GULF ENERGY ALLIANCE

Supporting policies and regulations that encourage investment, innovation, and job creation in the offshore industry in the Gulf of Mexico

OMB/OIRA Meeting Materials
February 21, 2024

GULF ENERGY ALLIANCE

The Gulf Energy Alliance & Alliance Partners

- Independent producers and small businesses exclusively focused on the Gulf of Mexico
- Formed in 2016 in response to existential threat posed by the Bureau of Ocean Energy Management's NTL 2016-N01 to work with regulators, elected officials, and other stakeholders to develop a reasonable framework for financial assurance requirements that protects US taxpayers and allows for a viable and thriving offshore oil and natural gas industry
- Vast supply chains across the Gulf Coast and US, employing tens of thousands of people in Disadvantaged Communities (DACs) across the country according to the White House Climate and Economic Justice Screening Tool*

LOGA
LOUISIANA OIL & GAS ASSOCIATION

IPAA
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

US Oil & Gas Association
ADVOCATE FOR THE OIL & GAS INDUSTRY
SINCE 1917

SOUTHEAST OIL & GAS ASSOCIATION

MISSISSIPPI ENERGY INSTITUTE

* Source: Counsel on Environmental Quality's Climate and Economic Justice Screening Tool found at Explore the map - Climate & Economic Justice Screening Tool (geoplatform.gov).

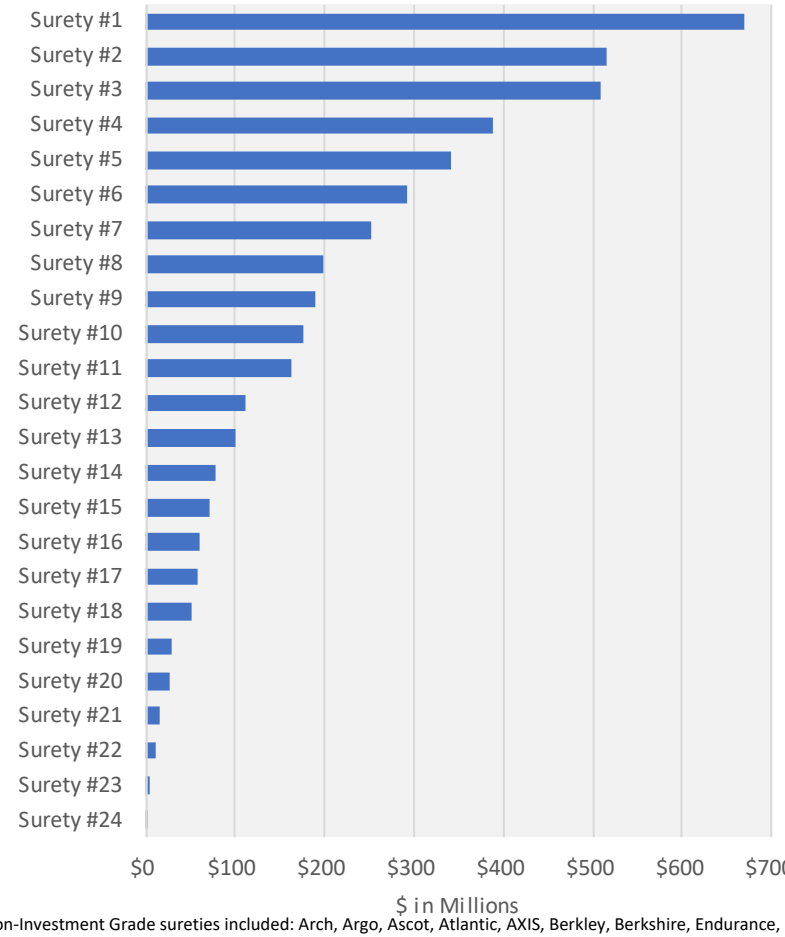
Summary

1. **The Surety Market Will Not Support the Proposed Rule**
2. **BOEM's "Solution" is Radically Disproportionate to the "Problem"**
3. **Cost-Benefit Analysis is Deeply Flawed**
4. **BOEM Failed to Consider Reasonable Alternatives**

