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Proposed Bureau of Safety and Environmental Enforcement Rule Continues Interior Department Focus on Decommissioning Costs and Obligations

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On August 12, 2016, the ***Bureau of Safety and Environmental Enforcement ("BSEE")*** unveiled a proposed rule that would require entities holding rights-of-way ("ROWs") for oil and gas pipelines on the *Outer Continental Shelf ("OCS")* to report the actual costs incurred by those entities during the decommissioning of pipelines. Comments on the proposed rule are due by September 12, 2016. BSEE's proposed rule represents the latest effort by the U.S. Department of the Interior ("DOI") to more accurately quantify decommissioning costs associated with OCS oil and gas activities and to ensure that OCS lessees, operators, and pipeline ROW holders have adequate financial resources available to cover those decommissioning costs.

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While BSEE's proposed rule should not come as a huge surprise to industry—the agency already requires OCS lessees and operators to submit cost information following the decommissioning of platforms, wells, and other facilities—the proposed rule does represent yet another potential cost and reporting requirement that the government seeks to impose on an industry struggling to adapt in an era of low oil and gas prices and enhanced regulatory scrutiny. This alert provides a brief summary of the proposed rule and evaluates the proposed rule in the context of DOI's broader efforts to update its offshore financial assurance policies to prevent the government, and ultimately the taxpayer, from being saddled with decommissioning expenses. This alert also offers several suggestions as to how companies can operate within DOI's new paradigm.

Summary of the proposed rule

With the proposed rule, BSEE seeks to amend existing regulations to require operators to submit a certified, itemized assessment of costs incurred during OCS pipeline decommissioning activities, including costs related to vessels, equipment, supplies and materials, transportation, personnel, and services used in the decommissioning process. The proposed rule would mandate that a ROW holder furnish this report to the appropriate BSEE Regional Supervisor within 120 days of completion of pipeline decommissioning activities. The proposed rule also would allow the Regional Supervisor to request additional information from a pipeline ROW holder in order to corroborate the information included in any submittal.

The proposed rule builds off of an earlier BSEE rule, finalized in December 2015, which requires OCS lessees and operators to provide cost information related to the decommissioning of platforms, oil and gas wells, and other facilities. The December 2015 rule was followed by an April 27, 2016 Notice to Lessees and Operators ("NTL"), which provides further guidance and clarification regarding the submission of decommissioning cost summaries.

In the agency's response to comments on the December 2015 rule, BSEE argued that the rule was necessary to ensure that the agency had access to accurate information related to platform and facility decommissioning expenditures, which would allow the agency to better estimate future decommissioning costs for those OCS activities. Likewise, the proposed rule is intended to serve a similar purpose—to allow BSEE to better estimate future costs associated with the decommissioning of pipelines.

The proposed rule—like the December 2015 rule—also should allow the ***Bureau of Ocean Energy Management ("BOEM")*** to use actual cost data collected by BSEE to more accurately determine the appropriate amount of supplemental bonding that a lessee, operator, or pipeline ROW holder must carry to ensure that sufficient financial assurance exists to cover the cost of future decommissioning obligations. Collectively, BOEM and BSEE have struggled to settle upon a consistent, reliable approach to estimate decommissioning costs. BSEE's cost estimates have been—and will continue to be until sufficient cost data is collected—derived using algorithms based upon a series of assumptions made after a review of available sources of information.

BSEE's proposed rule, therefore, represents only the latest effort by DOI to refine the way it manages the financial risks associated with oil and gas development on the OCS, and should be viewed in concert with other DOI efforts on this front, including BOEM's recent announcement to update its policy governing supplemental financial assurance. So while the proposed rule almost certainly will lead to incrementally higher costs and reporting burdens for those engaged in OCS activities, industry should be more concerned by the cumulative impacts resulting from changes to DOI's broader financial assurance policies.

Operating within the framework of DOI's revised financial assurance policies

As previously discussed, DOI's efforts to update its financial assurance policies could have adverse impacts on the offshore oil and gas industry—particularly on small and independent lessees, operators, and pipeline ROW holders. However, both BOEM and BSEE have expressed a willingness to work with industry to ensure that adverse impacts from these policy changes are minimized while ensuring that the government and taxpayer are protected. Therefore, those engaged in OCS oil and gas activities should consider taking the following steps:

1. Seek a recalculation of any higher-than-expected decommissioning cost estimates

Entities faced with higher-than-expected BSEE decommissioning cost estimates and/or a demand from BOEM for increased supplemental bonding amounts as a result of DOI's updates to its financial assurance policies should evaluate whether to seek a recalculation of BSEE's decommissioning cost estimates. While BSEE has noted that it intends to utilize existing algorithms and methodologies to calculate decommissioning estimates—at least until it has collected sufficient cost data from lessees, operators, and pipeline ROW holders—the agency has signaled a willingness to consider data derived from other sources, including, industry publications, operator presentations, and professional experience. Because there are a wide range of assumptions that can be used in BSEE's current approach to estimating decommissioning costs, any lessee, operator, or pipeline ROW holder may be able to support lower cost estimates by furnishing cost data and other evidence. Armed with the type of data it seeks in the proposed rulemaking, BSEE may be willing to recalculate its decommissioning cost estimates, which would result in a lower bond demand from BOEM.

2. Meet with BOEM to discuss compliance options

Additionally, companies faced with supplemental bonding demands should consider seeking a tailored plan from BOEM, whereby the company could seek to meet future decommissioning obligations through means other than the traditional surety bond or U.S. Treasury note (e.g., through an executed decommissioning contract or other means).

BOEM has noted that it will consider a tailored plan in which a company seeks to "phase-in" compliance with supplemental bonding demands over a period of time, ranging from several months to potentially a year or more. The mechanics behind this "phased-in" approach, however, are still not clear. As BSEE noted during an August 10, 2016 "Offshore Financial Security Workshop," the agency has no way of knowing the timing and order of multiple-asset decommissioning projects. Accordingly, BSEE decommissioning estimates—and BOEM supplemental bonding demands—are based on the assumption that all decommissioning activities will be performed at once rather than in tranches or part of "campaign or multi-asset project." Therefore, if a company should wish to defer its compliance, it is imperative for that company to be able to articulate why a phased-in approach is appropriate and demonstrate that the government and taxpayer will be shielded from future decommissioning liability.

3. Consider risk pooling

Another potential approach that lessees, operators, and pipeline ROW holders might consider is risk pooling. This concept is similar to what companies have done in the oil spill response context, with the post-*Deepwater Horizon* creation of the Marine Well Containment Company ("MWCC"). In the decommissioning context, a group of companies might consider funding a new entity to enter into decommissioning contracts with member companies at better rates than otherwise would be available on the open market. Such an entity may also be able to use pooled resources to secure a larger surety bond at a more favorable rate than member companies would otherwise receive if they sought bonds individually. In addition, there may be other collaborative mechanisms that companies could use to meet the challenges posed by DOI's new financial assurance requirements.