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Rural Development, Energy & Supply Chains Subcommittee

Energy Independence: How Burdensome
Regulations are Crushing Offshore Small Energy Producers

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Chairman Hunt, Ranking Member Perez, and Members and staff of the Committee and Subcommittee, thank you for the opportunity to testify this morning. My name is Mike Minarovic, and I am the Co-Founder and CEO of Arena Energy, an employee-owned independent exploration and production company exclusively focused on offshore oil and natural gas development in the shallow waters of the U.S. Gulf of Mexico (the "GOM").

Arena Energy

Arena is one of the largest independent operators in the GOM. Every year, we invest drilling and facilities capital of $250-300 million in the federal waters of the Gulf of Mexico. Arena currently owns 130 platforms on federal leases and is the second most active oil and gas company in the GOM based on wells drilled over the last ten years. Since inception, Arena has safely drilled more than 350 wells in federal waters with a commercial success rate exceeding ninety-four percent, contributing to over $1.4 billion in royalties paid to the U.S. government. Equally important, Arena has decommissioned over three hundred wells and forty-five platforms and has funded its decommissioning costs with not a single dollar falling to the U.S. taxpayer.

Despite the challenging regulatory environment over the past several years, we have expanded our commitment to the U.S. Gulf of Mexico by capitalizing new companies to provide drilling rigs, pipeline transportation, and environmental remediation services to the offshore industry. Arena made these investments to ensure safer operations, mitigate pollution risk, and to provide needed capacity to decommission wells, pipelines, and platforms in the GOM.

The Gulf Energy Alliance

I also speak today on behalf of the Gulf Energy Alliance, a coalition of leading independent offshore producers formed in 2016 to work with regulators, elected officials, and other stakeholders to develop a reasonable framework for financial assurance requirements that

protect the U.S. taxpayer in a manner that does not threaten the viability of independent offshore producers. All GEA members, like Arena, are small businesses almost exclusively focused in the GOM. Arena and other independent offshore producers are not household names and have distinctly different business models than the major oil and gas companies. But collectively, independent producers were responsible for approximately 35% of Outer Continental Shelf oil and natural gas production in 2022.[1]

I. The Biden Administration Aims to Shut Down Offshore Oil and Natural Gas Production

There are many examples I could cite today to illustrate the burdensome and unnecessary regulations crushing small businesses operating in the GOM. And every single one of those examples must viewed through the lens of a President intent on shutting down domestic oil and natural gas production when and wherever possible.

In a recent interview, President Joe Biden reiterated his campaign pledge to do so:

> I wanted to stop all the drilling on the east coast, and the west coast, and in the Gulf, but I lost in court. ***But, we're still pushing, we're still pushing really, very hard.***[2]

On his first day in office, President Biden issued an Executive Order pausing permits for new oil and gas drilling on federal lands and waters, and the cascade of overly burdensome executive actions and new regulations targeting domestic production has accelerated over the past year. The administration's hostility to domestic production, particularly in federal waters, is difficult to comprehend, particularly when you consider the administration's stated goal of reducing global greenhouse gas emissions. As global oil demand continues to grow, the cleanest barrels on the planet should be produced first, and those barrels are produced in the GOM.[3]

I am here today to discuss a new regulation recently proposed by the Bureau of Ocean Energy Management (BOEM) that poses an existential threat to small offshore businesses. Specifically, BOEM recently proposed new regulations (the "Proposed Rule") related to bonding requirements for offshore decommissioning liabilities that, very simply, cannot be met.[4] BOEM's

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[1] Office of Natural Resources Revenue; Bureau of Safety and Environmental Enforcement (2023).

[2] President Joe Biden. Television interview. *The Weather Channel*, August 8, 2023 (https://weather.com/news/climate/news/2023-08-09-president-biden-the-weather-channel-climate-comments).

[3] *GHG Emission Intensity of Crude Oil and Condensate Production*, ICF (May 8, 2023).

[4] *Risk Management and Financial Assurance for OCS Lease and Grant Obligations* (June 29, 2023) (RIN 1010-AE14) (to be enacted at 30 CFR Parts 550, 556, and 590) ("BOEM Proposed Rule").

rule relies entirely on the surety industry as a "solution" to a massively overstated problem—i.e., taxpayer exposure to these liabilities—and the surety market has responded that BOEM's "solution" will not work. Notably, the U.S. Small Business Administration's Office of Advocacy (the "SBA") has also weighed in on this rulemaking, concluding that the proposal explicitly favors major oil and gas companies over small businesses without any corresponding benefit for taxpayers.[5]

Proposing a rule with a solution that is irrational and unworkable—and unjustifiably harms small business—is not in the best interests of the government, the industry, or taxpayers. As the State of Louisiana concluded, "the Proposed Rule is fundamentally flawed in multiple ways, but what makes it uniquely troubling is its obvious insincerity. While the Proposed Rule reflects a valiant attempt at facial neutrality, it cannot be read without considering the Biden Administration's pervasive animosity toward domestic oil production."[6]

II. BOEM's Proposed Rule is a Massive Overreach to a Limited Problem

Arena and the GEA support policies and regulations that provide workable solutions for real problems. BOEM's Proposed Rule focuses on a ***potential*** problem—protecting taxpayers from financial liability for the costs of decommissioning offshore oil and natural gas wells, platforms, and related infrastructure in federal waters of the GOM, which BOEM acknowledges as a "rare" occurrence." [7] Indeed, BOEM recently disclosed that potential taxpayer liability for decommissioning after seventy-five years of offshore production amounts to $58 million.[8]

To address the $58 million in potential taxpayer exposure, BOEM now seeks an additional **$9.2 billion** in new bonding, which will cost small businesses in the GOM $5.7 billion.[9] "Overkill" barely begins to describe BOEM's "solution"; this is cracking a nut with a sledgehammer.

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[5] U.S. Small Business Administration Office of Advocacy Comment Letter ("SBA Comment Letter"), https://www.regulations.gov/comment/BOEM-2023-0027-1699, at p. 3.

[6] State of Louisiana Comment Letter, https://www.regulations.gov/comment/BOEM-2023-0027-1985, at p. 4.

[7] 88 Fed. Reg. at 42141.

[8] On July 26, 2023, BOEM communicated to the House Subcommittee on Energy & Mineral Resources that the estimated decommissioning costs for current orphan well and infrastructure inventory on the OCS is approximately $73 Million with an estimated $25 Million available for decommissioning activities, which includes approximately $15 Million BOEM has collected in forfeited bonds and BSEE's $6 Million in appropriated funds and $4 Million in Bipartisan Infrastructure Law funding.

[9] This is according to BOEM's own analysis, which is an undiscounted number and includes erroneous assumptions about the cost of capital and collateral requirements for the new bonds. Correcting for BOEM's flawed assumptions, the actual costs to small businesses is closer to $870 million annually.

Since 2004, there have been more than thirty-two bankruptcies of offshore oil and gas lessees involving decommissioning liabilities of approximately $17 billion—and less than 0.5% of that total might fall to U.S. taxpayers. Contrast that with the financial benefits to U.S. taxpayers resulting from GOM oil and gas development over the same period. Since 2004 offshore oil and natural gas production has generated over $124 billion in royalties, lease bonuses, and rentals for the U.S. Treasury.

A. The Proposed Rule Explicitly Favors Major Oil and Gas Companies Over Small Businesses

Offshore oil and gas operations began in the Gulf of Mexico in 1947.[10] Offshore drilling at that time was exclusively conducted by major oil and gas companies. From the late 1940s into the 1990s, major oil and gas companies installed almost all the platforms, pipelines, and facilities in the GOM, creating the decommissioning obligations at issue in BOEM's Proposed Rule.

Beginning in the late 1980s, after recovering most of the oil and natural gas and taking considerable profits along the way, major oil and gas companies sold their shallow water properties to smaller, independent producers to chase bigger returns in more lucrative fields in the deepwater GOM and elsewhere.[11] And in every single one of those transactions, the major oil and gas companies—among the most sophisticated buyers and sellers of assets on the planet—had absolute clarity as to their continuing liability for their accrued decommissioning obligations as defined by statute, regulation, common law, and the lease forms.[12] In other words, when selling these properties, major oil and gas companies made risk-adjusted commercial

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[10] Kerr-McGee installed the first offshore platform that was out of sight of land in 1947.

