



Erik G. Milito
President

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**NATIONAL
OCEAN
INDUSTRIES
ASSOCIATION**

Sent Via E-Mail

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Mr. Kevin Karl
Deputy Regional Director
Bureau of Safety and Environmental Enforcement
1201 Elmwood Park Boulevard
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Dear Mr. Karl,

Through this letter, the National Ocean Industries Association (NOIA) submits to the Bureau of Safety and Environmental Enforcement (BSEE) the most significant issues that we and our members have with the recently-issued Special Case Royalty Relief guidance (the "Guidance"). NOIA is the only national trade association representing all segments of the offshore energy industry. For over 45 years, NOIA has been committed to ensuring a strong, viable U.S. offshore energy industry capable of meeting the energy needs of our nation in an efficient and environmentally responsible manner. NOIA member companies are engaged in traditional oil and natural gas exploration and production, as well as offshore wind energy development. Our member companies are proud that they contribute to America's energy security, and we want to continue providing that service in a way that protects our environment, rich cultural history, and the interests of communities across the country.

Our most significant concern is that the Guidance definition of "Allowable Expense" is artificial, unduly narrow, and fails to capture many substantial expenses actually incurred by lessees in operating offshore leases. The definition only includes direct lease-level operating expenses associated with production and ignores the many additional operational and corporate expenses that are both obligatory and necessary to operate offshore oil and gas leases. For example, lessees consider abandonment costs into investment decisions, but those are not "allowable," nor are they a typically monthly expense that can be captured under the revised Guidance. The standard that the Guidance uses is akin to a "paying quantities" standard, which serves a unique and completely different purpose (i.e., lease maintenance) than the "promote development or increased production" standard that Congress provided for royalty relief. NOIA respectfully requests that BSEE not apply a definition developed for a wholly different purpose (lease maintenance) to determine an operator's entitlement to royalty relief in a time of unprecedented national and international economic upheaval.

Offshore operators make economic decisions based on their corporate financial records. Every offshore operator follows U.S. Generally Accepted Accounting Principles ("GAAP"), which is a common set of accounting principles, standards, and procedures issued by the federal Financial Accounting Standards Board ("FASB"). Pursuant to the rules and regulations governing stock exchanges, public companies in the United States are required to follow GAAP. Companies hire international accounting companies to audit their corporate financial records for accuracy and to ensure compliance with GAAP. Moreover, in auditing a federal

lessee's royalty payments, the *Department of Interior's own regulations* expressly embrace GAAP. (See 30 CFR 1206.101 & 1206.151 (defining royalty audits as "a review, conducted under generally accepted accounting and auditing standards"); see also the attached exhibit which provides more detail regarding how Interior uses GAAP).

Since the "paying quantities" standard concerns a categorically different issue, and given the well-established controls inherent in GAAP-based financial accounting upon which Interior already relies in conducting royalty audits, NOIA proposes that BSEE replace the artificial standard articulated in the recently-issued Guidance with GAAP in determining "Allowable Expenses" which should be considered in evaluating whether a lease is economic for purposes of royalty relief.

To provide additional context, following are a few specific examples of expenses which are currently excluded under the Guidance as an "Allowable Expense" but which are in fact fundamental to lease-level economics and should be included:

- **Labor Costs for Corporate Support Staff:** The Guidance only allows the inclusion of a small portion of corporate support staff (up to 5% of the Labor costs listed in the definition of each line item of Allowable Expense). This ignores a substantial portion of the lessee's costs, including the costs for health, safety and environmental support, regulatory compliance, risk management, etc.
- **Finance Charges and Interest:** Finance charges and interest are listed as "Non-Allowable Expenses." As you know, offshore operations are capital intensive endeavors requiring equipment and infrastructure that can cost several hundred million dollars or more. Any prudent corporation would use a mix of cash/equity and debt to finance these expensive operations. Finance and interest charges can be one of the most expensive items for a lessee so to exclude these costs paints an inaccurate picture of the economics of a particular lease.
- **Capital Costs and Expenses Incurred Before or After The Production Month:** Tying "Allowable Expenses" to a particular production month demonstrates how the Guidance erroneously applies a "paying quantities" standard to a completely different set of issues. In making decisions on their investments in ongoing development and production, offshore operators necessarily take a broader view of their expenses, including capital costs that are often excluded from a "paying quantities" analysis. These costs are some of the biggest drivers in determining the economics of a lease. Further, these costs easily fit into the definition of "production" set forth by Congress in the Outer Continental Shelf Lands Act, 43 USC 1331 and repeated by BSEE in 30 CFR 250.105 ("*Production* means those activities that take place after the successful completion of any means for the removal of minerals, including such removal, field operations, transfer of minerals to shore, and workover operations").
- **Income Taxes:** Income taxes, which are a substantial cost to lessee, is listed in "Non-Allowable Expenses".

