



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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JUNE 2, 1980

The Honorable Mark O. Hatfield
Ranking Minority Member
Committee on Energy and Natural Resources
United States Senate

The Honorable Wendell H. Ford
Chairman, Subcommittee on Energy
and Materials Production
— Committee on Energy and Natural
Resources
United States Senate



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Subject: *2/1* Impact of ~~an~~ All Competitive Onshore
Oil and Gas Leasing System (EMD-80-79)

On May 1, 1980, you asked the General Accounting Office to evaluate Amendment no. 1684 to Senate bill 1637, 96th Congress. 1/ As you suggested, our prior work on onshore oil and gas leasing 2/ does enable us to respond to your request.

The key issue surrounding Amendment 1684 is that it abolishes the current competitive and noncompetitive leasing systems, and establishes a new all competitive leasing system in their place. Consistent with the direction of your request, we did not evaluate all the positive and negative issues touched on by the Amendment. We, instead, are directing our comments here to the all competitive leasing aspect.

The Department of the Interior's mineral management has involved the balancing of three goals for a leasing system--(1) orderly and timely development of the resource, (2) recovery of fair market value, and (3) protection of the environment.

1/ Amendment 1684, with one modification, was adopted and reported out of the Senate Committee on Energy and Natural Resources on May 8, 1980 as a substitute text for S. 1637. To avoid confusion with the legislation originally introduced as S. 1637, we are retaining the term "Amendment 1684" for purposes of this letter. The bill, as reported out of the Committee, is reprinted here as an enclosure.

2/ "Onshore Oil and Gas Leasing--Who Wins the Lottery?" . EMD-79-41, Apr. 13, 1979, and "Impact of Making The Onshore Oil and Gas Leasing System More Competitive," EMD-80-60, March 14, 1980.

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Amendment 1684 does not impact on the environmental protection goal. Environmental protection is covered by other pieces of legislation and Interior's responsibility and authority are not changed by Amendment 1684. As to the other two goals, We doubt that an adequate balance can be achieved under Amendment 1684. For the reasons outlined below, and for those reasons developed in our prior report, we continue to believe that the modifications we recommended to the present mixed competitive/noncompetitive system offer the best opportunity for achieving a balance of these mineral management goals.

AMENDMENT 1684's IMPACT ON TIMELY AND ORDERLY DEVELOPMENT OF THE RESOURCE

Amendment 1684 likely would have a negative impact on the timely development and production of oil and gas through delays in the leasing process and the adverse impact on some incentives to development.

Section 17 (b) of the amended language states that nominated tracts shall automatically be offered for lease if the Secretary of the Interior finds that they are available and suitable for oil and gas leasing. To see that a nominated tract is available would at least involve making sure that the U.S. Government owns the mineral rights, and that the land is not presently leased or withdrawn. What is meant by "suitable" is not defined in the Amendment.

In any event, criteria would have to be established to determine what suitability is, which could entail detailed analyses of land use plans, studies of oil and gas potential versus other possible uses, assessment of environmental conditions, etc. If oil and gas potential is to be part of a suitability determination, studies similar to presale evaluations now being done for competitive tracts may have to be done for all tracts. These actions could result in a considerable workload for Interior, and delays in leasing.

Our work indicated that a great deal of land presently leased has little potential and is often never drilled. Thus, a great deal of land use type planning--solely on oil and gas considerations--could be done on land that (1) has low potential, (2) would never be developed, and in many cases, (3) would be of little beneficial use to the taxpayer.

Relatedly, developing and implementing these procedures could be time consuming and result in delays in the leasing process. Although the bill, as reported out of the Senate Committee on Energy and Natural Resources, calls for the system to be implemented within 180 days after enactment, there is no guarantee that it could actually be done that quickly. As worded, the bill goes into effect immediately upon enactment. Presumably then, all leasing would be suspended until the provisions could be implemented. Even if the 180 day implementation goal of the Committee was met, that would still entail a 6-month suspension of all leasing.

In addition, the Amendment does not seemingly prohibit leasing suspension in the future, say under a new Administration or Secretary, while Interior develops new programs or information to comply with a new or revised interpretation of the law. One need only look at the suspension of coal leasing in 1971 to see the potential for delay. Full-scale leasing is yet to be reinstated.

Also, in certain instances--particularly in wildcat areas--noncompetitive leasing could be preferable to competitive leasing. It is apparently a fairly widespread practice for individuals to seek out and acquire over-the-counter leases and assign them to producers for development. Identifying this land is a laborious process involving searching through literally thousands of maps and related data in BLM state offices. Our work showed a significant amount of land still being leased in this way, 1/ as was the overthrust belt earlier, which for years was considered of limited potential, but is now one of the Nation's most promising new areas. If the reward for this searching is the opportunity to nominate the tract for competitive bidding, rather than to acquire the lease, there will probably be little incentive to continue the research process.