[11] In many of these sales, major oil and gas companies required bonding, trust accounts, or other forms of security in case the successor owner(s) defaulted on its decommissioning obligations. In many other sales, the majors made the commercial decision to maximize the sales price and did not require the purchasers to provide security to cover their potential default on decommissioning liabilities.

[12] *See* 30 CFR § 250.1703 (joint and several liability for all lessees and grant holders); 30 CFR § 556.710 (joint and several liability for all predecessors)("If you assign your record title interest, as an assignor you remain liable for all obligations, monetary and non-monetary, that accrued in connection with your lease during the period in which you owned the record title…"). See also, 30 CFR § 250.1702 (when decommissioning obligations accrue). Indeed, in the largest offshore bankruptcy, Fieldwood Energy LLC (Case No. 20-33948) (S.D. Texas), involving $9 billion (government's estimate) of decommissioning liability, predecessors assumed 100% of the decommissioning liability, resulting in zero exposure to the taxpayer. Instead, abandonment liability devolved to predecessors in the chain of title who were aware of that risk when they sold the assets to Fieldwood.

decisions to balance cash proceeds versus protection against a potential default by immediate and subsequent purchasers of these assets.

As the State of Louisiana and the SBA point out in their respective comment letters, the Proposed Rule completely ignores a bedrock principle of offshore production: By law, regulation and practice, all current and previous owners stand in front of the taxpayer and remain collectively responsible for decommissioning obligations. Selling a property in no way relieves an owner of its continuing decommissioning obligations under the law, the terms of its lease, and its contractual obligations to buyers. ***But solely for the purposes of this rulemaking***, BOEM chooses to ignore this foundational principle.[13]

As the SBA notes:

> BOEM's proposed rule distorts the marketplace by ignoring a key element of the leases, joint and several liability. All participants in the market know and understand this liability in their business dealings. … This proposed rule explicitly favors large businesses over small businesses without providing the taxpayer the intended protection from unfunded liabilities.[14]

Even though the existing regulatory regime has consistently protected the American taxpayer, major oil and gas companies have seized upon BOEM's rulemaking as an opportunity to retroactively re-trade past transactions. That would get things exactly backwards. The singular focus of this rulemaking should be protecting the American taxpayer, and not major oil and gas companies, who reaped the substantial profits of exploiting offshore properties before selling these properties to independents, often at substantial additional profits.

B. Compliance Costs Under the Proposed Rule Will be Borne Almost Entirely by Small Businesses

BOEM concedes that small businesses will bear the staggering costs imposed by the new bonding requirements:

> Based on these criteria, approximately 407 (76 percent) of the businesses operating on the OCS subject to this proposed rule are considered small; the remaining businesses are considered large entities. All of the operating businesses meeting the SBA 'small business' classification is potentially impacted; therefore, BOEM expects that the proposed rule would affect a substantial number of small entities.[15]

[13] 88 Fed. Reg. at 42141.
[14] SBA Comment Letter at p. 3.
[15] 88 Fed. Reg. at 42157.

Moreover, the SBA explained

> …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***.[16]

The SBA raised several additional concerns in its comments to the Proposed Rule, including how the rule will relieve sellers of the need to perform due diligence on the buyer, encouraging—not discouraging— "moral hazard" in transactions:

> This proposed rule imposes an unreasonable burden for financial assurances on small businesses. BOEM should include a waiver from this requirement for leases with credit worthy predecessor leaseholders. Small businesses should not be required to stand alone and assume the full responsibility for making the taxpayer whole, especially where large businesses are equally liable under DOI regulations and the terms of the lease.[17]

Consequently, the SBA urged BOEM to withdraw the Proposed Rule in favor of a solution that would require supplemental bonding only by the first leaseholder and allow the market to allocate risk through private security required in transactions, which would acknowledge that large companies remain contingently liable for making the taxpayer whole under the regulations and the terms of the lease.