Excluding these important items substantially limits the number of leases that would qualify for royalty relief under the Guidance and defeats the Congressionally-expressed purpose of “promot[ing] development and increased production.” An objective, third-party definition of expense should be utilized by BSEE.

The Guidance document expressly allows other expenses to be included in the definition of Allowable Expenses if approved by BSEE. Accordingly, to accommodate NOIA’s request to use GAAP to determine whether a lease is economic would not require modification to the Guidance.

The second aspect of the Guidance that will create unnecessary burdens for both the industry and BSEE is the monthly application process. NOIA requests that the royalty relief be granted on a forward-looking basis for a financial quarter (three months). This would dramatically reduce the number of applications that would have to be drafted and reviewed. This is particularly important given the fact that there are over 2,500 active leases offshore. Further, the economic fundamentals of offshore assets are very unlikely to change significantly on a monthly basis.

Third, under the Guidance, royalty relief is only available if leases become economic merely by the granting of royalty relief. Given the historic and unprecedented demand-destruction, oil prices are at near 20-year lows. While royalty relief certainly improves the economics of all leases, the mere granting of royalty relief will not make many leases economic under current circumstances. Royalty relief will, however, help ensure that when oil prices recover, more leases will become economic sooner, leading to increased production. NOIA requests that BSEE consider eliminating the requirement that that a lessee demonstrate that a lease will become economic merely due to the granting of royalty relief in order to obtain it.

Fourth, at least implicitly, the Guidance provides that royalty relief will be terminated once the lease becomes economic. In other words, if a lease becomes profitable by one dollar, royalty relief is no longer available. Lessees do not take on the technical and economic risks of operating an offshore lease to make a single dollar. Instead, to justify the risk and to account for technical and financial contingencies associated with operating offshore leases, lessees require some reasonable level of return on the capital invested into the lease. In November 2019, BOEM and BSEE issued a report entitled *Recommended Discount Rates and Policies Regarding Special Case Royalty Relief for Oil and Gas Projects in Shallow Water* which determined that a discount – or return rate - of 25% was justified in determining whether royalty relief would be granted for shallow water leases. NOIA suggests that this 25% discount or return rate be utilized in determining whether leases are economic.

Fifth, the Guidance requires oil and gas executives to certify that without royalty relief their company is at “significant and imminent risk of failure to meet contractual requirements to the United States of America and other contractual counter-parties.” This certification—which is not lease-specific but rather a broader corporate certification—is problematic for several reasons. The certification is tantamount to saying that without receiving royalty relief for the lease or unit associated with the application the company is insolvent. NOIA requests that the certification state that the lease is uneconomic, applying GAAP.

Sixth, the Guidance requires that the various accounting documents be approved by third-party Certified Professional Accountants (“CPA”). This would impose significant costs on lessees applying for royalty relief, especially in light of the fact that royalty relief is granted on a lease-by-lease basis, thereby creating hundreds of applications which would require CPA approval. Instead, NOIA suggests that BSEE accept a certification by the CEO and CFO of the lessees certifying—under penalty of perjury—the accuracy of the accounting documents.

While there are a number of other issues we have with the Guidance, without the modifications suggested herein, the Special Case Royalty Relief program will fail along with many of the leases operated by offshore oil and gas companies, stranding oil and gas – likely forever.

Thank you for your attention to this important matter. NOIA and its members are available for follow-up questions or discussion.

Best regards,

A handwritten signature in black ink, appearing to read "Erik G. Milito". The signature is fluid and cursive, with a prominent initial "E" and a long, sweeping underline.

Erik G. Milito