OUTER CONTINENTAL SHELF LEASE SALES: EVALUATION OF BIDDING RESULTS AND COMPETITION

ANNUAL REPORT TO CONGRESS
FISCAL YEAR 1999

U.S. Department of the Interior
Minerals Management Service
Economics Division

Herndon, Virginia
February 2000

Introduction

This report analyzes the two Gulf of Mexico (GOM) Outer Continental Shelf (OCS) oil and gas lease sales held in Fiscal Year (FY) 1999. In addition, competition for leases pursuant to sections 8 and 15 of the OCS Lands Act (OCSLA) (43 U.S.C. 1337 and 1343) is evaluated.

The report's objectives are to review bidding results and to assess industry competition in the two sales held during FY 1999. Cash bonus bidding with both 1/6- and 1/8-royalty rates was used in each GOM sale with a $25 per acre minimum bid requirement in water depths less than 800 meters and a $37.50 per acre minimum bid in water depths of 800 meters or more. In addition, to comply with the Deep Water Royalty Relief Act of 1995 (DWRRA) in the GOM, potential royalty suspension volumes for leases by water depth category were set as follows:

(1) 17.5 million barrels of oil equivalent in water depths of 200 to 400 meters;
(2) 52.5 million barrels of oil equivalent in water depths of 400 to 800 meters; and
(3) 87.5 million barrels of oil equivalent in water depths of 800 meters or more.

Review of FY 1999 Lease Sales and Bidding Systems

Two OCS lease sales were held in FY 1999: Sale 172, Central Gulf of Mexico (CGOM) and Sale 174, Western Gulf of Mexico (WGOM).

In the two GOM sales, 7,458 tracts (about 40 million acres) were offered, and 360 tracts (1.92 million acres) received bids. Of the tracts receiving bids, 92.5 percent (333 tracts) were leased. Sale results for the fiscal year are summarized in Table 1.

Table 1. Bidding Results for FY 1999 Lease Sales

	Sale 172 – CGOM (3/17/99)	**Sale 174 – WGOM (8/25/99)**	**Total – FY 1999 (2 Sales)**
Tracts Offered	3,807	3,651	7,458
- Receiving Bids	207	153	360
- Leased	191	142	333
- Percent Rejected	7.73 %	7.19 %	7.50 %
Bids Received	272	177	449
Average Bids/Tract	1.31	1.16	1.25
Sum of All Bids	$199,638,752	$104,211,708	$303,850,460
Sum of High Bids	$171,804,696	$94,649,044	$266,453,740

Overall bidding results by royalty rate and DWRRA water depth zone for the GOM sales held in FY 1999 are shown in Table 2. As in previous GOM sales, a water-depth criterion was used to assign royalty rates. In the GOM, a fixed 1/6-royalty was specified in water depths of less than 400 meters and a fixed 1/8-royalty was specified in water depths of 400 meters or more. However, for water depths of 200 meters or more, DWRRA-specified royalty relief volumes, listed previously, apply on new leases.

Table 2 indicates that the majority of tracts receiving bids in FY 1999 GOM sales were shallow water tracts with 1/6-royalty rates. These tracts received a higher number of average bids per tract than deepwater tracts with 1/8-royalty rates. However, the average high bid per tract for the 1/6-royalty tracts was about 69 percent lower than that observed for the 1/8-royalty tracts. The 1/6-royalty tracts (less than 400 meters) accounted for 52.5 percent of tracts receiving bids, 54.4 percent of tracts leased, and 25.6 percent of high bids received in the two FY 1999 GOM lease sales. Conversely, the 1/8-royalty tracts (400 meters or more) accounted for 47.5 percent of tracts receiving bids, 45.6 percent of tracts leased, and 74.4 percent of high bids received in the two FY 1999 GOM lease sales. As shown in Table 3, the mean high bid of $0.74 million per tract receiving a bid was a decrease of 35.1 percent compared to the FY 1998 sales.

