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U.S. Department of the Interior,
Bureau of Ocean Energy Management
Attention: Kelley Spence
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[Submitted via *www.regulations.gov*]

September 7, 2023

Subject: Shell Comments to BOEM's Notice of Proposed Rulemaking on "Risk Management and Financial Assurance for OCS Lease and Grant Obligations", RIN 1010-AE14 (BOEM-2023-0027-0001)

Dear Kelley Spence,

Shell Offshore Inc., along with its affiliates supporting the exploration, development production, and transportation of the United States' natural resources on the US Outer Continental Shelf (OCS), (collectively, Shell) appreciates the Bureau of Ocean Energy Management's (BOEM) efforts to revise its regulations on Risk Management, Financial Assurance and Loss Prevention, and we are pleased to provide these comments to the subject Proposed Rule. Shell also supports the joint comments submitted by the American Petroleum Institute (API) and the Louisiana Mid-Continent Oil and Gas Association (LMOGA), except where those comments differ herein.

Shell has been operating on the OCS (including the Gulf of Mexico (GOM), Pacific, and Alaska Regions) for over 65 years, and we are currently one of the largest leaseholders and the largest producer of oil, producer of gas, and royalty payor from federal leases on the OCS. We also operate about one-third of all daily oil production from the GOM and we deploy approximately $2 billion annually in capital and operating expenses toward these ventures. Moreover, there are thousands of employees in Gulf Coast states, across

the US, and around the world directly supporting our US GOM activities, with an even greater number of contractors supporting the same.

Accordingly, Shell appreciates the complexities of managing the financial risks associated with multi-billion-dollar OCS ventures, particularly with respect to the decommissioning of offshore wells, pipelines, and facilities.

Shell recognizes the Federal government is tasked with safeguarding people and the environment while also making the nation's resources on the OCS available for expeditious and orderly development. Shell also recognizes the Federal government must ensure, through its financial assurance regulatory regime, that: (1) US Taxpayers are never responsible for fulfilling unperformed and abandoned decommissioning obligations on the OCS, and (2) the US OCS remains an attractive investment case, while not creating undue burdens on Industry, including small businesses.

Shell believes a critical approach to the Federal government achieving the above is to ensure current lessees (record title and operating rights owners) and Right-of-Way (ROW) and Right-of-Use Easement (RUE) grant holders perform their obligations, and to require security from those current owners when there is an unacceptable risk of default of the performance of their accrued obligations.

Overall, Shell believes the Proposed Rule strikes the appropriate balance among these many factors and contains many improvements to BOEM's current regulations. Therefore, we generally support the Proposed Rule and Shell supports finalization and implementation as outlined in this comment letter.

I. BOEM's Proposed Regulations

A. Shell supports the proposal to modify 30 CFR § 556.901(d) to rely on issuer and proxy credit ratings.

Shell appreciates BOEM's effort to streamline its evaluation criteria for determining whether lessees (record title and operating rights owners) and ROW/ RUE grant holders may be required to provide security above the prescribed amounts for base security to secure their outstanding decommissioning obligations.

Shell supports BOEM's proposal to drop the five factors contained in current 30 CFR §556.901(d) and to instead utilize issuer credit ratings from S&P, Moody's, Fitch as the primary and leading indicator of an entity's propensity to default. Likewise, Shell supports BOEM's modifications in the proposed §§ 550.166(b) and 550.1011(d) to rely upon issuer and proxy credit ratings for RUEs and ROWs, respectively.

Shell also supports BOEM's proposal to utilize proxy credit ratings by using S&P Global's Credit Analytics credit model and the proposal to rely upon audited financials. Shell believes BOEM should accept financial statements created under International Financial Reporting Standards (IFRS) in addition to BOEM's acceptance of financial statements created under Generally Accepted Accounting Principles (GAAP).

Lastly, Shell requests BOEM provide clarity on whether and how frequently it will monitor credit ratings. Shell suggests BOEM monitor issuer credit ratings, provided by S&P, Moody's, and Fitch, at least on a yearly basis and prior to the approval of an assignment. In the case of a proxy rating, BOEM should reevaluate the entity at least on an annual basis, when audited financial statements are available, prior to the approval of an assignment, and when there is a "material adverse change" – for example, when an entity accrues new decommissioning liabilities (e.g., under 30 CFR § 250.1702) greater than a prescribed amount or percentage of the entity's existing decommissioning liabilities.

B. Shell does not support the automatic reliance on "co-lessees" in 30 CFR § 556.901(d)(3)

Firstly, the Proposed Rule permits BOEM to consider only the credit rating of the current owner (record title interest holder, operating rights owner, RUE grant holder, or ROW grant holder, as applicable) that is named on the applicable instrument and has accrued the liability for which BOEM is evaluating for supplemental financial assurance.

For example, assuming "Company A" is the only named record title holder of a lease, then BOEM cannot apply the issuer (or proxy) credit ratings of any other "Company A" entities to determine the financial assurance requirements of

"Company A". In this example, "Company A" is the only entity that accrues liability under the lease and applicable regulations.