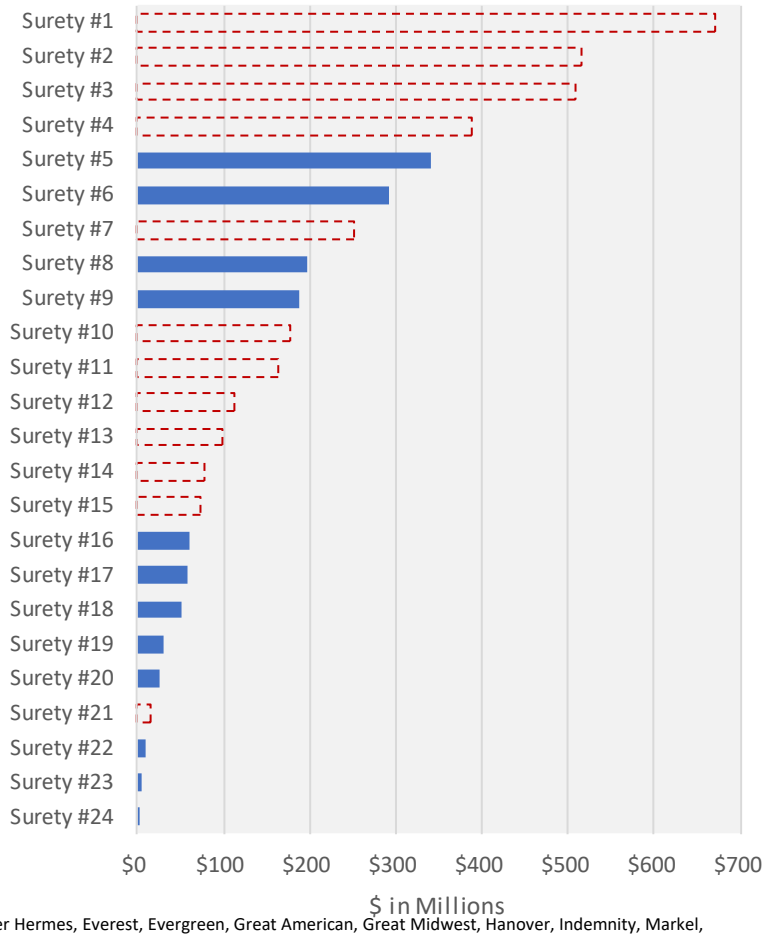
As proposed, BOEM's rule **Will Fail**
to protect the taxpayer as it is **Unworkable**
Whereas a targeted solution focused on
Actual Taxpayer Risk, i.e. Sole Liability
would be supported by **Existing Surety Markets**

1. Surety Market Will Not Support the Rule

Pre-Fieldwood / Cox Bankruptcies
24 Sureties
Treasury Listing of $4.3 Billion



Today
12 Sureties
Treasury Listing of $1.3 Billion



Non-Investment Grade sureties included: Arch, Argo, Ascot, Atlantic, AXIS, Berkley, Berkshire, Endurance, Euler Hermes, Everest, Evergreen, Great American, Great Midwest, Hanover, Indemnity, Markel, Pennsylvania, Philadelphia, RLI, SiriusPoint, US Fire, US Specialty, XL Re, Zurich

Source: GOM Energy Surety Brokers

1. Surety Market Will Not Support the Rule

CAC Specialty™

~$2 Billion of Surety Losses in Recent Bankruptcies

CAC is a specialty broker that places in excess of $1 billion of sub-investment grade Gulf of Mexico bonds

- BOEM cites surety as the source for the $9.2 billion increase to financial assurance, however, sureties are not obligated to commit funds
- The bond increase comes on the heels of some of the largest related surety losses in history (~$2 billion)
- **"Like a Greek Tragedy, the BOEM's actions could expedite the outcomes it wished to avoid"**