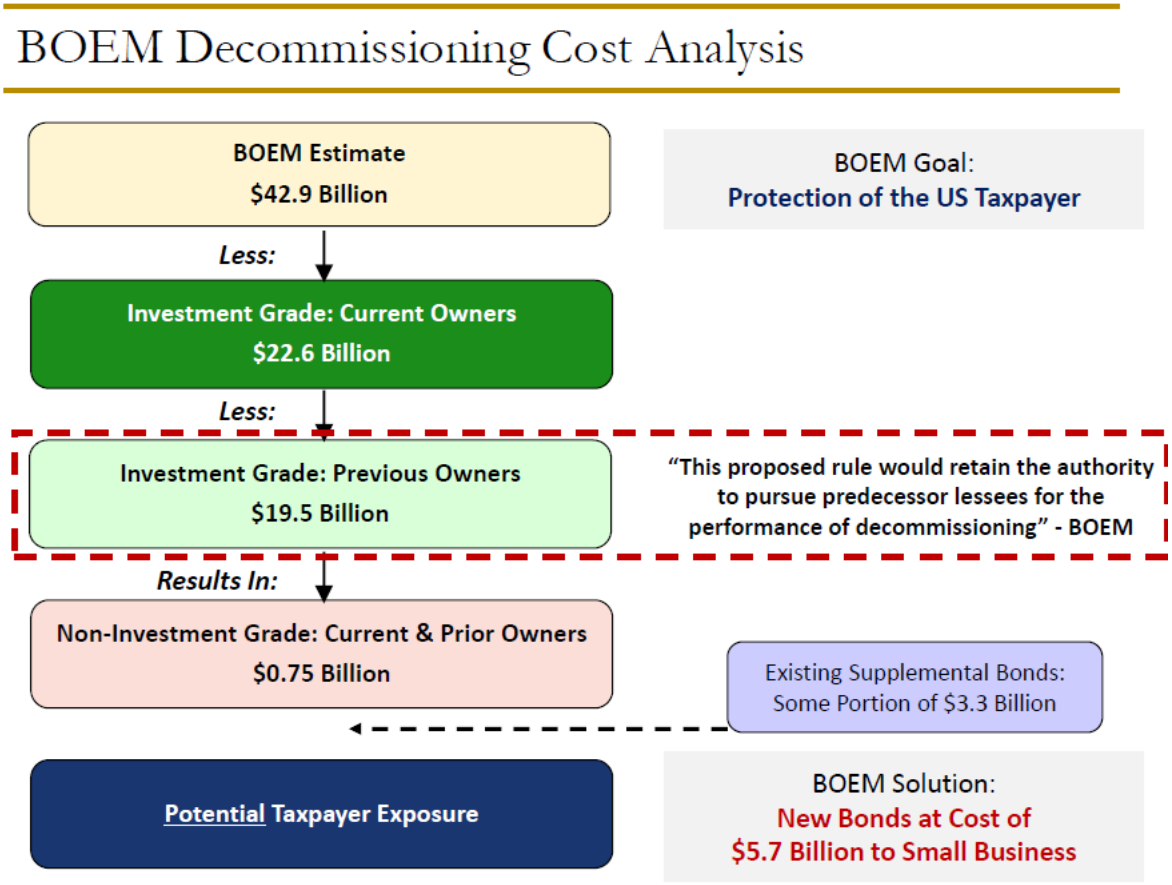
III. The Proposed Rule is Devastating for Small Businesses on the Gulf Coast

A. The Cost of the Proposed Rule Vastly Exceeds Any Potential Benefit

The Proposed Rule claims that the total decommissioning liabilities are approximately $42.8 billion.[18] This exposure is overstated.[19] According to BOEM, the total decommissioning liabilities associated with properties in which majors or large independents (representing $1.8 trillion in combined market capitalization) are not part of the current ownership or previous chain-of-title