Secondly, BOEM's proposal uses the term "co-lessees"; however, this is an undefined term and may not distinguish or match up liabilities amongst applicable record title and operating rights owners. Therefore, , if BOEM proceeds with its proposal in 30 CFR § 556.901(d)(3) (which Shell does not support as discussed below), then BOEM should replace "co-lessees or co-grant holder" with "co-record title owner, co-operating rights owner, or co-grant holder" or otherwise make clear in proposed 30 CFR § 556.901(d)(3) that a co-lessee may only rely on other co-lessees to the extent that the accrued liabilities align.

Third, and just as with assignments by distant successors in the chain of title, current owners do not always select their co-owners (e.g., a divestment by a single co-owner). Nonetheless, the Proposed Rule would create forced implied sureties between co-owners that would potentially undermine carefully crafted contracts among the parties, such as joint operating agreements and decommissioning security agreements.

Instead, BOEM should modify its Proposed Rule to strike proposed 30 CFR § 556.901(d)(3), issue financial assurance demand orders to the designated operator and each co-owner based on its proportionate ownership interest. BOEM should also allow the *option* for co-owners to satisfy their financial assurance demand orders by providing BOEM a single security.

C. Financial assurance should reflect that it secures asset-specific obligations.

Financial assurance (security) is designed to secure lease specific obligations. E.g., see 30 CFR § 556.902(a)(2). Accordingly, Shell believes the Proposed Rule should include a *requirement* that BOEM distribute any funds received from any forfeited bond or other financial assurance to a party (predecessor or otherwise) that in response to a BOEM or BSEE order performs decommissioning or other corrective action.

Therefore, Shell recommends BOEM modify 30 CFR § 556.907(h) as follows:

Recommended Text:

* * *

The Regional Director ~~may~~ shall pay the funds from the forfeited financial assurance to a co- or predecessor lessee or third party who is undertaking the corrective action required to obtain partial or full compliance with the regulations and the terms of your lease or grant.

* * *

In their comments and proposed changes to 30 CFR § 556.902(a), API and LMOGA recognized this important issue and suggested that any bond or other financial assurance be payable upon demand "to a party other than current interest holders that in response to a BOEM or BSEE order actually performs decommissioning or other corrective action", effectively making all bonds multi-beneficiary bonds. BOEM also should consider adding a new provision in 30 CFR § 556.902(a) for ensuring the negotiated security instrument protects the allocated asset regardless of who is the party performing the decommissioning.

Recommended Text:

* * *

(a)(4) be payable to the party performing the decommissioning or other lease or grant obligation.

* * *

With this change, the Proposed Rule would expressly recognize the of use "dual-obligee bonds" (security), consistent with the stated intent of BOEM's revisions in the Proposed Rule. ("The proposed rule would revise the section heading [of 30 CFR § 556.902] to read, "General requirements for bonds or other financial assurance," to recognize that other types of financial assurance, such as a dual-obligee bond or a pledge of Treasury securities, may be provided under 30 CFR part 556." 88 Fed. Register at 42,153) Dual-obligee bonds remain an important tool for lessees and transacting parties as they help facilitate OCS transactions and investments while avoiding "double securing" lease obligations (i.e., whereby separate security is held

both between private entities and by the US Government for the same decommissioning obligations).

D. Shell supports a credit rating regime in proposed 30 CFR § 556.901(d) built around, at a minimum, investment grade.

Firstly, Shell reiterates that BOEM's evaluation of "You" under proposed 30 CFR § 556.901(d) must be based on the entity named on the applicable instrument that accrues liability under the instrument and regulations, and not some unnamed entity, such as an affiliate, parent, or subsidiary.

Secondly, in 2020, Shell suggested BOEM consider implementing a tiered structure in 30 CFR § 556.901(d) by which entities are placed into three distinct classes based on an annual review of their public or proxy credit ratings. We suggested the highest tier of lease owners and ROW / RUE grant holders would have an at or above A– (S&P) or A3 (Moody's) credit rating and should be excused from posting additional financial assurance under 30 CFR § 556.901(d). We also suggested the second tier of entities, having a credit rating of BBB+ to BBB– (S&P) or Baa1 to Baa3 (Moody's), should be assessed using additional information provided to BOEM that is consistent with some of the current criteria in § 556.901(d)(1). Lastly, we suggested the third tier would include those entities with credit ratings below BBB– (S&P) or Baa3 (Moody's), and those entities should be required to provide an amount and form of security sufficient to secure their entire outstanding accrued decommissioning obligation.

Shell appreciates BOEM's intent with the Proposed Rule, like the 2020 proposed rule, to establish a single threshold credit rating. We also appreciate there are additional burdens and potential pitfalls of employing a multi-tiered credit rating system for determining supplemental financial assurance, particularly in the absence of clearer criteria for the evaluation of entities in the Tier 2 category.

Therefore, Shell supports BOEM's approach in the Proposed Rule to utilize a single credit threshold.

Shell endeavors to conduct its commercial transactions with financially strong counterparties, or counterparties that can provide satisfactory credit support. We acknowledge that BOEM's objectives with the Proposed Rule means that Shell and BOEM credit rating thresholds may not align in all respects and commend BOEM on establishing, at a minimum, an investment grade credit rating threshold in the Proposed Rule.