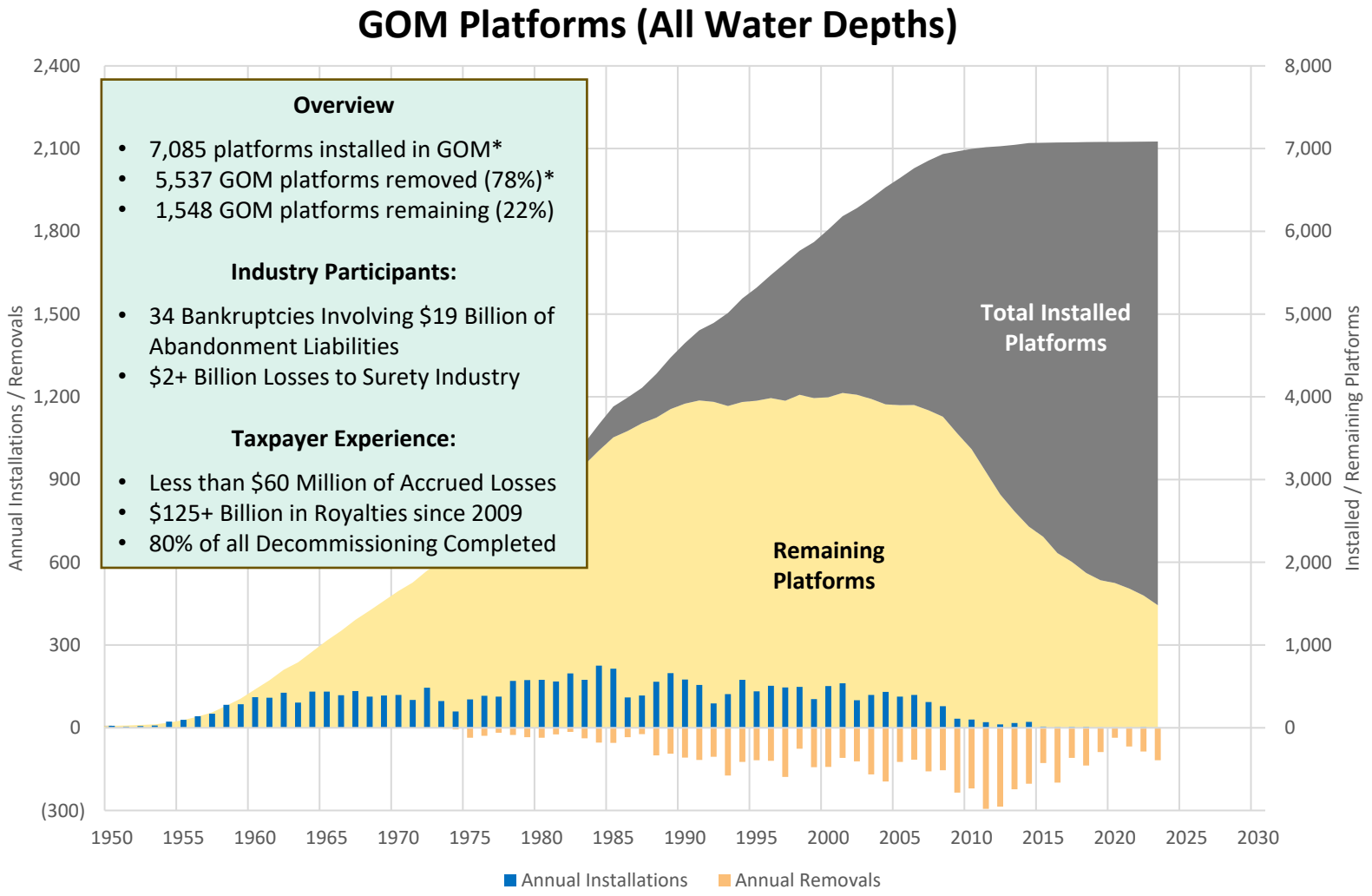
SFAA THE SURETY & FIDELITY ASSOCIATION OF AMERICA

Higher Pricing **Will Not** Increase Surety Capacity

SFAA represents 98% of available surety bond market capacity

- BOEM estimates surety pricing to range from 2% to 12%, ***but sureties do not price based on pooled expected loss levels***
- Unlike insurance, where risk is pooled and premium calculated to cover the anticipated losses from the risk profile of the policyholders in the pool, ***surety companies underwrite risks based on a single credit with an expectation of zero losses***

