U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF ADVOCACY
REGULATION • RESEARCH • OUTREACH

August 28, 2023

VIA ELECTRONIC SUBMISSION

Liz Klein, Director
Bureau of Ocean Energy Management
Department of the Interior

Re: Risk Management and Financial Assurance for OCS Lease and Grant Obligations, RIN 1010–AE14.

Dear Director Klein:

On June 29, 2023, the Department of Interior's Bureau of Ocean Energy Management (BOEM) published a proposed rule entitled Risk Management and Financial Assurance for Outer Continental Shelf (OCS) Lease and Grant Obligations.[1] This letter constitutes the Office of Advocacy's (Advocacy) public comments on the proposed rule.

This proposed rule harms small businesses holding current leases for oil and gas extraction in the OCS by ignoring the joint and several liability of large predecessor leaseholders in Department of the Interior (DOI) regulations and written into the leases. It requires small businesses that have already paid for assurance bonds agreed as part of the sale of the lease to purchase duplicative assurance bonds for the federal government. BOEM should narrowly tailor this rule to cover only those liabilities for which there are no predecessor leaseholders that BOEM considers credit worthy.

I. Background

A. The Office of Advocacy

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small entities before Federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA). As such, the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),[2] as amended by the Small Business Regulatory Enforcement Fairness Act

[1] 88 Fed. Reg. 42136 (June 29, 2023).
[2] 5 U.S.C. §601 et seq.

(SBREFA),[3] gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, the RFA requires federal agencies to assess the impact of the proposed rule on small entities and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.[4] The agency must include a response to these written comments in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, unless the agency certifies that the public interest is not served by doing so.[5]

Advocacy's comments are consistent with Congressional intent underlying the RFA, that "[w]hen adopting regulations to protect the health, safety, and economic welfare of the nation, federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public."[6]

B. The Proposed Rule

On June 29, 2023, BOEM published a proposed rule to modify its criteria for determining when oil and gas lessees in the Outer Continental Shelf (OCS) would be required to provide bonds or other financial assurances to ensure their ability to comply with lease conditions, including decommissioning. BOEM issued this proposal in response to concerns about bankruptcies by leaseholders exposing taxpayers to significant unfunded liabilities for the decommissioning of OCS operations. Citing several recent bankruptcies, BOEM estimates the total offshore decommissioning liability is approximately $7.5 billion. However, BOEM also states that the actual financial risk to the United States is significantly less than that figure because multiple other private parties share responsibly for decommissioning costs.[7]

BOEM proposes that leaseholders provide additional financial assurance bonds to the federal government. BOEM estimates that there is a total offshore decommissioning liability of over $42 billion and believes that this rule would help protect taxpayers from this liability. As part of the effort to reduce the impact of this rule, BOEM proposes that companies with sufficiently high credit ratings or sufficiently high reserve ratios would be exempt from this requirement. BOEM recognizes that this exemption would apply to few small businesses. Excluding these large businesses, BOEM estimates that there will be an additional $9.6 billion in new financial assurance provided, with an annual premium cost of $379 million. These costs would be borne mostly by small businesses. Importantly, BOEM proposes that for these purposes it would not recognize the joint and several liability borne predecessor leaseholders and would require financial assurances from current leaseholders only.

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[3] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. §601 et seq.).
[4] Small Business Jobs Act of 2010 (PL. 111-240) §1601.
[5] *Id.*
[6] *Id.*
[7] 88 Fed. Reg. at 42,139. Although there is no official figure representing the actual liability, Advocacy understands that BOEM provided a preliminary estimate to Congress that the unfunded taxpayer liability was less than one percent of this value.

BOEM prepared an Initial Regulatory Flexibility Analysis for this proposed rule and discussed a less stringent regulatory alternative that would reduce the burden on small businesses. This alternative would recognize the credit worthiness of predecessor leaseholders in determining when additional financial assurance would be required. The agency rejected that option, stating "consideration of predecessor lessees and grantees encourages moral hazard by incentivizing current lessees to pass risk to predecessors rather than proactively prepare for decommissioning and related obligations."[8]

II. Advocacy's Small Business Concerns

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. The 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. This proposed rule explicitly favors large businesses over small businesses without providing the taxpayer the intended protection from unfunded liabilities.

A. Joint and several liability protects taxpayers by ensuring that predecessors cannot shed liability and will instead engage in due diligence.

Joint and several liability is a fundamental characteristic of OCS leases. It has been a part of leases and in DOI regulations for decades. As a result, all market participants, past and current, have incorporated joint and several liability into their business decision, including the contractual sale to subsequent leaseholders. Decommission liabilities and the risk of default by subsequent leaseholders are well understood.