Table 2. GOM Lease Sale Bidding Results for FY 1999 by Royalty Rate

	Fixed 1/6-Royalty		Fixed 1/8-Royalty		
FY 1998 (2 Lease Sales)	Less than 200 meters	200 to 400 meters	400 to 800 meters	More than 800 meters	Total
Tracts Offered	2,286	230	409	4,453	7,458
- Receiving Bids	173	16	18	153	360
- Leased	165	16	17	135	333
Bids Received	219	20	19	191	449
Average Bids/Tract	1.27	1.25	1.06	1.25	1.25
Percent of Tracts with Multiple Bids	16.76 %	12.50 %	5.56 %	17.65 %	16.39%
Sum of High Bids ($MM)	$59.27	$8.98	$5.75	$192.45	$266.45
Mean High Bid ($MM)	$0.34	$0.56	$0.32	$1.26	$0.74

Table 3. Mean High Bid ($ millions) per Tract (FY 1990 - FY 1999), GOM Sales

Fiscal Year	Fixed 1/6-Royalty	Fixed 1/8-Royalty	Total (Both Rates)
FY 1990	$ 0.73	$ 0.60	$ 0.70
FY 1991	$ 0.59	$ 0.34	$ 0.50
FY 1992	$ 0.41	$ 0.43	$ 0.41
FY 1993	$ 0.39	$ 0.28	$ 0.37
FY 1994	$ 0.62	$ 0.23	$ 0.58
FY 1995	$ 0.57	$ 0.32	$ 0.49
FY 1996	$ 0.63	$ 0.52	$ 0.57
FY 1997	$ 0.71	$ 0.82	$ 0.78
FY 1998	$ 0.70	$ 1.30	$ 1.14
FY 1999	$ 0.36	$ 1.16	$ 0.74

Performance of Bidder Groups in Lease Sales

This section discusses the rate of winnings (percent of successful high bids and acreage) acquired by the restricted joint-bidder (RJB) group. The RJBs are specified pursuant to 30 CFR 256.41, and entities identified are restricted from bidding with other specified entities unless bidding is with an affiliate or subsidiary within the same group.

During the portion of FY 1999 when the lease sales were held, four companies and their subsidiaries were identified as RJBs: Exxon Corporation, Shell Oil Company, Mobil Oil Corporation, and BP America Incorporated, which became BP Amoco Corporation in the March/April listing of RJBs. (A full listing of all companies in each group is included in Appendix A.)

Tables 4 and 5 present bidding results for RJBs and non-restricted bidders. For both bidder groups analyzed, the sales data were adjusted to account for the percentage share of ownership attributable to firms in each group (i.e., a joint bid that was 50 percent RJB and 50 percent non-restricted results in 50 percent of the high bid and acreage being assigned to each group).

In FY 1999, non-restricted bidders continued to be the dominant force in the GOM, as they were high bidders on 95 percent of the acreage leased and accounted for 88 percent of the winning high bids, in terms of dollars bid. Since FY 1990, non-restricted bidders were awarded at least 66 percent of the acreage leased and submitted at least 70 percent of the winning high bid dollars.

Table 4. Acreage Leased to Restricted Joint Bidders Versus Non-restricted Bidders
FY 1990 - FY 1999, GOM Lease Sales

Fiscal Year	Percentage of Acreage Leased		Number of Entities Participating
	Restricted	Nonrestricted	
1990	34	66	106
1991	33	67	101
1992	17	83	71
1993	22	78	71
1994	22	78	82
1995	26	74	94
1996	24	76	105
1997	28	72	118
1998	23	77	102
1999	5	95	76

The non-restricted bidders' share of winning high bid dollars was less than their percentage of acreage leased, for the first time since FY 1990.