Lastly, a fully competitive system could work a hardship on the independent oil developer because (1) tracts which will be obtained through cash bidding may be of greater interest to the majors than the present system of small leases that have to be methodically consolidated into an efficiently-sized unit and (2) a high-per-acre bid combined with the

1/Fourteen percent of all Wyoming leases issued in 1978.

potential for the larger tracts might create some financial hardships for many independent producers to meet the bonus bid competition. Our earlier report pointed out that independent oil producers are responsible for the vast majority of oil and gas produced onshore and that they are also an integral part of the drilling and exploration operations of many major and nonmajor oil companies. If the independent is not able to compete successfully under the proposed system, is denied access to lands now available to him, or experiences delays in leasing potentially productive lands, production could be sacrificed.

AMENDMENT 1684's IMPACT ON
RECOVERY OF FAIR MARKET VALUE

Competitive leasing is often advocated as a fair means to assure that the Government (and therefore the American people) receives the fair market value of the oil and gas being leased. It is also felt that a truly competitive situation will guarantee equal access to the land by eliminating actual or potential abuses of the present lottery system or the regular over-the-counter system. While the amendment will certainly correct any abuse irregularities in the noncompetitive system, it will not necessarily ensure a competitive situation, or fair market value recovery.

Fair market value is often defined as either what could be realized in a competitive market, or realization of an assessed presale and/or postsale value. Amendment 1684 does not assure this happening. The Amendment would allow any one qualified bidder regardless of amount bid to be awarded the lease. There is no assurance of a competitive situation; thus, there is no assurance that fair market value will be received by the Government.

The Amendment is silent on whether presale or postsale evaluations would be needed under this leasing system, but presumably they would not be, because, as the bill is written, any bid would be accepted regardless of how it relates to any appraised values. In our prior work on S. 1637, we noted bids as low as a nickel an acre.

If evaluations were used to measure fair market value, the workload would be substantial. In recent years, there have been an average of about 280 competitive leases a year versus an average of 12,000 noncompetitive leases. The Interior Department conducts sale evaluations on the competitive leases but not the noncompetitive ones. Thus, in an

all competitive situation, an attempt to recover fair market value through evaluations would represent a considerable expansion of the Department of Interior's casework and certainly would require more time. Further, as discussed above, some sort of prelease evaluation might still be needed for another reason, i.e., determining whether a tract is "available" and "suitable" for oil and gas leasing.

While not directly related to the receipt of fair market value, it should be pointed out that Amendment 1684 will likely increase competitive bid lease offerings receipts with or without a system of fair market value appraisal. Also, while it will increase the rental on most land from \$1 to \$2 an acre per year, it will likely be accompanied by significant reductions in the amount of land subject to a rental. It will totally eliminate filing fee receipts, and it may reduce royalties through its possible reduction in oil production. According to Interior, bonus bids brought in \$12.7 million in 1978, land rentals \$55.7 million, royalties \$308.7 million, and filing fees \$29.7 million.

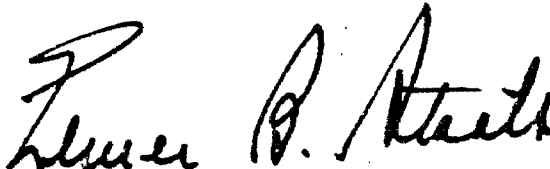
GAO's past work suggests that a great deal of land presently leased may not be leased under a totally competitive system. First, it may not be nominated and thus not leased. Secondly, we would see a reduction of independent involvement. If these things happened, rental, royalty and bonus bids would be adversely affected.

Also, some slippage in land rental receipts will occur because of the quarterly offerings. As we reported in analyzing the Administration's proposal, BLM/Wyoming calculated that conversion from the present monthly to a quarterly offering could cost that State's operation alone more than \$2 million a year in rental receipts. The impact of Amendment 1684 is likely to be more severe than this. The nominating process under Amendment 1684 can cover up to two quarters, as can the time before a nominated tract is actually leased. Thus, the entire process, from nomination to lease issuance, could take as long as 9 months to 1 year. Finally, there is the possibility that the time involved in carrying out the requirements of this legislation in the future could result in delays in leasing, and therefore cause slippages in all types of receipts, including bonus bids, rents, and royalties.

CONCLUSIONS

After evaluating Amendment 1684, we still conclude that our previously recommended changes to the existing system are the preferred course of action because of the Amendment's likely negative impacts on the goals of timely and orderly resource development and the recovery of fair market value.

We hope our observations will be of use in considering the amended S. 1637. Copies are being sent to Members of the House Subcommittee on Mines and Mining. As arranged with your office, copies are also being made available to other interested parties.


Luther B. Smith
Comptroller General
of the United States

Enclosure

AMENDMENT NO. 1684

Purpose: To establish competitive oil and gas leasing and modify leasing procedures for onshore Federal lands.

IN THE SENATE OF THE UNITED STATES—96th Cong., 2d Sess.

