DESPITE PROGRESS IN BOEM NTL REQUIREMENTS – NEW CAPITAL MUST EMERGE

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Introduction

Since the Bureau of Ocean Energy Management ("BOEM") released Notice to Lessees ("NTL") No. 2016-N01 in July 2016, the oil and gas industry has been working together to understand BOEM's decommissioning costs estimates and its timing and methodologies for enforcing the NTL.

Certain wholly-owned subsidiaries of the Majors were surprised to learn they didn't qualify for self-insurance if they lacked stand-alone audited financial statements or credit ratings. BOEM's estimated decommissioning cost estimates remain a mystery and appear to disregard evidential facts and defy industry trends. For the many lessees who were unable to qualify for self-insurance based on their own balance sheets or BOEM's creative application of common financial ratios, individual companies have been scrambling to post supplemental financial assurance to guarantee the future decommissioning costs for oil and gas properties in which they own a working interest.

However, to BOEM's credit, the bureau has been working with the industry by both hosting and attending numerous workshops to assist lessees with implementation of the NTL. BOEM representatives have also met with individual companies and industry organization to understand the concerns raised.

One such concern raised by the Gulf Energy Alliance ("GEA"), a coalition of leading independent producers and allied organizations, has been that the risk to the U.S. taxpayer is overstated. The U.S. taxpayer has never had to pay for the decommissioning of oil and gas offshore assets due to federal regulations that require previous owners to remain responsible for the P&A costs of wells and facilities that existed at the time of the sale.

Opportune Study

Opportune LLP ("Opportune"), an international energy consulting firm, performed an initial study of the BOEM NTL shortly after the NTL was issued (the "Initial Study"), which showed how the bonding requirements in the NTL are wholly disproportionate to any potential risk. Opportune's cost-benefit analysis of the NTL's impact on the economy showed that the decline in industry spending caused by the NTL's requirements would have serious long-term impact on economic growth and jobs on the Gulf Coast and United States that far outweighed any potential benefit to taxpayers.

In the Initial Study, Opportune analyzed BOEM lease data to understand the impact on the different sizes of producers, looking at small independents, large independents and majors. Each category of operator was impacted differently by the new NTL, depending on level of decommissioning liabilities, existing collateral under the old rules and capability to self-insure under the new NTL.

The following table presents how the BOEM's estimated decommissioning liabilities of over $38.9 billion, considering all OCS leases, is split between small independents, large independents and majors. This table also presents the collateral in place to cover the liabilities, just prior to the NTL being issued. The difference is the amount of BOEM liabilities not covered by existing collateral.

($ billions) **Category**	**BOEM Decommissioning Liabilities**	**Less Collateral**	**Uncovered Decommissioning Liabilities**
Small Independents	$ 2.8	$ (0.6)	$ 2.2
Large Independents	6.2	(0.4)	5.8
Majors	29.9	(1.6)	28.3
Total	$ 38.9	$ (2.6)	$ 36.3

In the Initial Study, Opportune believed that a decrease in spending and associated economic impact assumed that financial assurance would be needed for the entire $2.2 billion of uncovered liabilities for small independents, but that large independents and majors would be largely unaffected.

January 2017 Update

As a result of the cooperation between the industry and regulators (and, likely, the expected pro-Energy Trump Administration), it appears that progress is being made. On January 6th, BOEM announced that it would:

i) focus on obtaining financial security for sole liability properties (i.e., leases with no previous owners); and

ii) extend the implementation of the NTL for non-sole liability properties (i.e., leases with previous owners in the chain-of-title) by six-months.

The BOEM's move was applauded by Matt McCarroll, CEO of Fieldwood Energy LLC, Founding Member of the GEA, who made the following statement in a related press release:

"...BOEM's decision to focus on sole liability properties reflects the persistent industry concerns voiced by GEA and partner associations regarding the complexity of the initial, sweeping regulation under the original, unachievable timeline. It is encouraging that BOEM responded favorably to increased industry engagement spawned as a result of a process that skirted formal rulemaking and appropriate parameters under the Administrative Procedures Act..."

The following table summarizes BOEM decommissioning cost estimates by sole liability and non-sole liability properties.

($billions) Category	BOEM Decommissioning Liabilities	Less Multi-Lessee Properties	Less Related Collateral	Sole Liability Properties
Small Independents	$ 2.80	$ (2.74)	$ (0.02)	$ 0.04
Large Independents	6.20	(5.85)	(0.00)	0.35
Majors	29.90	(29.38)	(0.00)	0.53
Total	$ 38.90	$ (37.96)	$ (0.02)	$ 0.92

Based on BOEM's latest statements, Opportune believes that the decrease in future spending as a result of the NTL may be limited to the $395 million in uncollateralized sole liability properties of the small and large independents. Consequently, Opportune updated its cost-benefit analysis as of January 2017 (the "2017 Update") based on the sole-liability data above, assuming that the Small and Large Independent lessees would not qualify for self-insurance.