To be clear, Shell does not support a credit threshold below investment grade, and we believe BOEM's 2020 proposal contained too low a threshold by relying on speculative-grade ratings (a/k/a "non-investment grade" or "junk ratings"). Specifically, the 2020 proposal set a minimum S&P one-year issuer credit rating threshold of "BB–". S&P defines that rating as reflecting "major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitments on the obligation."[1] Moody's classifies its similar Ba3 rating as "Not Prime", and is Moody's lowest rating for an entity having "[o]bligations [that] are judged to be speculative and are subject to substantial credit risk."[2] For comparison, the requirement by the U.K. Department of Business, Energy and Industrial Strategy's Offshore Petroleum Regulator for Environment and Decommissioning is a minimum rating of BBB– and Baa3 from S&P and Moody's, respectively, both of which are investment-grade credit ratings.[3] Further, according to S&P's "Default, Transition, and Recovery: 2022 Annual Global Corporate Default And Rating Transition Study" , the five year default rate for entities holding BBB- rating is 2.44 percent as compared to 8.57 percent for BB-, 22.97 percent for B-, and 45.63 percent for CCC.[4]

E. Shell does not support BOEM's proposed expanded definition and use of "contingent liabilities" in 30 CFR § 556.901(d)(2)(ii).

[1] https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352

[2] https://www.moodys.com/sites/products/AboutMoodysRatingsAttachments/MoodysRatingSymbolsandDefinitions.pdf

[3] **"Oil & Gas UK: Liability Provision Guidelines for Offshore Petroleum Operations" Rev. 01 (Feb. 15, 2018) at pg. 18**

[4] https://www.spglobal.com/ratings/en/research/articles/230425-default-transition-and-recovery-2022-annual-global-corporate-default-and-rating-transition-study-12702145 **at Table 26.**

Shell does not support BOEM's proposal to include "contingent liabilities", as the Proposed Rule may potentially include liabilities not otherwise considered "contingent liabilities" under GAAP or IFRS. Private entities should not be penalized for obtaining and relying upon a proxy rating, and instead BOEM should mirror the methodology adopted by NRSROs and applicable to issuer credit ratings. Moreover, the scope of "contingent liabilities" is vague in the Proposed Rule, which could lead to inconsistent application.

Therefore, Shell recommends BOEM strike § 556.901(d)(2)(ii) in its entirety.

F. Shell supports the ratio of the net present value (NPV) of the remaining proved reserves to the decommissioning of those reserves in proposed 30 CFR § 556.901(d)(4).

Firstly, Shell supports BOEM's reliance on regulations and methods established by the US Securities and Exchange Commission (SEC) as guidance to the calculation of proved reserves, though further clarification on how to calculate the ratio in proposed 30 CFR § 556.901(d) may be required from BOEM, in part, because proved reserves are reported to the SEC, for example, at continent or country levels rather than at the lease level.

Secondly, Shell believes the Proposed Rule appropriately selects a ratio of three times the value of the remaining proved reserves to the decommissioning obligations. While some leases, particularly those with lower total volumes of proved reserves, may still lack sufficient remaining economic value at the three times ratio to attract potential buyers – for example, in the event of a bankruptcy – on balance, transactions tend to include multiple leases with varying resource recovery potential.

Therefore, we believe BOEM's framework and three-to-one ratio in proposed § 556.901(d)(4) are appropriate alternatives when the owner or co-owner does not satisfy the threshold issuer or proxy credit rating.

With that, we offer the following suggestions that aim to improve BOEM's proposed framework:

i. *Calculation of proved reserves.*

It is Shell's understanding that the Bureau of Safety and Environmental Enforcement's (BSEE) decommissioning estimates reflect the current cost of decommissioning (i.e., the cost in today's dollars). Accordingly, BOEM should calculate proved reserves using undiscounted costs applied to future cash flows and then discount those totals to present value using the 10 percent discount rate included in the SEC regulations cited in the Proposed Rule.

The calculation of proved reserves should also exclude asset retirement obligations (AROs, being the company's estimated decommissioning liabilities) from this calculation. Shell believes including AROs in the calculation of proved reserves (1) double counts the decommissioning obligations on both sides of the ratio, thereby deflating the value of the proved reserves, and (2) calculates the numerator (being the proved reserves) based upon the *company's* AROs, whereas the denominator is based upon *BSEE's* decommissioning estimates.

ii. *Include in the denominator of the ratio all decommissioning obligations on the lease.*

The Proposed Rule would excuse current owners from posting security for their present outstanding idle decommissioning obligations by relying on a ratio based on the decommissioning costs associated only with <u>future</u> proved reserves. ("There are proved oil and gas reserves on the lease, as defined by the SEC Regulation S–X at 17 CFR 210.4–10 and SEC Regulation S–K at 17 CFR 229.1200, the value of which exceeds three times the estimated cost of the decommissioning associated with the production <u>of those reserves</u>, and that value must be based on reserve reports submitted to the Regional Director and reported on a per-lease basis.") Proposed 30 CFR § 556.901(d)(4) (emphasis added.)

Instead, 30 CFR § 556.901(d)(4) should be revised to consider the value of the remaining proved reserves as a ratio to the combined currently outstanding <u>and</u> future decommissioning obligations on the lease.

<u>Recommended Text (combines the two prior recommendations):</u>

* * *

(4) There are proved oil and gas reserves on the lease, as defined by the SEC Regulation S–X at 17 CFR 210.4–10 and SEC Regulation S–K at 17 CFR 229.1200, but excluding asset retirement obligations, the value of which exceeds three times the estimated cost of the decommissioning associated with the production of those reserves and any unfulfilled decommissioning of wells, pipelines, platforms, or other facilities installed under the lease, and that value must be based on reserve reports submitted to the Regional Director and reported on a per-lease basis.

