

**UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE
GULF OF MEXICO OCS REGION**

NTL 98-18N
December 28, 1998

**NOTICE TO LESSEES AND OPERATORS OF FEDERAL OIL AND GAS AND SULPHUR
LEASES IN THE OUTER CONTINENTAL SHELF**

Supplemental Bond Procedures

This NTL informs lessees how MMS will implement the requirements for supplemental bonds. The MMS may require additional security(s) in the form of a supplemental bond or bonds when the cost to meet all potential present and future lease obligations exceeds the amount of the general bond unless one of the current lessee(s) can demonstrate the financial capability to meet these obligations. These obligations include rents, royalties, and amount of plugging and abandonment costs necessary to ensure performance of regulatory requirements

1. Authority

The Minerals Management Service (MMS) Regulations, at 30 CFR 256.53(d) and (e), give the Regional Director the authority to require additional security(s) in the form of a supplemental bond(s) or an increase in the amount of coverage of an existing surety bond requirement, if he or she deems additional security necessary, to cover royalty due to the Government or costs and liabilities of the lessee for regulatory compliance.

2. Definitions

We (or us or our) refers to the Regional Director of an MMS Region that issues a lease or an official authorized to act on behalf of the Regional Director.

You (or your) refers to the lessee providing bond coverage for a given lease.

3. General

- a. This document is an updated summary of the procedures that we will use in assessing the financial strength of Outer Continental Shelf (OCS) lessees as they implement the requirement to submit a supplemental bond. These procedures apply to all OCS Regions. In the Gulf of Mexico (GOM) Region these procedures supersede the procedures described in the Leasing Activities Information document dated October 22, 1993. In the Pacific OCS Region, these procedures supersede the Letter to Lessees dated May 6, 1994.
- b. To ensure performance of regulatory requirements, we may require all companies submitting bonds to provide additional security. The additional required security will be for an amount not more than the full amount of plugging and abandonment costs in cases when none of the lessees can demonstrate the financial capability and strength to carry out present and future obligations. This notice describes:
 1. The information that you may submit to us to demonstrate the necessary financial capability, and
 2. The guidelines we will use in determining whether posting of a supplemental bond is necessary.
- c. This NTL contains the guidelines and criteria that we will use to implement regulations governing the requirements for, and the submission of, supplemental bonds by lessees. The information is provided to assist lessees in planning and submitting supplemental bonds. We reserve the right to vary from the procedures or criteria in this NTL on a case by case basis when the changes or variations are within the framework established in the governing regulations.

4. Reviews of Cumulative Potential Lease Abandonment Liabilities

We will review the lessee's general and supplemental bond(s), cumulative liabilities, and financial strength and, if warranted, will require supplemental bond(s). We may conduct a review at any time. Generally, we will initially conduct a review when a lessee submits an Exploration Plan (EP) for approval.

- a. We will conduct subsequent reviews when a lessee requests our approval of one of the following:
 1. Assignment of the lease record title interest (lessee of record), or a portion of the record title interest in a lease.
 2. Significant revision to an approved EP.
 3. Development and Production Plan (DPP) or a significant revision to an approved DPP.
 4. Development Operations Coordination Document (DOCD) or a significant revision to an approved DOCD.
 5. Application for a pipeline right-of-way (ROW) or modification to existing pipeline ROW.
 6. Assignment of record title interest of an existing or approved pipeline ROW permit with platform amenities.

7. Significant revision to an approved pipeline installation plan for a pipeline having platform amenities.
- b. At our option, we may conduct reviews:
 1. periodically,
 2. when we become aware of information that indicates a change in the financial strength of the company or potential cumulative liability, or
 3. when we issue Notices of Incidents of Noncompliance for incidents related to safety, environmental, non-payment of royalty, or other violations of MMS regulations.
- c. If you take an action that causes us to initiate a review and then you withdraw the action, at our discretion, we may carry the review of the need for additional bonds to completion. If we determine that it is needed, we will require the submission of a supplemental bond.