2. BOEM's "Solution" is Radically Disproportionate to the "Problem"



Install / Removal data through Jul-23

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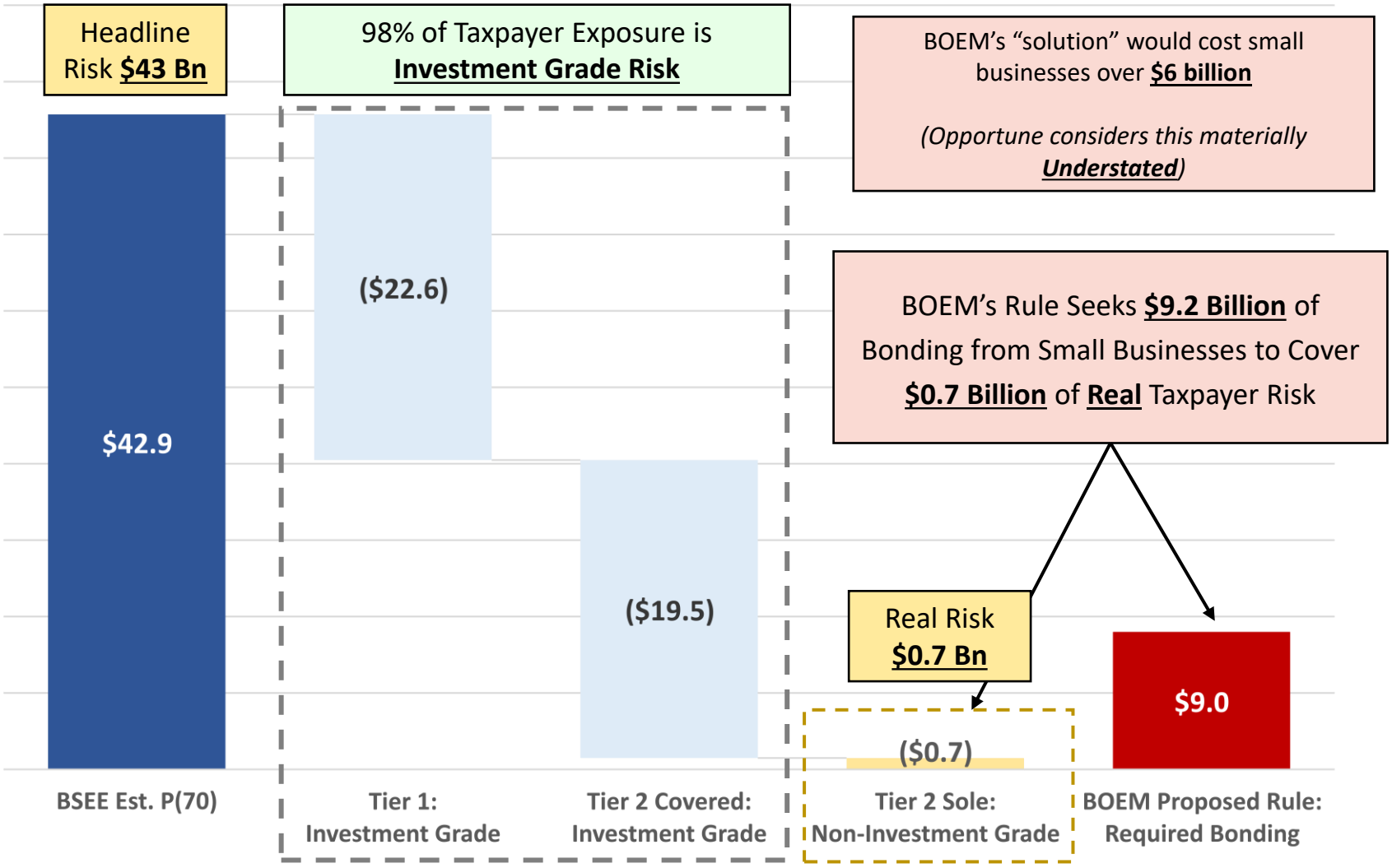


Source: BOEM Proposed Financial Assurance Rule

2. BOEM's "Solution" is Radically Disproportionate to the "Problem"

- Since 2009, there have been 30+ bankruptcies of offshore oil and gas lessees involving decommissioning liabilities of ~$19 Billion, resulting in < 0.4% going to U.S. Taxpayers
- Since 2009, GOM production has generated over **$125 billion** in royalties and other revenues (lease bonuses, rentals, etc.) for the U.S. Treasury
- **Fieldwood Bankruptcy**
  - ~$9 billion in Total Abandonment Obligations
  - 84% Assumed by Predecessors
  - 16% assumed by NewCo
  - **$0 to US Taxpayers**
- **Cox Bankruptcy**
  - 2020 Proposed Rule, if enacted and enforced, would have protected taxpayer from any uncovered liabilities that may result from Cox bankruptcy
  - Existing enforcement tools could have prevented potential taxpayer exposure to Cox liability
  - Predecessors voluntarily accepting joint and several liability – again demonstrating that joint and several liability is an important and effective tool for efficient protection of taxpayer