* * *

iii. *Evaluate only on a "per lease basis", and not on the unit or field level.*

Shell supports BOEM's proposed application of the ratio on a "per lease basis". When entities do not meet the other requirements of proposed 30 CFR § 556.901(d) (i.e., that no owner or co-owner holds the threshold credit rating), Shell supports the policy approach that the value of the lease self-secures the liability to decommissioning infrastructure installed pursuant to the rights granted by that lease and only that lease.

Shell also appreciates there are circumstances where off-lease infrastructure has been installed and remains economically supported by adjacent and near leases. Shell supports BOEM providing a limited pathway for owners to combine the value of their proved reserves on multiple leases with the infrastructure installed to explore and produce those leases (e.g., combine the value of the proved reserves of leases in a Unit where there is common ownership in the unitized leases and the infrastructure).

If BOEM were to allow lease owners and RUE / ROW grant holders to attribute off-lease decommissioning obligations to a lease(s) that lack common ownership, Shell believes the following challenges could arise:

(1) BOEM and Industry may be faced with the significant administrative burden of grouping and allocating these decommissioning costs across multiple leases and instruments (RUEs and ROWs);

(2) the distinct ownership among lease owners and RUE / ROW grant holders, especially when considering multiple leases, units, and fields, would require proportionate allocation of decommissioning costs to be spread among multiple entities, as those entities that often have varying interests across these instruments and therefore accrue their liabilities dissimilarly. This necessarily increases the complexity of the calculations and risks inaccurate allocations, which could lead to appeals and other delays in BOEM obtaining financial assurance;

(3) there is risk that decommissioning obligations for which a party has not accrued liability is ordered to provide (or by way of BOEM's permitted calculation, it provides) security through its lease. At the same time, other entities may use the complex calculation to outright avoid security by attributing their accrued decommissioning liabilities associated with their leases, RUEs, and / or ROWs to leases in which they do not hold any interest; and / or

(4) allocating off-lease decommissioning, particularly in the context of attributing decommissioning obligations under RUEs and ROWs to a lease, would be inconsistent with BOEM's stated intent in the Proposed Rule not to allocate proven reserves to RUEs and ROWs.

iv. "Proved Reserves" should not be restricted to artificial lease boundaries.

Shell believes BOEM should clarify in the preamble to its final rule that the calculation of proved reserves allows for the inclusion of all portions of the reservoir(s) that the lessee reasonably expects, consistent with the cited SEC regulations, to be produced from that lease, even if the boundaries of the reservoir(s) are located beyond the artificial lease boundary lines.

This general approach is consistent with the SEC regulations cited in the Proposed Rule, as well as conservation doctrines applicable to federal oil and gas leases on the OCS (e.g., correlative rights and the "rule of capture").

v. *Shell supports BOEM's reliance on BSEE's probabilistic estimates for decommissioning costs in proposed 30 CFR § 556.901(d)(4)(i) but recommends BOEM utilize 90 percent.*

In our 2020 comments, Shell suggested BOEM consider the use of company asset retirement obligations for calculating the ratio of proved reserves to decommissioning liabilities. However, Shell appreciates the importance of using a transparent and fixed approach to determining the decommissioning costs to establish supplemental financial assurance requirements. We also recognize that BSEE's decommissioning estimates are regularly updated using actual decommissioning costs provided by offshore operators and the regulated community.

Furthermore, in recent years, Shell has utilized BSEE's P90 estimates in our initial evaluations of Shell's potential decommissioning exposure, especially in the case of retained decommissioning liabilities ("legacy properties"), until we perform additional technical analyses, physical inspections, and solicit bids to perform any required decommissioning. We have found our assessments are sometimes higher and sometimes lower than BSEE's P90 decommissioning estimates. But in either case, BSEE's P90 estimates provide the most readily available and transparent figures.

Therefore, Shell supports the proposal to rely upon BSEE's decommissioning estimates, and we recommend BOEM utilize BSEE's P90 and not P70 estimates.

<u>Recommended Text:</u>

* * *

(i) Where BSEE-generated probabilistic estimates are available, BOEM will use the estimate at the level at which there is a ~~70~~ <u>90</u> percent probability

that the actual cost of decommissioning will be less than the estimate (~~P70~~ P90).

* * *

G. The modifications to proposed 30 CFR § 556.904 (Decommissioning Accounts) should better allow for the incorporation of private security arrangements created by Decommissioning Security Agreements.

Shell generally supports BOEM's proposed changes to 30 CFR § 556.904, subject to BOEM's incorporation of API and LMOGA's suggestions; however, BOEM's proposed subsection (a) states at the end, "The decommissioning account must be set up in such a manner that funds may not be withdrawn without the written approval of the Regional Director." This proposed text may impact current and future Decommissioning Security Agreements (DSA) and only further the existence of "double security". Furthermore, the proposed text may dissuade the use of DSAs, which are common arrangements in other regimes, such as the North Sea, and have been garnering greater support for future transactions in the US OCS.

Therefore, Shell suggest BOEM consider the following modifications:

* * *

(a) …The decommissioning account must be set up in such a manner that funds may not be withdrawn without the written approval of the Regional Director, subject to the terms of any agreement where the US Government is a named third-party beneficiary.

* * *

H. Qualification criteria for third-party guarantees in 30 CFR § 556.905.

Shell supports BOEM's proposal to assess the qualification of a third-party guarantor based solely on its issuer or proxy credit rating, especially given the traditional challenges BOEM has faced when attempting to apply the current criteria

in 30 CFR § 556.905(a) (e.g., defining "unencumbered net worth in the United States" could lead to a substantive interpretation, and BOEM and Industry faced considerable challenges surrounding BOEM's implementation of NTL No. 2016–N01).

Shell also supports BOEM's proposal to greatly reduce confusion in its current regulations by establishing a threshold public and proxy credit ratings to qualify a guarantor, and Shell supports BOEM's proposal to set the threshold in line with the credit rating applied to the lessees in proposed 30 CFR § 556.901(d).

I. Limited third-party guarantees in 30 CFR § 556.905.

Shell supports BOEM's proposal to modify third party guarantees to be limited to specific dollars and agrees with BOEM that its proposed approach is more likely to expand the use of guarantees.

Additionally, Shell suggests BOEM modify its regulations, as proposed by API and LMOGA, to allow guarantors to limit their guarantees to specific obligations. This modification is a logical extension from and consistent with the Proposed Rule, and it would only further ease pressure on the security market by removing from guarantees any additional and unstated obligations that are not included in BOEM's financial assurance demand order.

II. Additional Questions Solicited by BOEM in its Preamble and Section IX.

A. BOEM Question (88 Fed. Reg. at 42,143): "BOEM specifically requests comments regarding the use of fines and violations as a criterion in the determination of a company's ability to fulfill decommissioning obligations, and any data or analysis addressing any correlation between the number of violations and the risk of financial default. BOEM also requests comments on whether the elimination of the INCs criteria would create a disincentive to comply with the regulations. BOEM also requests comment on whether or not the cost of decommissioning is likely to increase based on the type, quantity, or magnitude of previous violations."

Shell Response: Incidents of non-compliance (INCs) are important indictors for the Department of the Interior and its subagencies to track and evaluate safety performance and regulatory compliance, and we commend BSEE for its increased use of INC data.

However, Shell supports BOEM's proposed elimination of "record of compliance" from the factors determining whether BOEM will require supplemental financial assurance. While there may be some correlations between the number and/or types of INCs and those entities that default, utilizing INCs to determine supplemental financial assurance requirements carries the following challenges and risks:

- There can be many confounding variables to a perceived correlation, such as enforcement decisions, number of leases, age of infrastructure, uses of technology, and number of individual components.

- BOEM's supplemental financial assurance criteria should target the probability of default in a five-year outlook given the size of decommissioning liabilities (this is consistent with BOEM's proposed reliance on issuer and proxy credit ratings). Even assuming the existence of a strong correlation between the ratio of INCs to defaults on decommissioning obligations, by the time the correlation is observable it is likely too late for BOEM to demand financial assurance to secure against a default.

- While companies at or near bankruptcy may have historically received a higher-than-average total number of INCs or ratio of INCs *to inspections*, a bankruptcy filing is distinct from an entity's likelihood of *default*.

- BSEE continues to refine its approach to INCs, such as using INCs to trigger risk-based inspections that inquire further into specific assets and/or operator performance. This is indicative that INCs are informative but require further investigation to determine underlying causes and potential risks.

- Shell has received decommissioning orders for several legacy assets. Upon inspection of some of those assets, we have observed disrepair and poor maintenance. This suggests some current owners will not be further dissuaded from meeting their compliance obligations should BOEM remove "record of compliance" as a supplemental financial assurance criterion.

B. BOEM Question (88 Fed. Reg. at 42,144): "BOEM requests comments on potential unknown risks associated with the use of P70. BOEM has examined the impact that the different P values would have on the amount of financial assurance required but lacks the data to estimate the impact that selecting a P90 value might have on offshore capital expenses and investments, and therefore has selected P70 in this proposal. We are also specifically seeking information and data related to these impacts from commenters.

. . .

BOEM requests comments and additional data on the costs and benefits of setting the supplemental financial assurance requirements based on each of the P50, P70, and P90 decommissioning liability levels. In particular, BOEM would like information on impacts to offshore capital expenses and investments of each liability level, as well as impacts to potential taxpayer liability. BOEM also solicits comment on whether setting assurance requirements based on different liability levels might be appropriate for different circumstances. BOEM also requests comments on costs and benefits of otherwise considering predecessor lessees or grantees in determining the level of required supplemental financial assurance. Additionally, BOEM requests comments on the possibility of using a higher BSEE decommissioning estimate (i.e., P90), including on how a P90 estimate would affect small entities."

Shell Response:

P70 versus P90 BSEE estimates.

As discussed above, Shell supports the use of BSEE's P90 decommissioning estimates. We have found instances where BSEE's P90 estimates are sometimes lower and sometimes higher than the cost of decommissioning upon execution,

including when Shell contracts "turnkey" decommissioning operations with third party contractors. Therefore, instead of promulgating a lower estimate of P70, BOEM should rely upon BSEE's P90 estimates and BSEE should continue to refine its decommissioning estimates to better reflect actual decommissioning expenses rather than BOEM accepting a greater risk (through P70) that it has under current secured offshore decommissioning liabilities.

The possible impact of P90 Estimates on investment and small entities.

We also recognize that BOEM's reliance on P90 estimates could lead to BOEM requiring additional financial assurance on more leases and from more owners. But this does not necessarily mean it will be a higher burden or that it will tie up more non-committed capital.

Even financially weak entities that intend to perform their decommissioning have two additional avenues in the Proposed Rule to secure their decommissioning obligations, all of which would avoid any unexpected impacts: (1) the lease self-secures its own decommissioning when the value of the proved reserves on the lease is three times the BSEE decommissioning estimates; or (2) even when an owner and its co-owners are too financially weak and lack sufficient remaining proved reserves for their leases to self-secure, a prudent entity should already have set aside cash to pay for its near-term decommissioning obligations. Entities that depend on *future cash flows* to pay for their *currently matured* decommissioning obligations are operating a "just in time" business model that is highly indicative of an entity seeking to defer its decommissioning obligations with no real business plan to ever perform them.

Stated differently, an entity that doesn't have the threshold credit rating and holds a lease(s) with little remaining economic value still should have set aside cash to perform its near-term decommissioning. That entity should not need to obtain a bond to meet its supplemental financial assurance obligations; instead, it can place its decommissioning funds, for example, into a Decommissioning Account to the benefit of the US Government.

Lastly, Shell is aware of arguments by some opponents to the Proposed Rule claiming the surety market is constrained and cannot meet the additional security requirements BOEM has projected to be required if it finalizes the Proposed Rule.

However, this is both logically and factually incorrect.

If BOEM's regulation increases demand upon the surety market, it would be illogical for the market not to reorganize itself to meet that demand. Instead, the relevant question is whether current owners requiring supplemental financial assurance can satisfy the sureties' low risk tolerance. Any current owner seeking a bond will need to show the prospective bonding agency it, at a minimum, has sufficient unencumbered collateral, creditworthiness, and can afford the premiums (the amounts being determined in part on the prior two factors) before the surety will award the security. When a current owner cannot obtain a bond, it is not because the surety market can't supply the demand for that bond. Instead, it is more likely the current owner cannot obtain the bond because the current owner lacks the financial wherewithal and credibility to prove they will not default on their obligations—which is precisely the risk BOEM aims to mitigate in this Proposed Rule.

Reliance on "predecessors".

With respect to BOEM's question regarding predecessor lessees, Shell does not support consideration of predecessors in determining supplemental financial assurance.

In BOEM's 2020 Proposed Rule (85 Fed. Reg. 65904), BOEM considered "predecessors" when determining the financial assurance that may be required to secure the obligations held by current owners.

To begin, Shell disagrees with BOEM's statement in its notice in this Proposed Rule that:

> "If BOEM were to take into account the financial capacity of predecessor lessees in determining the amount of supplemental financial assurance required of a current owner, the financial burden on small companies would

be substantially reduced compared to that resulting from the proposed rule, because a much smaller number of them would be required to post supplemental financial assurance."

As stated earlier in this comment letter and included in our comments to BOEM's 2020 proposal, any consideration of "predecessors" by BOEM must be limited only to those entities named on the lease, RUE, or ROW (as applicable) because that is the only entity that may have accrued and retained obligations. For example, there is no issuer credit rating upon which BOEM can rely when "Shell Offshore Inc." is in the named entity in the chain-of-title as a record title or operating rights owner in a lease.

While it appears BOEM acknowledges this in portions of its proposal, we noted in the 2020 proposed rule where BOEM incorrectly identified and attributed a parent entity's issuer credit rating to its subsidiary, despite parent entities not accruing liability under any lease, RUE, ROW, or BOEM or BSEE regulations.

Furthermore, reliance on predecessors would upend decades of OCS practice and the historical regulatory framework relied upon by OCS record title interest owners, operating rights owners, and ROW/RUE grant holders. Shell has engaged in commercial activity on the OCS over the past 65 years that assumed, based in part, on: the written statements of senior staff for the Mineral Management Service (MMS) made in the late 1980s; MMS's, and now BOEM and BSEE's, regulations; BOEM-approved assignments; and the assignees express asset to comply with all regulations and the terms of their leases, ROWs, and RUEs. Together, it was clear and remains clear that current owners are responsible for providing adequate financial assurance for their accrued decommissioning obligations without giving any consideration to the existence of predecessors.

By turning to predecessors, BOEM instead would punish and discourage future participation on the OCS by financially responsible predecessors, including predecessors that are leading in total oil production; gas production; bonusses, rents and royalties; tax contributions; new and sustained capital and operating investments; the drilling of new wells; new and sustained job creation; and total greenhouse gas reduction from their offshore operations. In fact, Shell has found

that some entities with "highly speculative grade" (S&P) issuer credit ratings and below issuer actually contribute very little (in term of percentage) to the total offshore oil and gas production, royalties, employment, or the drilling of new wells; yet, some of these entities have contributed to some of the highest ratios of INCs to inspections and reported greenhouse gas emissions from their offshore assets.

Allowing current owners to decrease or outright avoid their financial assurance obligations based on the existence of certain predecessors is bad policy and legally unsupportable.