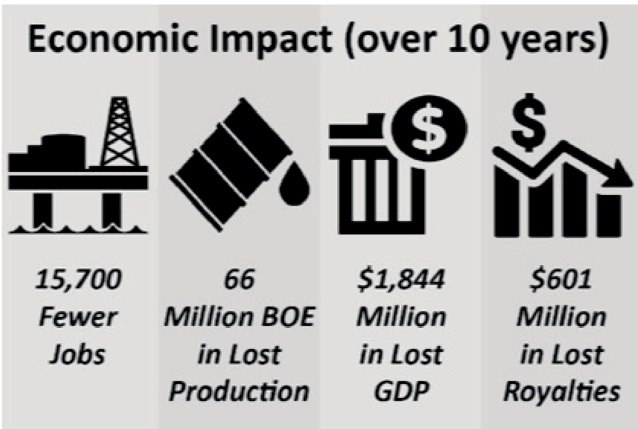
The following table summarizes the 2017 Opportune Study's updated conclusions on the impact that the NTL will have on OCS production, royalties, employments and GDP.

Estimated Impact of NTL over 10 years

		Direct Impact on Industry			Indirect Impact on Economy	
	Incremental BOEM Liability Requiring Coverage ($millions)	Reduced Production (million boe)	Reduction in Value of Production, $millions	Reduction in Royalties, $millions	Reduction in Employment (No. of Jobs)	Decrease in GDP ($millions)
Opportune 2017 Update	**395[2]**	**66**	**3,621**	**601**	**15,700**	**1,844**
Opportune Initial Study[1]	2,200[3]	367	20,187	3,351	87,532	10,280

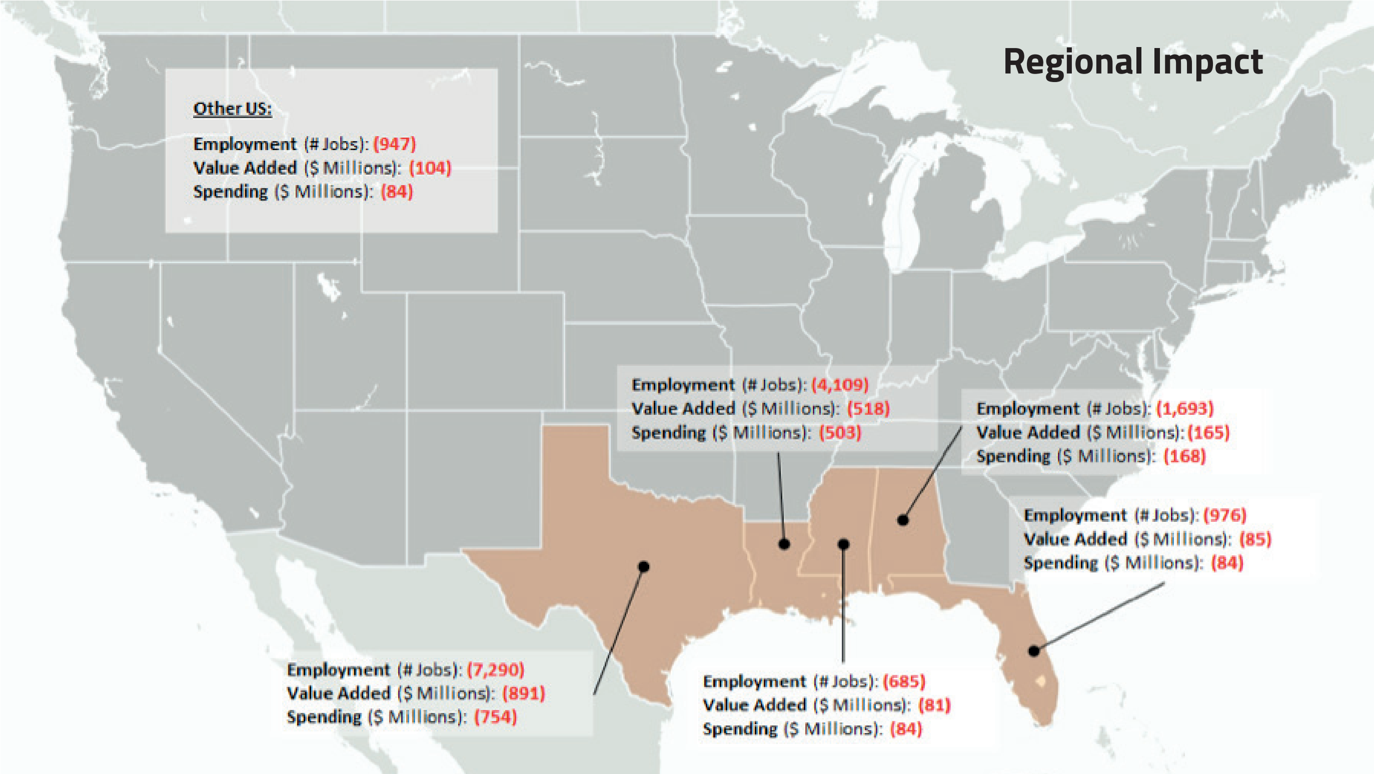
Notes:
(1) Original study assumed crude oil price of $75/b in determining lost royalies.
(2) Assumes of coverage required only for leases with sole liabilities for small and large independents.
Current feedback from industry indicates that a significant portion of large independents will not qualify for self insurance.
(3) Original analysis assumed that uncovered liabilities for small independents would have to be covered under NTL.