3. Cost-Benefit Analysis is Deeply Flawed

OPPORTUNE

Opportune is a leading global business advisory firm for the energy industry

- **Taxpayer Risks are Overstated**
  - Taxpayer Historical Accrued Losses: < $60 MM
  - BOEM Potential Taxpayer Exposure: $750 Million (Sole Liability Properties)
  - BOEM "Taxpayer" Solution: $9.2 Billion of New Bonds
- **Compliance Costs are Understated**
  - BOEM's Compliance Costs: $5.7 Billion
  - **Opportune' s Calculated Compliance Cost: $11.2 Billion**
    - Opportune used market cost of capital, rather than assuming 1.75% was universally available

Credit Rating	BOEM: Assumed Collateral Cost	Opportune: Assumed Collateral Cost	Opportune Notes:
US Treasuries		4.1% - 5.4%	3-mo to 10-yr
AAA to A-	1.75%	5.0%	Debt
BBB+ to BBB-	1.75%	6.2%	Debt
BB+ to BB-	1.75%	7.7%	Debt
B+ to B-	1.75%	11.1%	Debt
CCC+ and below	1.75%	25.0%	Largely equity

3. Cost-Benefit Analysis is Deeply Flawed

- BOEM Misapplies the S&P Cumulative Historical BB- Default Rates
  - BOEM cites one-year and five-year default rates of 1.2% and 9.03% but failed to consider historical recovery rates
  - Company default does not mean a total loss, as the historical S&P recovery rate is over 65%
- OCS recovery rates on decommissioning are almost 100%
  - Only .4% of offshore decommissioning liabilities since 2009 were not recovered

3. Cost-Benefit Analysis is Deeply Flawed

- **Opportune 10-Year Projection of Impacts of Proposed Rule:***
  - Decrease in oil and gas production of **55 million barrels of oil equivalent** from the US Gulf of Mexico
  - Destruction of **36,000 good-paying jobs**, particularly in the Gulf South
  - Loss of **$573 million in royalties** to the federal government
  - Reduction of Gross Domestic Product of **$9.9 billion** mostly in Gulf South and in disadvantaged communities (DACs)
- **Proposed Rule Will Jeopardize Taxpayers and the Environment by Making Future Abandonments and Bankruptcies More Likely**
  - **"Run on the Bank"** – Requiring large amounts of new bonds in already tight market will likely cause near-term financial distress and force many companies to seek bankruptcy protection due to sureties demanding collateral
  - Will **accelerate defaults** by independent producers who are unable to secure the required bonding due to lack of surety capacity, increasing decommissioning exposure to predecessors
  - Financially sound independent operators **will be impaired by substantial compliance costs** of Proposed Rule
  - New bonding **will impair the collateral** used to secure decommissioning liabilities by decreasing future cash flows related to those assets, meaning less cash for GOM investments and **less cash available for decommissioning**

* Assumes oil price of $61 per barrel of oil equivalent (boe) and finding and development costs of $25/boe.

Source: Opportune Study, "A Cost-Benefit Analysis of Increased OCS Bonding," July 13, 2023.

4. BOEM Failed to Consider Reasonable Alternatives

1. **Proposed rule protects large companies at expense of small companies**
   - Small, independent operators are unable to supply duplicative collateral
2. **BOEM should narrowly tailor its rule to the …liability of actual concern**
   - i.e., "Sole Liability Properties"
3. **Joint and several liability protects taxpayers**
   - Ensures predecessors cannot shed liability and will engage in due diligence
   - "Moral hazard" not a reasonable concern and does not justify ignoring existing market arrangements for allocating risk and liability (i.e., the joint and several liability framework)