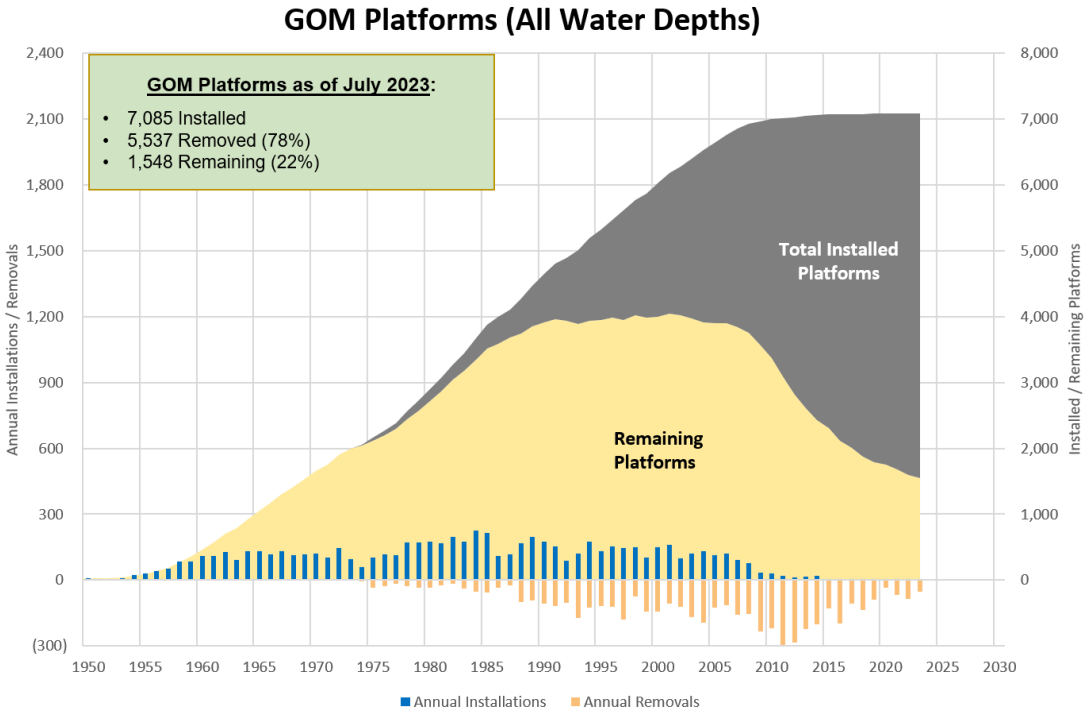
[16] SBA Comment Letter at p. 4.
[17] *Id.* at p. 5.
[18] 88 Fed. Reg. at 42137.
[19] *A Cost-Benefit Analysis of Increased OCS Bonding*, Opportune LLP (July 2023) (the "Opportune Study"), Stated differently, 93% of the total decommissioning liability has a major oil and gas or large independent in the chain of title and who jointly and severally liable with the current owners.

is only $750 million, which represents a small fraction of the total decommissioning liability in the GOM.



And the total decommissioning liability is rapidly decreasing. As the below diagram illustrates, of the seven thousand platforms installed in the GOM over the past seventy-five years, just over 1,500 remain. Over the past fifteen years, industry has removed structures at a rate of 168 per year and has plugged and abandoned approximately 735 wells per year over the same period. Independent producers have performed most of the decommissioning.

Gulf of Mexico Infrastructure: 1947 - 2023



Faced with the enormous costs of complying with the Proposed Rule, independent oil and gas companies will have no choice but to direct capital away from ongoing decommissioning efforts, increasing the potential risk to the government and taxpayer. As for independents who are financially *unable* to provide the costly supplemental bonding required under the Proposed Rule, the Surety and Fidelity Association of America, a national trade association whose members provide most bonds that secure regulatory obligations, stated

> It is unknown whether the oil and gas operators will retain sufficient ability to provide such collateral to the sureties in support of the new and existing obligations. Given that "less" (relatively speaking) creditworthy lessees will necessarily have restricted access to capital and would be the ones subject to the proposed financial assurance requirements, having their capital tied up in collateral obligations will present a substantial burden on these operators and likely lead to more financial failures. Such financial failures will have cascading negative impacts that undermine BOEM's stated purpose of increasing access to these bonds and alleviating the burden on the taxpayer.[20]

[20] Surety and Fidelity Association of America Comment Letter ("SFAA Comment Letter"), https://www.regulations.gov/comment/BOEM-2023-0027-1998, at p. 3. SFAA is a non-profit,

If finalized, this Proposed Rule will exacerbate the very "problem" it seeks to resolve. That is, it will accelerate the default of current lease owners in the GOM, increasing risk to taxpayers and destroying small businesses all along the Gulf Coast in its wake.