5. Evidence of Financial Strength and Reliability

We will not require you to submit a supplemental bond when we have determined that the lessee meets the following conditions, unless we determine that the financial or operational history of the company warrants that a bond is needed to ensure that the company will meet all abandonment and clearance obligations.

- a. If our estimate of your cumulative potential lease end-of-lease liability is less than or equal to 25 percent of the most recently available and independently audited calculation of the lessee's net worth, we will not require a supplemental bond if the company meets the criteria in paragraph (b) or (c) and shows adequate reliability as evidenced by the following:
 1. number of years of successful operations and production of oil and gas or sulphur in the OCS or in the onshore oil and gas industry,
 2. credit rating(s), trade references, and verified published sources,
 3. your record of compliance with the current and previous governing laws, regulations, and lease terms, and
 4. other items that indicate financial strength or reliability.
- b. You produce fluid hydrocarbons in excess of an average of 20,000 barrel oil equivalents (BOE) per day from your OCS leases, based on our calculation of your production for the most recent 12 months for which data and information are available. For the purposes of computing BOE for natural gas, 5.62 thousand cubic feet of natural gas equals 1 barrel of oil equivalent, as measured fully saturated at 14.73 psi and 60 degrees Fahrenheit according to 30 CFR 250.1203(b).
- c. The company can demonstrate financial strength to carry out present and future financial obligations. You may exhibit financial capacity by providing audited financial statements, including an independent auditor's report, balance sheet, and profit and loss sheet. This audit must demonstrate that the lessee falls within one of the criteria identified below:
 1. Stockholders Equity or Net Worth has a minimum value of \$50 million but does not exceed \$100 million, the current ratio (current assets/current liabilities) is equal to or greater than 1.0, and the Debt to Equity Ratio (total liabilities/net worth) is less than or equal to 2.5.
 2. Stockholders Equity or Net Worth has a minimum value of \$100 million but does not exceed \$150 million, the current ratio (current assets/current liabilities) is equal to or greater than 0.75, and the Debt to Equity Ratio (total liabilities/net worth) is less than or equal to 3.0.
 3. Stockholders Equity or Net Worth has a minimum value of \$150 million, the current ratio (current assets/current liabilities) is greater than 0.50, and the Debt to Equity Ratio (total liabilities/net worth) is less than or equal to 3.0.

STOCKHOLDERS EQUITY OR NET WORTH	CURRENT RATIO = CURRENT ASSETS/ CURRENT LIABILITIES	DEBT/EQUITY RATIO = TOTAL LIABILITIES/ NET WORTH
\$50 Million to \$100 Million	1.00	2.5
\$100 Million to \$150 Million	0.75	3.0
\$150 Million and Up	0.50	3.0

- d. Our determination of a company's financial strength is valid for one year. We will extend the determination for one year at a time if:
 1. an independent accountant submits verification of the company's current financial capacity at least 60 days prior to the expiration of the determination, and
 2. the company continues to meet the criteria established above. In determining whether the company continues to meet the criteria, we will consider changes in the financial strength of the company, changes in obligations of the company, and changes in the operational record of the company.
- e. If prior to the effective date of this NTL, we determined that you did not need to submit a supplemental bond, that determination expires one year after the latest date on which we notified you of the determination or notified you that we reviewed the determination. You must submit the information required in this NTL before the latter of:
 1. March 1, 1999, or
 2. sixty days before the expiration of our determination.

6. Determination of the Cumulative End-Of-Lease Liabilities

When we require you to provide and maintain a supplemental bond, the amount, in addition to the general bond, will be equal to the cost to meet all potential present and future lease obligations including rents, royalties, and amount of plugging and abandonment costs necessary to ensure performance of regulatory requirements.