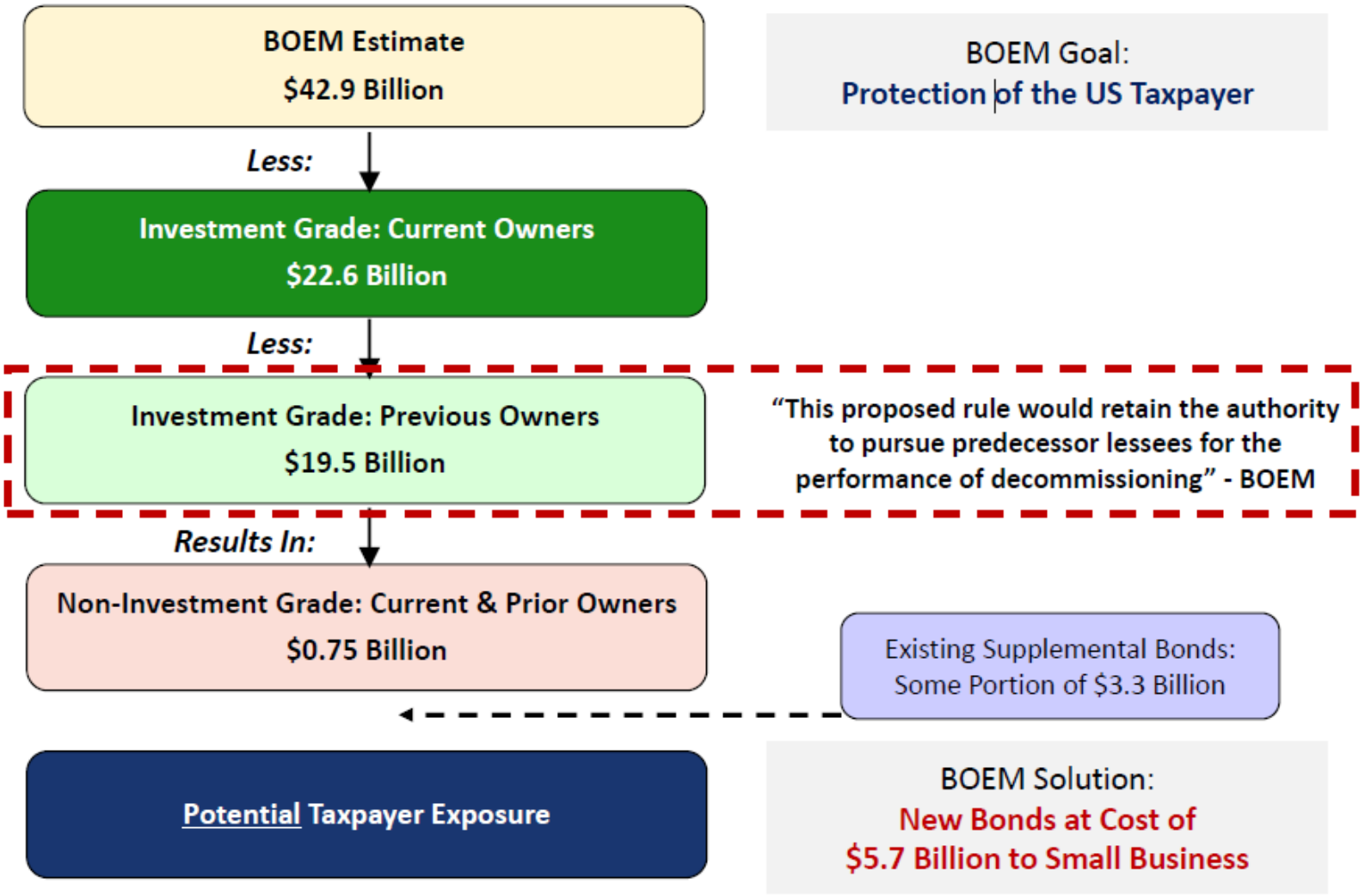
"BOEM's analysis intentionally ignores joint and several liability as the way that the taxpayers are protected from these unfunded liabilities. It presumes that these small businesses impose a significant risk to the taxpayer despite the full backing of companies that BOEM has exempted. As a result, small businesses are not only disproportionately harmed by the proposal, ***but only small businesses are harmed by the proposal.***"

4. BOEM Failed to Consider Reasonable Alternatives

- **A "Solution in Search of a Problem"**
  - BOEM recites a salutary objective: **protecting the American taxpayer** from having to maintain and decommission orphan wells on the OCS
  - BOEM's cost-benefit analysis is inadequate and fails to justify proposed "solution"
- **Spending a Dollar to Save a Dime: "Proposed Rule isn't worth it"**
  - BOEM has committed the cardinal error of regulators, spending a dollar to save a dime
  - BOEM must know that the costs and benefits of its Proposed Rule are blatantly lopsided
- **The Proposed Rule Ignores Joint and Several Liability**
  - "Moral hazard" justification a red herring

"Indeed, it is Louisiana's view that supplemental bonding is unnecessary. So long as a creditworthy party exists in the chain of title—there exists no meaningful decommissioning burden on the federal government."

4. BOEM Failed to Consider Reasonable Alternatives



4. BOEM Failed to Consider Reasonable Alternatives

- **Focus on Protecting the Taxpayer:**
  - The GEA has always been absolutely committed to the principle that taxpayers should never be responsible for decommissioning liabilities
  - The government should not interfere with private contracts; the Proposed Rule allows major oil and gas companies to re-trade private commercial transactions to secure contingent liabilities they clearly understood (otherwise, sellers would not require private security from buyers)
- **BOEM Should Withdraw the Proposed Rule and conduct a real and accurate cost-benefit analysis focusing on:**
  - Actual compliance costs and reasonably available regulatory alternatives
  - Capability of surety market to meet requirements of Proposed Rule
  - Clarification that bonds are intended exclusively for protection of taxpayer (rather than merely protecting "Big Oil") by having new bonds callable only after default of predecessors and exhaustion of existing security
  - Regulatory alternatives that do not discriminate against small businesses

A Calibrated & **Workable** Financial Assurance Framework

1. **Focus on actual taxpayer risk – "Sole Liability Properties"**
   - "Sole liability Properties" are those without a Tier 1 counterparty in the chain-of-title as either a predecessor or co-lessee
   - Provide mechanism for Operators to request P&A cost revisions to BSEE decommissioning estimates for wells and facilities and use alternate P&A abandonment costs verified by qualified third-party engineering/cost estimation protocols
     - Operators with a sufficient portfolio of assets (>10) should be allowed to use the aggregate of individual P50 cost estimates
   - Release financial security collected on properties that do not qualify as "sole liability" properties
   - Clarify that new bonds callable only after default of predecessors and co-owners – i.e., **"Taxpayer Protection Bonds"**

2. **Define other high-risk property types which may require supplemental bonding**
   - OCS properties on which new infrastructure has been installed by current owner(s) since being assigned the lease
   - OCS properties with no current owner(s) and no prior owner(s) in the chain-of-title with sufficient capacity to perform P&A in the event of default

3. **Exemption Criteria for New Supplemental Bonding**
   - Lower the Tier 1 credit rating threshold to BB- to account for S&P default and recovery rates
   - Exempt properties with at least one Tier 1 current owner or where there is a Tier 1 predecessor
   - No supplemental bonding required on properties with sufficient reserves (NPV of lease reserves >3X decommissioning estimate)
   - Provide waivers for assets with private security in place to cover decommissioning liability

Appendix

OMB/OIRA Questions to BOEM

- **OMB/OIRA Question**: "For transparency suggest BOEM also include the total liability currently outstanding in the OCS" and "See comment above – do you have figures on actual past costs to taxpayers?"
  - **Answer**: *BOEM provided no figures for total liability/currently outstanding liability provided, nor any figures on actual costs to taxpayers.*
- **OMB/OIRA Question**: "Suggest adding a short description of the substantive rationale for the change in course [in rejecting reliance on joint and several liability regime and 2020 Proposed Rule reliance on bonding for "sole liability" properties]" and "Suggest adding a substantive rationale for this [rejection of 2020 Proposed Rule".
  - **Answer:** *BOEM provided no description or rationale provided other than to suggest that reliance on joint and several liability would create a "moral hazard"; in addition, BOEM provided no "substantive rationale" for its abandonment of the 2020 Proposed Rule.*
- **OMB/OIRA** Question: "Do you have any numbers about how often taxpayers have been left to pay for OCS decommissioning or environmental response costs because of a lack of bonding, or what the cumulative price tag has been? The text above gives the $7.5 billion figure, but then explains why this amount does not reflect the actual decommissioning costs that have been incurred by taxpayers. Some numbers that address the actual cost to taxpayers would help make the case for this regulation, if they exist."
  - **Answer**: *BOEM provided no figures for total liability/currently outstanding liability provided, nor any figures on actual costs to taxpayers.*

OMB/OIRA Questions to BOEM

- **OMB/OIRA** Question: "How is this [joint and several liability of predecessors] enforced? Does it require additional litigation/compliance costs or is it self-executing and waterfalls through the chain of responsible parties?"
  - **Answer**: *Routinely enforced through issuance of decommissioning orders to all predecessors in the event of default (see 30 CFR 250.1708) and long-history of industry compliance with orders absent litigation*
- **OMB/OIRA** Question: "current or all [lessees jointly and severally liable]?"
  - **Answer**: ***All*** *lessees jointly and severally liable for accrued liability* (see 30 CFR 556.901(d) and 30 CFR 250.1701)