Indirect economic effects are estimated using the Regional Input-Output Modeling System (RIMS II) that is provided by the Bureau of Economic Analysis, US Department of Commerce. RIMS II is a tool for economic planners that provides for a systematic analysis of the economic impacts of projects or programs on regional economies. The economic impact is estimated for the Gulf Coast states, namely, Alabama, Florida, Louisiana, Mississippi and Texas, as well as the rest of the continental US.



Absent additional capital or supplemental bonding being identified to fund the incremental BOEM liability, the decrease in industry spending because of the proposed NTL could have an adverse effect in all the Gulf Coast states and the rest of the continental US over the next 10 years. Based on Opportune's 2017 Update, the decrease in spending would result in approximately 15,700 fewer jobs, 66 MBoe in lost production, and $0.6 billion in lost royalties over the 10-year time horizon.

Most of these lost jobs are in the Gulf Coast states, particularly Texas and Louisiana. Similarly, the decline in spending lowers the expected GDP by more than $1.8 billion over the 10 years compared to $10.3 billion in the Initial Study, again with Texas and Louisiana affected most.



New Forms of Capital Must Emerge

Although, through collaboration, the potential benefits of the NTL are coming more in-line with the potential costs, the NTL continues to be a net detriment to the U.S. taxpayer unless the availability of additional capital emerges. The near-term focus of BOEM on the approximate $920 million in supplemental bonding is not an insurance problem, it's a credit problem, as lessees may not have the collateral required to post the required bonds.

Historically, private equity firms, investment banks and lessees have used creative financial and/or reversionary interests like volumetric production payments, overriding royalties and net profits interest to either finance or invest in offshore properties. The desired or resulting accounting and legal treatment for such structures can be complex, as some investors want to avoid these instruments from being treated as debt (i.e., financing), while other investors want to avoid them being construed as a real property interest (i.e., part of the chain-of-title responsible for decommissioning liabilities). Today, a new wave of capital is ready to take on such risks for returns more akin to mezzanine equity multiples.

Sandton Capital is one firm that believes they have an answer for the industry's capital constraints. Robert Orr of Sandton Capital states:

> *"In this environment, sureties are looking for enhanced credit support from offshore operators. At the same time, these operators are facing a pullback in availability from traditional reserve-based lenders. Sandton Capital has stepped into the breach with a combination of the offshore E&P expertise and creative alternative financing structures necessary to offer solutions that work for both operators and sureties."*

For financially-distressed offshore lessees, particularly small independent operators, a reluctance to sell decision must be made on whether to sell-down a portion of their working interest in order to not only survive the current financial and regulatory market, but also continue investing in their future. Offshore lessees and their stakeholders should consider mezzanine capital to fund collateral requirements and bonding costs so that existing liquidity can earn greater returns through drilling – for the most distressed lessees, 80% of something is greater than 100% of nothing.

About Opportune LLP

Opportune LLP is a leading international energy consulting firm specializing in assisting clients across the energy industry, including upstream, midstream, downstream, oilfield services, power and gas, and commodities trading and logistics. Opportune's service lines include chemical engineering, complex financial reporting, corporate finance, dispute resolution, enterprise risk, outsourcing, process and technology, reserve engineering and geosciences, restructuring, strategy and organization, and tax. For more information on Opportune, please visit our website at www.opportune.com.

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