S. 1637

To establish competitive oil and gas leasing in favorable areas within producing geologic provinces.

March 18 (legislative day, January 3), 1980

Referred to the Committee on Energy and Natural Resources and ordered to be printed

AMENDMENT intended to be proposed by Mr. BUMPERS (for himself, Mr. JACKSON and Mr. METZENBAUM)

Viz: Strike all after the enacting clause and insert the following:

1 That this Act may be cited as the "Federal Oil and Gas
2 Leasing Act of 1980".

3 SEC. 2. Subsections (a) through (e) of section 17 of the
4 Act entitled "An Act to promote the mining of coal, phos-
5 phate, oil, oil shale, gas, and sodium on the public domain",
6 approved February 25, 1920 (30 U.S.C. 226(a) through (e)),
7 are amended to read as follows and subsection 17(f) and fol-
8 lowing are relettered accordingly:

9 "SEC. 17. (a) The Secretary may lease onshore Federal
10 lands for oil and gas development by competitive bidding
11 only. Competitive bidding shall be on the basis of those bid-

1 ding systems set forth in section 8(a)(1) of the Outer Conti-
2 nental Shelf Lands Act, as amended (43 U.S.C. 1335), which
3 the Secretary determines would maximize competition.

4 “(b) At least once each quarter, the Secretary shall
5 invite the public nomination of areas favorable for the discov-
6 ery of oil or gas. Any area of the public domain that receives
7 two or more public nominations and which the Secretary de-
8 termines to be available and suitable for oil and gas leasing
9 shall automatically be offered for lease by the Secretary at
10 one of the next two scheduled lease sales. Any area of the
11 public domain that receives a single nomination in two
12 successive quarters which the Secretary determines to be
13 available and suitable for oil and gas leasing shall automati-
14 cally be offered for lease by the Secretary at one of the next
15 two scheduled lease sales.

16 “(c) The Secretary shall hold competitive oil and gas
17 lease sales in states where tract nominations are received, on
18 a quarterly basis. Such sales shall consist of all available and
19 suitable tracts nominated for leasing as specified in section
20 17(b) and any additional areas selected by the Secretary of
21 Interior.

22 “(d) The Secretary shall issue a lease to the highest
23 responsible qualified bidder for each tract offered at a lease
24 sale.

1 “(e) No lease issued under this section shall be for a
2 tract exceeding five thousand one hundred and twenty acres,
3 unless the Secretary finds that a larger area is necessary to
4 comprise a reasonable economic unit.

5 “(f) Each lease that the Secretary issues under this sec-
6 tion shall be for an initial period of five years and so long
7 thereafter as oil or gas is produced in paying quantities or
8 drilling or well reworking operations as approved by the Sec-
9 retary are conducted thereon. A lessee may apply to extend
10 the initial term for an additional period or periods not to
11 exceed a total of five years. Each extension application shall
12 include an exploration plan for the extended term. The Sec-
13 retary, in his discretion, may extend the initial term only if he
14 finds that because of adverse technical, environmental or eco-
15 nomic conditions which are beyond the control of the lessee,
16 the lessee cannot adequately explore the lease during the ini-
17 tial five year term or any extended term. Nothing in this
18 subsection shall be construed as affecting existing leases.

19 “(g) All leases issued under this section shall be condi-
20 tioned upon payment by the lessee of a rental or not less than
21 \$2 per acre each year of the lease. Each year's lease rental
22 shall be paid in advance. A minimum royalty of \$4 per acre
23 in lieu of rental shall be payable at the expiration of each
24 lease year beginning on or after a discovery of oil or gas in
25 paying quantities on the lands leased.”

1 SEC. 3. Action taken by the Secretary pursuant to the
2 bidding, nomination, and lease procedures of subsections (a),
3 (b), and (c) of section 17 shall not be considered "major Fed-
4 eral actions" for purposes of implementing section 102 of the
5 National Environmental Policy Act. Nothing in this subsec-
6 tion shall be construed as affecting the application of section
7 102 of that Act to the issuance of a lease under section 17.

8 SEC. 4. Section 30(a) of the Act of February 25, 1920
9 (30 U.S.C. 187a) is amended by striking the third sentence
10 and inserting in lieu thereof "The Secretary shall disapprove
11 the assignment or sublease only for lack of qualification of the
12 assignee or sublessee or for lack of sufficient bond: *Provided,*
13 *however,* That the Secretary may, in his discretion, disap-
14 prove an assignment (1) of a separate zone or deposit under
15 any lease, (2) of less than six hundred and forty acres, or (3)
16 containing an overriding royalty which exceeds limitations
17 established by regulations."

Sec. 5.* The Secretary shall prescribe such rules
and regulations, or amendments to existing rules and
regulations, as may be necessary to reflect the amendments
made by this Act within one hundred and eighty days after the
date of enactment of this Act.

* Added by the Committee