C. BOEM Question (88 Fed. Reg. at 42,144): "BOEM is proposing to use and is requesting comments on this test [value of proved oil and gas reserves exceeding three times the decommissioning costs] as the criterion to replace the existing generalized "projected financial strength" criterion found currently at § 556.901(d)(1)(ii), which considers whether the estimated value of a lessee's existing lease production and proved reserves is significantly in excess of the lessee's existing and future lease obligations. BOEM requests comment on whether 3 to 1 is an appropriate threshold, or if there are better approaches and/or data sets available for analysis that would provide BOEM with better certainty that taxpayer interests will ultimately be protected."

Shell Response:

Shell supports using the value of proved oil and gas reserves exceeding three times the decommissioning costs test as proposed by BOEM in its evaluation of supplemental financial assurance.

Shell has modeled hypothetical projects based on several ratios under differing costs and decommissioning assumptions and found the three times ratio results in enough remaining economic life in the lease that, in Shell's opinion, should still attract potential buyers.

Lastly, though we found the three times ratio to be low in some cases when considering the total proved reserves of smaller reservoirs, we still believe a

single ratio and calculation across the OCS is the most appropriate balance when considering: the complexity of administration by BOEM; compliance by the regulated community; and that transfers and assignments often include multiple leases packaged together and not transactions involving a single lease.

D. BOEM Question (88 Fed. Reg. at 42,146): "BOEM invites comments on the appropriateness of relying on S&P Global Credit Analytics credit model, or other similar, widely accepted credit rating models to generate proxy credit ratings. Additionally, BOEM invites comments on the appropriateness of using a proxy credit rating when determining the need to provide additional financial assurance."

Shell Response: Shell supports the option in proposed 30 CFR § 556.901(d)(2) for a proxy credit rating to be determined by the Regional Director based on audited financial information (under GAAP or IFRS) for the most recent fiscal year. Shell also supports BOEM's proposal to use S&P Global's Credit Analytics credit model, which we believe will better ensure predictability and transparency, as well as consistency with issuer credit ratings.

E. BOEM Question (88 Fed. Reg. at 42,147): "BOEM invites comments on the appropriateness of this approach of relying on lessee and grant holder credit ratings, including whether BOEM has proposed an appropriate credit rating threshold of BBB-, and if not, what threshold or set of thresholds would best protect taxpayers while not imposing undue burdens on industry. Also, BOEM invites comments on alternative options for determining the need for financial assurance other than credit ratings. Additionally, BOEM invites comments on whether financial assurance should be required of all companies, regardless of credit rating, and the impacts of a such a requirement might have on OCS investment and on potential taxpayer liabilities."

Shell Response:

Use of credit ratings

BOEM current regulations are mostly unchanged since they were significantly revised in 1997. Since that time, the five factor criteria, from Shell's perspective,

has been difficult for BOEM to administer and for the regulated community to incorporate into its activities.

This has resulted, in our opinion, in BOEM requiring very little supplemental financial assurance and the growing problems of default, poor asset management, and bankruptcy filings designed to manage the economic breach of decommissioning obligations.

Instead, we support BOEM's use of credit ratings, which are widely used across all sectors and industries, to determine the likelihood of default on accrued obligations. This approach introduces a necessary and much-needed bright line test to the OCS.

Appropriate credit threshold

See Shell's comments in Section I.D.

Requiring financial assurance of all entities.

Supplemental financial assurance regulations should be designed to require additional security only to the extent necessary to ensure the decommissioning obligation incurred by the respective party can be performed with readily available funds.

"High" issuer and proxy credit ratings are only attributed to financially strong entities with little history of default, such that those entities are expected to perform their assumed obligations. Therefore, it is unnecessary to require supplemental security from these entities because those entities have proven they *will* (to a near-zero percent probability) meet their performance obligations.

In the case of entities that have "low" issuer and proxy credit ratings, these entities have shown they lack financial strength and may have a history of significant default. Therefore, supplemental security is necessary because those entities have proven they are very unlikely to meet their performance obligations.

Even more, some of these entities with ownership interests is OCS leases, RUEs, and/or ROWs have gone even further to argue that supplemental security should only be required when the US Taxpayer is at risk of receiving decommissioning obligations, which they believe is significantly reduced by the existence of predecessors in the chain of title. Unsurprisingly, many of these same entities have been assigned below investment grade issuer credit ratings by NRSROs—being credit ratings that are associated with higher probabilities of default.

Shell believes the Proposed Rule generally strikes the appropriate balance of requiring neither too little nor too much supplemental security to ensure the US Taxpayer does not fund offshore decommissioning liabilities directly (through abandoned assets) or indirectly (shifting decommissioning liabilities to predecessors and increasing their costs to produce energy).

F. BOEM Question (88 Fed. Reg. at 42,128): "BOEM requests comment on whether the three-to-one reserves-to-decommissioning ratio is in fact an appropriate threshold, or if there are better approaches and/or data sets available for analysis that would allow BOEM to provide better certainty that taxpayer interests will ultimately be protected."

Shell Response: Shell respectfully refers BOEM to its other comments in this letter that generally support BOEM's proposed 3 to 1 ratio of the value of proved reserves on the lease to BSEE's P90 decommissioning estimates.

G. BOEM Question (88 Fed. Reg. at 42,148): "BOEM is requesting comments from potentially affected parties about this phased approach and how it could most effectively be implemented to minimize any unnecessarily adverse effects from an increased supplemental financial assurance requirement."

Shell Response: Shell supports BOEM's phased-in compliance period over an initial three-year period in the proposed 30 CFR § 556.901(h).

In Shell's view, a compliance period of several years will give adequate notice to the surety (security) markets; allow BOEM to identify questions and issue clarification on compliance; and allow entities that must provide supplemental financial assurance sufficient time to identify the underlying collateral and equity

necessary to obtain the security. We also expect the proposed compliance period to reduce requests for time extensions that would otherwise be necessary if BOEM did not include a phased-in compliance period.

H. BOEM Question (88 Fed. Reg. at 42,156-57): "BOEM is considering the inclusion of offshore joint and several decommissioning liabilities (of the co-lessees that would otherwise have exempted the lessee from providing supplemental financial assurance) in the determination of a proxy credit rating when these liabilities are "disproportionately high" and may encumber that co-lessee's ability to carry out future obligations. BOEM is requesting comments on the appropriate criteria to determine what constitutes "disproportionately high" offshore liabilities, for example, a ratio of decommissioning liabilities to the net worth of the co-lessee above X times, or other financially significant and reasonable criteria on how these liabilities should best be incorporated into the proxy credit rating that BOEM will derive."

Shell Response: Shell appreciates the objective BOEM aims to achieve with this proposal. However, the determination of a proxy credit rating should be as near identical to an issuer credit rating as possible. Otherwise, BOEM would effectively penalize unrated entities by attributing higher risk than BOEM's proposed use of the S&P Global's Credit Analytics credit model would generate.

Further, "disproportionately high" is vague and subjects BOEM and the regulated community to unnecessary confusion about what qualifies and does not qualify.

Instead, BOEM should generate proxy credit ratings using audit financials created under GAAP or IFRS and not seek to artificially modify the audited financials and inputs into the modeling such these modifications increase (or somehow decreases) the resulting probability of default.

I. BOEM Question (88 Fed. Reg. at 42,157): "The use of End-of-Life (Years) in the evaluation of asset value as an alternative to using the decommissioning costs ratio. BOEM requests comments on the use of a minimum number of years of production remaining criterion to qualify for an exemption from supplemental financial assurance. Possibly, End-of-Life criteria could be an alternative to the 3:1 ratio of value of reserves to decommissioning costs."

Shell Response: Shell supports a ratio based on value and not time.

While the models and inputs may vary, the framework in the Proposed Rule is very similar and would align generally with Industry practice internationally. For example, Shell and its counterparties (often through DSAs) sometimes establish security obligations based upon a ratio of the value of the expected volumes (calculated by volumes to be produced, an assumed cost, and an assumed average commodity price) to a calculated total cost to decommission.

If BOEM were to focus on time, then it would require the added step (after calculating value) to then determine at what point in time that value is beneath the ratio selected.

Even if BOEM were to calculate the remaining life of a lease without calculating value, Shell understands the Proposed Rule intends for the lease to self-secure its own decommissioning liabilities such that a potential buyer would still want to acquire the lease because there is remaining *value*, and not because there is remaining time to produce the lease. Therefore, a calculation based on time would not meet the stated intent of the Proposed Rule.

J. BOEM Question (88 Fed. Reg. at 42,157): "The consideration of bond issuance ratings, in addition to issuer credit, in determining the financial risk posed by lessees and grant holders. BOEM also invites comments on determining an appropriate threshold for bond issuance ratings, such as general unsecured debt ratings."

Shell Response: Shell supports BOEM considering the credit ratings of sureties, just as Shell supports BOEM's proposal to establish credit rating thresholds for the qualification of guarantors.

Generally, the market for financial institutions and sureties is comprised of institutions with high credit ratings as a reflection of their efforts to protect their investors from financial loss; this is similar to BOEM's efforts to maintain the investment case for the US OCS and to protect the US Taxpayer from the non-performance of decommissioning obligations on the OCS. Therefore, Shell believes BOEM should require the same credit rating threshold for entities issuing

bonds as BOEM requires for lessees, RUE and ROW grant holders, and guarantors.

K. BOEM Question (88 Fed. Reg. at 42,157): "Should BOEM exclude third party guarantors from the requirement of § 556.902(a)(2) that guarantees must "guarantee compliance with all obligations of all lessees, operating rights, owners and operators on the lease" in addition to allowing a third-party guarantee to be limited in amount?"

Shell Response: Yes. In addition to the comments provided by API and LMOGA, Shell believes limiting the obligations of third-party guarantors to specific obligations, as well as to specific amounts, would expand the available security market beyond traditional bonding agencies, thus easing the burden for entities required to provide additional supplemental financial assurance.

III. Conclusion

Shell appreciates BOEM providing this opportunity to comment on the Proposed Rule, and for their efforts to revise and improve the financial assurance program of the OCS. Shell has been engaged in BOEM's efforts to revise its supplemental financial assurance regulations for many years, and Shell believes the Proposed Rule contains several substantive improvements to the current regulatory regime.

Therefore, Shell supports finalization of the Proposed Rule, subject to the modifications recommended herein.

Please contact Kevin Simpson at [redacted] if you have any questions concerning these comments.

Regards,

[redacted]

Colette Hirstius
President, Shell Offshore Inc.