B. Taxpayers and Small Businesses Pay a Steep Price for the Proposed Rule's Limited Protection

The fallout of the Proposed Rule will not be limited to the small businesses singularly burdened with enormous and unjustified compliance costs; it will also harm American taxpayers. BOEM readily acknowledges these consequences:

> This action, which is a significant regulatory action under Executive Order 12866 is likely to have a ***significant effect on the supply, distribution, and use of energy.***
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> * * * * *
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> BOEM recognizes that this action may 'adversely affect' ***in a material way the productivity, competition, or prices in the energy sector***.' By increasing industry compliance costs, the regulations could adversely make the U.S. offshore oil and gas sector less attractive than regions with lower operating costs. ***Additionally, increased costs may depress the value of offshore assets or cause continuing production to become uneconomic sooner, leading to shorter-than-otherwise useful life and potentially a loss of production.***[21]

An informed evaluation of any proposed regulation is not possible without a fulsome cost-benefit analysis. If BOEM had conducted an adequate and accurate cost-benefit analysis for the Proposed Rule, it is incomprehensible that BOEM could have concluded that the Proposed Rule is justified.

Opportune LLP, a leading global energy advisory firm, conducted its own cost-benefit analysis of Proposed Rule and concluded that it would, if implemented:

- Result in a decrease in production of approximately fifty-five million barrels of oil equivalent from the GOM;
- Destroy 36,000 high paying jobs, mostly in disadvantaged areas;

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national trade association of more than four hundred companies that write 98 percent of surety and fidelity bonds in the United States. SFAA is licensed as a rating or advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of surety and fidelity experience. SFAA members provide most bonds that secure regulatory obligations.

[21] 88 Fed. Reg. at 42168 (emphasis added).

- Forfeit $573 million in royalties to the U.S. Treasury;

- Reduce Gross Domestic Product (GDP) (particularly in the Gulf Coast states) by as much as $9.9 billion.[22]

In addition, finalizing the Proposed Rule will (1) increase overall emissions as the U.S. replaces the cleanest barrels in the world produced in the GOM with foreign, dirtier barrels, (2) reduce competition in the offshore oil and gas industry by forcing out smaller independents, and (3) weaken an already tenuous supply chain supporting the offshore oil and gas industry, (shipyards, steel manufacturers, rig owners, equipment manufacturers, construction workers and welders, seaman and vessel providers, aviation contractors, etc.), which could permanently harm the industry's ability to continue production and support future decommissioning activities.[23]

IV. BOEM's Proposed "Solution" is Not Workable, as $9.2 Billion of Additional Surety Market Capacity for Bonds Does Not Exist

Despite repeated inquiries from the surety industry, independent offshore producers, and other stakeholders, BOEM has failed to answer a critical threshold question underpinning the rulemaking: Is it the government's intent to treat these new bonds as "the last dollar out" protecting only the taxpayer, or is it the government's intent to transfer risk from predecessors to the surety industry?

As the SFAA noted in its comment letter:

> BOEM is silent as to how and when the required financial assurance will be called upon. Without knowing the order of attribution of when the financial assurance is required to be utilized to fund decommissioning activity it provides an extreme amount of uncertainty to [sureties] being asked to provide the financial assurance on behalf of lessees…This is critically important for the sureties to understand when underwriting lease operators and the Gulf of Mexico lease marketplace generally, specifically whether to continue to write in this space or how to change the terms under which they will continue to write bonds for lease operators.[24]

The answer to this question determines whether (1) a surety market exists for BOEM's "solution," (2) whether the supplemental bonds will priced in a manner that does not create an undue burden, (3) whether the sureties providing the supplemental bonds will require cash collateral to provide new capacity, (4) whether there is a capital market that is willing to provide

[22] *See* Opportune Study at p. 7.
[23] For example, in 2014, there were thirty-six active jack-up drilling rigs in the GOM; today, there are only six active drilling rigs. *See* IHS Petrodata.
[24] SFAA Comment Letter at p. 7.

that funding for cash collateral, and (5) ultimately, who will benefit from the new bonding: major oil and gas companies or American taxpayers.

CAC Specialty, a broker that places approximately $1.5 billion of energy surety bonds, noted in its comment letter, "[t]his massive bond increase the BOEM seeks comes on the heels of some of the largest OCS related surety losses in history. Markets have withdrawn, capacity is low, reinsurance expenses and losses have driven up rates."[25]

If the new supplemental bonds are intended to protect major oil and gas companies from their joint and several liabilities, then there will be little to no capacity in the surety market. We understand that the current offshore surety market guarantees approximately $5 billion of obligations and that recent losses exceeding $1.9 billion associated with two bankruptcies have crippled the industry's ability to support current (and new) risks for the benefit of predecessors in title.[26]

CAC Specialty noted that "only about a dozen carriers remain, which means that, if distributed evenly, each carrier would take on an average of $750 million in new bonds, a potentially futile exercise."[27] The SFAA echoed this sentiment, stating that "it is unlikely that whatever appetite would exist [for these new bonds] will be in the aggregate amounts contemplated in the proposed rule, making commercial implementation of the Proposed Regulations unlikely through surety bonds alone."[28]

What is more, the more financially sound independent operators will be impaired by the substantial cost of complying with the Proposed Rule, which as written does not allow operators to receive credit for previously posted private-party security. As the SBA pointed out, "[t]he proposed rule would require small businesses to pay twice to protect against decommissioning liabilities, once through the sales contract and again to the federal government."[29]

In other words, the Proposed Rule is unimplementable if BOEM intends for the new supplemental bonding to transfer risks from predecessors to sureties given the recent losses sustained by the surety market. Moreover, if BOEM does not clearly state its intent for whom the new bonds will benefit, sureties must assume that the new bonds may protect predecessors, and capacity will not materialize.

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[25] CAC Specialty Comment Letter, https://www.regulations.gov/comment/BOEM-2023-0027-1201, at p. 2.
[26] *See* CAC Specialty's Comment Letter.
[27] *Id.* at p. 2.
[28] SFAA Comment Letter at p. 2.
[29] SBA Comment Letter at p. 3.

V. Congressional Oversight is Needed to Ensure that the Department of Interior Arrives at a Workable Solution to this Limited Problem

BOEM's Proposed Rule seeks to impose a $6 billion "solution" to a $58 million "problem." This is equivalent to "spend[ing] a dollar to save less than a nickel."[30] The ostensible provider of BOEM's "solution"—the surety industry—has made clear that there is no capacity in the surety market to support the Proposed Rule. At a more fundamental level, the fact that this rulemaking directly targets the viability of small businesses in the GOM necessitates a closer look at the true intent underpinning this rulemaking exercise. There is a path forward on this issue, but Congressional oversight is necessary to ensure BOEM's solution is commensurate with the actual risk to taxpayers.

Arena and the GEA have expended considerable effort and resources seeking resolution of this issue for over a decade, and we remain committed to working with BOEM and other stakeholders to develop a financial assurance framework focused on actual taxpayer risk. The offshore industry sorely needs finality on these regulations. But instead of protecting major oil and gas companies by ignoring security already in place and re-trading private, commercial transactions between buyers and sellers, any bonding framework must recognize the joint and several liability of all current and former owners for decommissioning as a fundamental and grounding principle, which would be consistent with BOEM's actual practice and the stated intent of the Proposed Rule.[31]

I certainly recognize that there are many other regulations I could speak to today in the context of this hearing—whether already in place, proposed, or anticipated—negatively impacting small businesses in the GOM. But from my perspective, there is no issue of greater importance to small businesses in the GOM than this one.

Thank you for the opportunity to testify this morning and I look forward to your questions.

[30] State of Louisiana Comment Letter at p. 2.

[31] The Proposed Rule states that "[t]his proposed rule would retain the authority to pursue predecessor lessees for the performance of decommissioning." 88 Fed. Reg. at 42141.