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on behalf of the

National Ocean Industries Association,

Independent Petroleum Association of America,

Natural Gas Supply Association, and

U.S. Oil & Gas Association

regarding

Availability of Bonds to Meet Federal Requirements for Mining, Oil and Gas Projects

before the

Subcommittee on Energy and Mineral Resources of the Committee on Resources

U.S. House of Representatives

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Madam Chairwoman and Members of the Subcommittee, I appreciate the opportunity to testify here today on the subject of the availability of bonds to meet the requirements of the Minerals Management Service for offshore oil and gas operations. ATP is a member of the National Ocean Industries Association (NOIA), the only national trade association representing all segments of the offshore energy industry. This testimony is submitted on behalf of NOIA, the Independent Petroleum Association of America, the Natural Gas Supply Association, and the U.S. Oil & Gas Association.

I am the Senior Vice President for ATP Oil and Gas Corporation. ATP Oil & Gas Corporation was formed in 1991 as a Texas corporation and became a public company in February of 2001. ATP trades publicly as ATPG on the NASDAQ National Market. The company is engaged in the acquisition, development and production of natural gas and oil properties primarily on the Outer Continental Shelf (OCS) of the Gulf of Mexico. During 2001, ATP additionally entered into agreements to expand its business in the shallow-deep waters of the Gulf of Mexico and in the Southern Gas Basin of the U.K. North Sea. The company focuses on natural gas and oil properties with proven reserves that are economically attractive to ATP but are not strategic to major or exploration-oriented independent oil and gas companies.

We work to secure reliable access to the nation's valuable offshore hydrocarbon resources in order that they may be developed, produced and supplied in an environmentally responsible manner. As such, we understand and are supportive of the Minerals Management Service's (MMS) intent to insure against default of obligations by smaller and possibly underfunded entities owning leases, rights-of-way, or exploration permits. However, external events beyond the control of industry have severely limited the availability of bonds and led to a relatively tight market that it is now hampering exploration and development efforts on the OCS to the extent that hydrocarbons are not being recovered due to an inability of industry to obtain the bonds necessary to satisfy the regulators.

Minerals Management Service Bonding Requirements

In recent years, there have been changes in the regulatory requirements for the oil and gas business, as well as an increase in bonding requirements to cover end-of-life obligations on the plugging, abandonment and site remediation of oil and gas wells and their related support equipment.

At the end of lease operations, oil and gas lessees must plug and abandon wells, remove platforms and other facilities, and clear the lease site sea floor. The MMS requires that companies operating on the OCS obtain surety bonds to ensure that the companies meet these obligations. In 1997, the MMS issued a final rule amending the agency's surety bond requirements for operations on the OCS. Under the MMS rule, lessees and owners are jointly and severally liable for compliance with the terms and conditions of the leases. Furthermore, when leases are transferred from one company to another, the assignor of the lease, as well as the new lessee, remains responsible for all wells and facilities that were in existence at the time the assignor assigned its interest until the wells are plugged and abandoned, the facilities are decommissioned, and the site is reclaimed. There is also a higher level of bonding required for the holder of geological and geophysical permits to drill deep stratigraphic test wells. The MMS is authorized to demand a supplemental bond from the holder of these permits or pipeline rights-of-way.

There are three tiers of bonds prescribed by the MMS. First, when there are no operations, the agency requires a $50,000 bond per lease, or a $300,000 areawide bond. These bonds are for leases with no MMS-approved operational activity plan or leases under an MMS-approved operational activity plan with no submittal to MMS of assignment or operational activity plans. A lessee does not need to provide this bond if an applicable lease or areawide bond is in place in accordance with one of the following, higher requirements.

The second tier of bond is for exploration. The agency requires a $200,000 bond per lease or a $1,000,000 areawide bond for leases of a proposed exploration plan or a significant revision to an approved exploration plan, or a proposed assignment of a lease with an approved exploration plan. A lessee does not need to provide this bond if an applicable lease or areawide bond is in place in accordance with one of the following, higher requirements.

The third tier of bond is for development. Here, the agency requires a $500,000 lease bond or $3,000,000 areawide bond for leases of a proposed Development and Production Plan or Development Operations Coordination Document, or a significant revision to an approved Development and Production Plan or Development Operations Coordination Document or a proposed assignment of a lease with an approved Development and Production Plan or Development Operations Coordination Document.

In practice, these bond requirements are often floors the agency uses in setting bond rates. This is due to the fact that under the MMS regulations, the Regional Director is authorized to raise these levels on a case-by-case basis, requiring companies to provide additional security in the form of supplemental bonds or an increase in the amount of coverage of an existing general lease surety bond. This determination is based on his evaluation of the company's ability to carry out present and future financial obligations. Companies may submit evidence to rebut the determination of the agency, and in principle the agency may then reduce the amount of the bond required, based on that information. In our experience, the amount is seldom reduced after the determination is made. In effect, this means that often the bond requirements are higher than prescribed above, leading to regulatory uncertainty for companies, and little recourse if they do not agree with the analysis of the agency.