In response to this risk, leaseholders are rational market participants and seek their own assurances. These include not just financial bonding, of which there are billions of dollars outstanding. Sellers perform due diligence and establish long-term relationships to protect their financial interests. Leases are not sold like commodities, between faceless actors by price-takers. Each lease sale is negotiated, and joint and several liability is an ever-present factor. Taxpayers are protected by leaseholders understanding their liabilities and making sound business decisions to protect themselves.

However, BOEM treats these sellers as if they are naïve and lack experience in OCS leasing. In rejecting the regulatory alternative that would recognize predecessor leaseholders, BOEM cites moral hazard. Moral hazard is a situation in which a party carrying some kind of insurance, like a financial assurance bond, lacks incentives to avoid risks because they are insulated from the consequences.

Moral hazard is a symptom of asymmetric information because the insured party has more information about themselves and their future intentions than the insurer. This proposal does not solve a moral hazard problem, nor would the alternative create a new one. First, these markets are dominated by sophisticated sellers who do their due diligence and carefully negotiate the terms of sale and assurance. Second, this industry has repeated interactions and reputational

[8] *Id.* at 42,159.

consequences. Businesses and their agents that take unreasonable risks face consequences in higher premiums and loss of business. While bankruptcies can occur, this is not evidence of moral hazard nor of a failing of the existing allocation of liabilities through contract. Moral hazard is not a reasonable concern here. It does not justify a wholesale discarding of the market arrangements to allocate risk and liability that the free market itself has developed in response to the joint and several liability of the lease.

To the contrary, by creating a system that requires bonding for only for current leaseholders, BOEM is insulating predecessor leaseholders from joint and several liability and relieving the sellers of the need to perform due diligence on the subsequent leaseholder. This jeopardizes taxpayers and the environment by making future abandonments and bankruptcy more likely.

B. The proposed rule protects large companies at the expense of small current leaseholders.

The negotiated free market sale of leases, in the light of joint and several liability, includes the distribution liability through private assurance bonds. Small businesses have already paid for billions in private bonds to protect prior leaseholders. All parties are fully aware of the lease conditions and the risks to be shared.

In this proposal, BOEM ignore the liability of predecessor leaseholders in setting the bonding requirement, and BOEM recognizes that it is doing so by rejecting less stringent regulatory alternatives. As a result, this rule interferes with the market's allocation of risk. It shifts liability away from those best able to handle it, i.e., large businesses that were the initial leaseholders, and imposes it directly on small businesses with weaker credit ratings who are less able to afford it. Even worse, these small businesses had already paid assurance bonds for the benefit of the predecessor leaseholders, so these small businesses are paying to cover decommission liability twice.

BOEM asserts that this imposition of additional obligations on these small leaseholders is necessary to protect the taxpayer from their bankruptcies. However, it is unclear why BOEM believes that the taxpayer needs protection for the full value of these liabilities given its recognition that the actual financial risk is significantly less.

C. BOEM should narrowly tailor its rule to the unfunded decommission liability of actual concern.

BOEM has proposed that its requirements for additional bonding would not apply to companies with sufficiently strong credit rating. These requirements imply that BOEM is only worried about unfunded decommissioning liabilities held by small companies that do not have a sufficiently strong credit rating. But 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.

In its effort to protect the taxpayer, the agency should not ignore the role of the market in allocated risk. BOEM should instead focus its efforts on those risks for which there is no predecessor leaseholder that it trusts to have the resources necessary to make the taxpayer whole.

For this reason, the "first best" economic solution would be to require bonding only by the first leaseholder and allow rational economic actors to allocate risk through contracts. Recognizing that BOEM cannot often reach back to the first lessee, BOEM should include a waiver for leases with predecessor leaseholders who meet the proposed creditworthiness standard.

III. Conclusion

This proposed rule imposes an unreasonable burden for financial assurances on small businesses. Most of the burden is unnecessary because it ignores a core element underlying the commercial arrangements among leaseholders since the inception of OCS leasing, joint and several liability. 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.

If you have any questions or require additional information, please contact me or Assistant Chief Counsel Dave Rostker at (202) 205-6966 or by email at david.rostker@sba.gov.

Sincerely,

/s/

Major L. Clark, III
Deputy Chief Counsel
Office of Advocacy
U.S. Small Business Administration

/s/

Dave Rostker
Assistant Chief Counsel
Office of Advocacy
U.S. Small Business Administration

Copy to: The Honorable Richard L. Revesz, Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget