepting tailored plans as forms of supplemental bonding that better suit the demands of the operator. Legge recalled that while sharing a panel with Celata and Jim Christie, Head of Decommissioning for the UK Oil & Gas Authority, at DecomWorld's 2016 Decommissioning and Abandonment Summit, the three men discussed the regulators' interest in obtaining "functional and reasonable security and methods of assembling financial assurance that met the regulation requirements."

He says the initial thought behind tailored plans was that the current bond market would not be sufficient to accomplish the task of providing the vast majority of assurance needed by regulators on behalf of operators. This opportunity to think outside of the box has called for exploring the potential of insurance markets to provide security, like the insurance packages already offered in the UK. Commercial insurance can play an important role in financial assurance, particularly as it acts similarly to tailored bonds, and as the current market is relatively soft it may be a good time to consider their effectiveness.

Tailored plans offer a very open approach and real opportunity for financial creativity. Legge doesn't believe that any financial arrangement or combination is strictly off limits at this stage. He advises that operators and regulators make sure there is mutual understanding about the various financial mechanisms. Another source told DecomWorld that some lawyers and financial advisors are recommending the use of treasury bonds over private third-party bonds due to the 2-3% interest that can be earned on a treasury bond, which can be used to offset payments for other financial instruments. Legge recommended that operators be brave enough to suggest "different or innovative" solutions that just might meet BOEM requirements and satisfy their own financial concerns.

All up, Legge understands BOEM's desire to change financial assurance programs, and he said the regulators have learned a great deal since the insolvency of ATP Oil and Gas in 2012 and the oil-price crash.

He said, "We don't like to embark on large-scale problem-solving issues until there has been a catalyst event that energizes us to move in that direction. BOEM's regulations present the catalyst and fertile ground for innovation that can significantly offset this bureaucratic burden."

Speaking again with DecomWorld following Donald Trump's victory in the U.S. presidential elections, Legge commented, "Although it is too early to determine the impact that the presidential election will have on the offshore regulations, we hope that BOEM will be open to innovative tailored plans that may be secured with new types of financial resources."

By Sayo Rotimi



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