- a. We will estimate the amount of cumulative abandonment liability including the lessee's obligations to plug and abandon wells, remove platforms and other facilities, and restore the lease to its original condition by clearing the obstructions from wells, platform sites, and ROW's. We will make this estimate based on the assumption that all facilities will be removed and abandoned onshore.
- b. We will estimate costs based on available historical costs. The following example is drawn from historical data for 4-pile platforms in the Gulf of Mexico and includes costs for removing platforms from the lease and scrapping the platform onshore, plugging and abandoning wellbores according to the requirements of 30 CFR 250 Subpart G, and clearing the site according to 30 CFR Subpart I and Gulf of Mexico NTL 98-26. The estimate is based on costs in the Gulf of Mexico and assumes that a lessee will use a rig to plug and abandon all wellbores. We will adjust these figures when available information shows that the numbers are not accurate. Other OCS Regions will base estimates on the best available information. You may provide additional information for us to consider when we estimate end of lease costs. When providing additional data, you should explain the basis for the data. We will estimate costs as follows:

- 1. Plugging and abandoning a borehole will cost \$100,000 per borehole for all water depths.
- 2. Dismantling and abandoning a platform will vary with water depth as follows:

Estimated Costs of Removing a Platform and Scrapping it Onshore (According to Water Depth)			
Water depth of 150 feet or less	Water depth between 151 and 200 feet	Water depth between 201 and 299 feet	Water depth of 300 feet or more
\$400,000	\$600,000	\$1,250,000	\$2,000,000+

- 3. Clearing a lease will vary with water depth as follows:

Estimated Cost of Site Clearance (According to Water Depth)		
Water Depths of 150 feet or less	Water Depths between 151 - 249 feet	Water Depths of 250 feet and greater
\$300,000	\$400,000	\$500,000+

- c. We will use the following procedure to estimate the need for and amount of supplemental bonds for all companies that have provided a general bond for one or more leases. We will take the following steps:
 - 1. Identify all leases for which the company is a lessee.
 - 2. Apply lease specific bonds (i.e., lease specific general bonds, lease specific supplemental bonds, and lease specific guarantees) to identified leases.
 - 3. Exclude from the lessee's lease abandonment and clearance liability calculation, for the purpose of supplemental bond determination, up to the full amount of the clearance liability for any lease(s) for which we have determined that one or more co-lessees have such financial strength that it is not necessary to require submission of a supplemental bond. We will exclude less than the full amount in cases where we determine that additional security is needed as a result of the financial or operational history of the companies involved.
 - 4. Deduct a reserve account for the Royalty Management Program from the general bonds on file. We will credit this account \$50,000 per lease or \$300,000 per area-wide bond on file.
 - 5. Apply the remaining general area-wide bonds to leases in chronological order beginning with the lowest lease numbers on file.
 - 6. After calculating the remaining potential liability, we will evaluate the financial strength and reliability of the company using the procedures in Section 7. We will then determine the need for a supplemental bond and the amount.
 - 7. Request lease-specific supplemental bonds through the designated operator who coordinates the submittal with the lessees.
- d. You may facilitate the review and approval/disapproval of your request by providing detailed information on existing leasehold facilities. You may provide evidence to support an adjustment in our estimate of your cumulative potential abandonment and clearance costs. That evidence may include:
 - 1. The itemized data and information by lease used as a basis for your estimate of the cumulative potential abandonment and clearance costs represented by wells and facilities on your lease(s), and
 - 2. The itemized data and information by lease on which a third party bases its estimate of your cumulative potential lease abandonment and clearance costs.
- e. When conducting a subsequent review of the need for a supplemental bond, our analysis will consider the number of wells drilled or plugged and abandoned in the time that has elapsed since the last review of your cumulative potential

liabilities, the number of platform installations or removals since the last review, changes in the amount and value of hydrocarbons being produced, the projected rates of oil and gas production, inflation, and other changes in the market conditions. The objective of our review and analysis will be to ensure that the supplemental bond coverage or alternate form of security you provided is in an amount that is not less than the amount we establish based on your cumulative potential lease abandonment and clearance liabilities.