Bonds for Plugging and Abandoned Older Wells

Earlier this year, the MMS announced that the agency was reviewing its methodology for supplemental bonding requirements for all unplugged well bores which are twenty years of age or older. Currently, the agency uses the sum of $100,000 per well bore to calculate liability. The MMS suggested that they thought the number might need to be increased to as much as $450,000 per well bore, with a rebuttal of the amount on a case by case basis. For companies subject to bonding, a change such as this would require posting of additional supplemental bonds, and for those companies that are now exempt, the new figure would be added to the companies' liabilities. This, in turn, could cause some companies that are currently exempt to lose their exemption.

Such changes would have been unnecessary and overreaching. The data on the costs to plug and abandon wells did not support such drastic measures. Fortunately, MMS did not simply implement the changes. The agency admitted that it did not have data to determine the average cost to plug a well, and sought information before making its decision. Industry representatives, including NOIA members, the Louisiana Independent Oil and Gas Association, Louisiana Mid-Continent Oil & Gas, and Energy Partners Ltd., provided the MMS with extensive data on close to 600 wells that had been plugged and abandoned over the past six years. The data showed that the average cost of plugging a well is actually less than $100,000. The MMS reviewed the data provided, and made a reasoned decision that there was no cause to raise the bonding floor. This decision was based on facts and statistical data, rather than on speculation and unfounded concerns.

The Bond Market

Some of the events in recent years have dramatically altered the bond market for everyone, including the offshore oil and gas industry. There have been large bankruptcies of companies like K-Mart, Enron and Superior National. In addition, there have been natural disasters such as tropical storm Allison, and the disaster of September 11.

These events have severely impacted the bonding industry, as well as the insurance industry. Insurance and surety companies are for-profit entities. Their response to these types of losses has been to raise premiums, cut risks or exit lines of business. All of these responses are present in the market today. In the oil and gas arena, premiums for insurance have multiplied by as much as five or six times over what it was last year, with no change in conditions. Furthermore, some coverages are not available at any price. OPA 90 coverage, where there have been no losses, has increased several times over what it was, with only a few syndicates in London providing the coverage.

Like insurance, the surety industry has been severely affected by large bankruptcies. Sureties have been in a long period of depressed pricing. When conditions converged to bring large losses into contact with falling investment income, the shock to the surety industry was profound. Several companies, such as Reliance, Amwest and Frontier, have gone out of business. Several other companies, such as St. Paul and CNA, have severely restricted the writing of commercial sureties.

In many cases, these impacts were driven by reinsurers, who were hit with the same loss from many different sureties. Reinsurers write for many sureties. Several direct surety companies were writing different bonds for the same account, such as K-Mart, so that when losses occurred, there were huge aggregations at the reinsurer's level. Since reinsurers have for years been writing commercial surety (of which oil and gas is a subset) at low premiums, this type of loss resulted in enormous changes in reinsurance. Rates went up dramatically; exclusions were greatly increased, and much larger retentions by the direct insurer were required. The trickle down on direct surety has increased the prices for oil and gas surety and severely limited the capacity.

The effect of all of this on the oil and gas industry has been to require that industry pay many times more for the same bonds they used to receive, and sometimes to pay cash when a bond is not available. Industry supports bonding, and is committed to conducting our operations, including the termination of those operations, in the most environmentally responsible manner possible. Bonding is an effective tool for both industry and the regulators to allow us to meet our commitments. Unfortunately, even though there have been no incidents in our industry to raise liability costs or risks, the increasingly tight bonding market has made the bonding process an impediment to our safe operations, rather than a tool.

Some sureties are now requiring that companies deposit cash for a portion, sometimes 50% of the bond amount, in order to obtain the bond. There is no additional coverage or protection for the environment provided with these changes. And, when the surety industry is unable to meet the bonding requirements, cash is the alternative. Cash for 100% of the required bonding amount may have to be posted for the plugging and abandonment obligations. This takes cash directly out of the pool of money available for exploration and development, and is a much less efficient manner to employ in order to meet our obligations. In some cases, the net effect has also prohibited operations because of the inability to obtain sureties.

<u>Summary</u>

The tight bonding market impacts virtually every company that conducts business on the OCS. Companies that are required to bond their activities are finding it more and more difficult to do so. Companies that self bond find it difficult to transfer operations to entities that are not exempt. It is a fairly common practice for large (normally exempt) companies to sell producing properties in the sunset phase of their productive life to smaller (normally not exempt) companies; however, the lack of adequate bonding capacity is making this increasingly more difficult and costly, and in some cases impossible.

Too much capital pulled out of the exploration and development budgets because the surety industry is unable to meet the bonding demands leads to less development, which impacts our country's energy security, as well as tax and royalty collections to the federal and state governments. The tight bond market, combined with the high bonding amounts often imposed, is creating a situation where offshore operations are unreasonably costly, and sometimes prohibitive.

This concludes my prepared remarks. I will be happy to answer any questions.

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