7. Compliance with Requirements to Provide a Supplemental Bond

You may submit and maintain a supplemental bond(s) in the following ways:

- a. Submitting lease-specific supplemental bond(s), United States Treasury Securities, or an alternate form of supplemental security approved by us, in the full amount we determine is needed. If the value of your security falls below the level of the supplemental bond we require, or if the U. S. Treasury no longer certifies the company that issued your bond as being acceptable, you must notify us within 15 days.
- b. Submitting, with our prior approval, a plan under which you commit to fully fund a lease-specific abandonment escrow account according to 30 CFR 256.56. Generally, you must fully fund a lease-specific abandonment account within four (4) years or by the beginning of the year which we project that you will have cumulatively produced 80 percent of the originally recoverable reserves, whichever is earlier. You must submit this plan within fourteen (14) days after we notify you that you need to submit a supplemental bond. The plan must include the following:
 1. An initial payment into the lease-specific abandonment account that is generally equal to or greater than 50 percent of our estimate of the cumulative potential lease abandonment and clearance liabilities. The lessee will base the amount of the initial payment on our analysis of current, past, and projected rates of production from the leasehold(s), or cash flow for facilities utilized by ROW, characteristics of the producing reservoir(s), plugging and abandonment information available in our databases, and/or other information provided to us.
 2. A prescribed time schedule for making specified incremental payments (e.g., monthly payments) in amounts that will ensure that the amount in the lease abandonment account will increase at a faster rate than the rate at which the originally recoverable hydrocarbons are being produced from the lease; and,
 3. Commitment by the financial institution in which the lessee established the lease-specific abandonment account to notify us of the date and amount of the initial deposit and of each subsequent incremental payment into the account.
 4. Submitting a risk insurance policy to us that covers the residual liability in the event of any catastrophic failure that prevented the completion of the remaining payments.
- c. You must immediately submit, and subsequently maintain, a supplemental bond in an amount equal to the remaining portion of our estimate of the amount of your cumulative potential lease abandonment and clearance liabilities in the event you fail to:
 1. make the initial payment into a lease-specific abandonment account, or
 2. pay on the date due an incremental payment into the lease-specific abandonment account in the amount agreed.
- d. The following table provides an example of a plan for incremental payments.

An Example of Incremental Payment Schedule

The following is an example of a lease-specific abandonment account, the time schedule prescribed, and the amount of each incremental payment, to fund the account over a four-year period. This example describes a situation in which, based on our estimate of your cumulative potential unfunded lease abandonment and clearance liabilities, we required a \$5 million supplemental bond.

Year	Percent of Recoverable Hydrocarbons Produced at End of Year as a Percentage of Recoverable Hydrocarbons Originally in Place	Dollar Amount (Security) Required at Start of Year	Quarterly Payment During Year
1	20%	\$2,500,000	\$156,250
2	40%	\$3,125,000	\$156,250
3	60%	\$3,750,000	\$156,250
4	75%	\$4,375,000	\$156,250

1. Total Supplemental Bond Payment: \$5,000,000.
2. The amount of the initial payment is 50 percent of your cumulative potential lease abandonment and clearance liabilities, since 50 percent is greater than the percentage of the recoverable hydrocarbons originally in place that we project will be produced by the end of Year 1.
3. By the end of year 3, you will have produced 60 percent of the recoverable hydrocarbons originally in place. The fund will need to have not less than 60 percent of the total supplemental bond (\$3,000,000 = 60% x \$5,000,000) by the start of year 3.

4. By the end of year 4, you will have produced over 80 percent of the recoverable hydrocarbons originally in place. The fund will need to have the full \$5,000,000 by the end of year 4. Quarterly payments of \$156,250 during the 4 year period will increase the fund to \$5,000,000 by the end of year 4.

8. Using a Third-Party Guarantee Instead of a Supplemental Bond

You may submit a third party guarantee in lieu of a supplemental bond. Your guarantee must be provided by a third party (guarantor) who will guarantee compliance with all lease obligations. The guarantor must also comply with all requirements in 30 CFR 256.57. We will accept a third-party guarantee if the guarantor and the indemnity agreement are found to be acceptable. The guarantor must meet all requirements in this section.

- a. The guarantor must:
 1. meet the qualifications for a lessee in 30 CFR 256.35(b),
 2. demonstrate satisfactory levels of financial strength and business history that exceed financial and production thresholds in Section 5, and
 3. have total outstanding and proposed guarantees that do not exceed 25 percent of its unencumbered net worth in the United States.
- b. We will review the financial information that either you or your guarantor submit to determine a guarantor's financial strength, business history, and compliance with current financial and production thresholds. You or your guarantor will provide information we determine is necessary including the guarantor's:
 1. current rating for its most recent bond issuance by either Moody's Investor Service or Standard and Poor's Corporation,
 2. net worth, taking into account potential liabilities under its guarantee of compliance with all the terms and conditions of the lease, our regulations, and any other existing guaranties to MMS,
 3. ratio of current assets to current liabilities, taking into account potential liabilities under its guarantee of compliance with all the terms and conditions of the lease, our regulations, and any existing guaranties to MMS, and
 4. unencumbered fixed assets in the United States.
- c. If guarantor's financial data are not publicly available, then we will review the following financial information that either you or your guarantor submit and that an officer of the company certifies as correct:
 1. Financial statements for the most recently completed fiscal year verified by an independent certified public accountant (CPA) using generally accepted accounting principles and containing no adverse opinion by the CPA.
 2. Yearly updates of the financial statements submitted 90 days before the end of the guarantor's fiscal year or an annual date we set.
- d. We will, in part, base an evaluation of the stability of the guarantor on the length of time that the guarantor has been in continuous operation. A guarantor's continuous operation:
 1. is the time immediately before submission of a guarantee, and
 2. does not include periods of interruption of operations not within guarantor's control and does not affect the likelihood of the guarantor remaining in business during your exploration, development, production, plugging, removal, and clearance operations on the lease business.
- e. The guarantor must meet the criteria in Section 5 for financial strength and reliability.
- f. The submission of an indemnity agreement providing for compliance with all your lease obligations, the obligations of all operating rights owners, and the obligations of all operators on the lease. A third party guarantee must contain each of the following provisions:
 1. If you, your operator, or an operating rights owner fails to comply with any lease term or regulation, your guarantor must take corrective action or provide within seven (7) calendar days sufficient funds for us to complete corrective action.
 2. If the guarantor takes corrective action to bring a lease into compliance with our requirements or provides funds for us to bring the lease into compliance, these actions do not reduce the guarantor's liability.
- g. If a guarantor wishes to terminate the period of liability under its guarantee, it must:
 1. Notify you and us at least 90 days before the proposed termination date,
 2. Obtain our approval for the termination of the period of liability for all or a specified portion of your guarantor's guarantee, and
 3. Remain liable for all work and workmanship performed during the period that your guarantor's guarantee is in effect.
- h. If we approve your third-party guarantee, the guarantor must submit an indemnity agreement.
 1. The indemnity agreement must be executed by your guarantor and all persons and parties bound by the agreement.
 2. The indemnity agreement must bind each person and party executing the agreement jointly and severally.

3. When a person or party bound by the indemnity agreement is a corporate entity, two corporate officers who are authorized to bind the corporation must sign the indemnity agreement.
4. Your guarantor and the other corporate entities bound by the indemnity agreement must provide us copies of:
 - i. the authorization of the signatory corporate officials to bind their respective corporations;
 - ii. an affidavit certifying that the agreement is valid under all applicable laws; and
 - iii. each corporation's corporate authorization to execute the indemnity agreement.
5. If your third-party guarantor or another party bound by the indemnity agreement is a partnership, joint venture, or syndicate, the indemnity agreement must bind each party who has a beneficial interest in your guarantor; and provide that, upon our demand under your third-party guarantee, each party is jointly and severally liable for compliance with all terms and conditions of your lease.
6. The indemnity agreement must provide that, within seven (7) calendar days of a demand for forfeiture under 30 CFR 256.59, your guarantor will either commit itself to take all necessary corrective action or provide sufficient funds for us to take corrective action.
7. The indemnity agreement must contain a confession of judgment. It must provide that, if we determine that you, your operator, or an operating rights owner is in default of the lease or in violation of the OCS Lands Act (OCSLA) or its implementing regulations, the guarantor will not challenge the determination but will remedy the default.

9. **Termination of Bond, Guarantee, or Determination that a Supplemental Bond is Not Necessary**

We reserve the right to deny your request for a finding that submission and maintenance of a supplemental bond is not necessary, even though an independent accountant provides an audit and certification that you meet the financial strength and performance criteria described herein. Normally, we will base such a denial or revocation of a previous finding on our review of independently audited information that indicates to us that recent or anticipated future events may adversely affect the lessee's/lessees' ability to comply with current and/or future lease obligations. We may also require a supplemental bond on any leases, regardless of any prior determination under these requirements, if it is determined that the designated operator has not fully and consistently complied with our regulations.

- a. When any of the following occur, you need to immediately take necessary action to meet these requirements. If you do not, we may issue a civil penalty, stop operations on your lease, or take any other action authorized by the OCSLA or the implementing regulations.
 1. We require you to provide a supplemental bond when we had previously determined that your financial strength was sufficient that we did not require a bond. In such cases, we will give you a minimum of 20 days notice before requiring a supplemental bond.
 2. Your third party guarantor ends the period of the guarantee.
 3. Your bonding company ends the period of bond protection.
 4. The value of your security falls below the level of the supplemental bond we require.
 5. The U. S. Treasury no longer certifies that the company that issued your bond is acceptable.
- b. If you choose to provide an escrow account instead of providing a bond, we may allow you up to an additional 70 days to prepare and allow us to review a plan for incremental payments and to add funds to the account, according to the plan.

10. **Submitting Information**

Use the following contacts to obtain further information or to submit information for activities located in the:

Alaska OCS to:

Minerals Management Service, Alaska OCS Region
 Attn: Regional Supervisor, Field Operations
 949 East 36th Avenue, Third Floor
 Anchorage, AK 99508-4302
 (907) 271-6065

Gulf of Mexico OCS or Atlantic OCS to:

Minerals Management Service, Gulf of Mexico OCS Region
 Attn: Jim Haddox, MS 5421
 1201 Elmwood Park Boulevard
 New Orleans, LA 70123-2394
 (504) 736-5703

Pacific OCS to:

Attn: Frederick L. White, MS 7300
770 Paseo Camarillo
Camarillo, CA 93010-6064
(805) 389-7830

11. **Paperwork Reduction Act of 1995 Statement:** Paperwork Reduction Act of 1995 (PRA) Statement: The information collection referred to in this NTL provides clarification, description, or interpretation of requirements in 30 CFR 256. The Office of Management and Budget (OMB) has approved the information collection requirements in these regulations and assigned OMB control number 1010-0006. This NTL also refers to approved information collection requirements in 30 CFR 250, subparts B, J, and I. The respective OMB control numbers are 1010-0049, 1010-0050, and 1010-0058. This NTL does not impose additional information collection requirements subject to the PRA.

This NTL is also on the MMS worldwide website at <http://www.mms.gov>.

Dated: 12/24/98

Signed: Thomas A. Readinger for
Carolita U. Kallaur
Associate Director
for Offshore Minerals Management