Table 5. Winning High Bids by Restricted Joint Bidders Versus Nonrestricted Bidders
FY 1990 - FY 1998, GOM Lease Sales

Fiscal Year	Percentage of Winning High Bids		Number of Entities Participating
	Restricted	Nonrestricted	
1990	30	70	106
1991	20	80	101
1992	13	87	71
1993	13	87	71
1994	11	89	82
1995	17	83	94
1996	17	83	105
1997	22	78	118
1998	12	88	102
1999	6	94	76

The RJBs tend to be relatively more active bidders in deepwater (400 meters or more) areas of the GOM (RJBs accounted for about 8 percent of the deepwater acres with bids and 6 percent of high bid dollars). Although the deepwater areas of the GOM have high costs of exploration and development, these areas also provide the potential for major discoveries that are of interest to large international companies, which are RJB's. Conversely, a number of non-restricted bidders are independent natural gas and oil companies that are interested in exploring and developing smaller fields in shallow water where the costs and risks are lower than the deepwater areas.

In FY 1999, the RJBs were far less active than normal in the GOM lease sales. Reasons for this lower level of activity could include high inventories of unexplored tracts from previous sales in the area and the mergers that were occurring/planned during this time period that included most of the companies on the RJB list.

Bidding Systems

Section 8(a) of the OCSLA required testing of alternative bidding systems over a 5-year period from September 18, 1978, to September 17, 1983. This subject was discussed in detail in the 1987 Annual Report. The inconclusive bidding results achieved during the test period, as well as the administrative complexity of some of the systems tested, led the Department of the Interior (DOI) to cease experimenting with alternative systems. However, the use of these systems could be specified for future OCS sales if analysis determines that their use could best meet the OCSLA's goals.

In November 1995, the DWRRA was passed, which requires use of bidding systems that allow for royalty suspension volumes for new fields in water depths greater than 200 meters for leases awarded in the CGOM and WGOM lease sales that occur prior to November 28, 2000. Thus, in the FY 1999 oil and gas lease sales in the GOM, the royalty rates continued to be those used in the past, but in water depths of 200 meters or more, royalty relief was provided at the depth-specific rates mandated in the DWRRA. However, after the previous three years of high levels of leasing activity in water depths of 200 meters or more, bidding interest in the water depth categories covered by the DWRRA declined markedly in FY 1999.

Supplies of Oil and Gas for Independent Refiners

Section 15(2)(E) of the OCSLA requires the Secretary to provide "an evaluation of present measures and a description of additional measures dealing with supplies of oil and gas to independent refiners and distributors." As of October 1, 1999, there were five offshore and no onshore royalty-in-kind contracts. In FY 1999, 12.5 million barrels of OCS oil were used in this program. The low numbers of refiners participating in this program would indicate that adequate supplies of oil to meet refining requirements are, in general, available through normal markets.

In addition, Section 8(b)(7) of the OCSLA includes a provision requiring lessees to offer 20 percent of the crude oil, condensate, and natural gas liquids produced from a lease to small or independent refiners. For FY 1999, about 45 million barrels of liquid hydrocarbons were available from leases issued after September 18, 1978, containing this requirement. The exchange of liquid hydrocarbons under this lease obligation is handled directly between the lessee(s) and an eligible refiner without Government intervention.

Schedule of FY 2000 Lease Sales

Lease sales scheduled for FY 2000 under the 5-year leasing program are listed in the table below.

Lease Sale (Date)	Bidding Systems
Sale 175 - CGOM (March 2000)	Cash bonus, fixed 1/6-royalty Cash bonus, fixed 1/6-royalty with potential royalty suspension volume Cash bonus, fixed 1/8-royalty with potential royalty suspension volume
Sale 176 - WGOM (August 2000)	Cash bonus, fixed 1/6-royalty Cash bonus, fixed 1/6-royalty with potential royalty suspension volume Cash bonus, fixed 1/8-royalty with potential royalty suspension volume

APPENDIX A

Restricted Joint Bidders in OCS Oil and Gas Sales during FY 1999

Under the joint bidding provisions of 30 CFR 256.41, each entity within any of the groups shown in the "List of Restricted Joint Bidders" is precluded from bidding with any entity in any other identified group at OCS oil and gas lease sales held during the specified bidding periods.

For FY 1999, pertinent Lists of Restricted Joint Bidders were published in the Federal Register as follows:

> October 2, 1998 (at 63 FR 53097), for the bidding period November 1, 1998, through April 30, 1999.
>
> March 26, 1999 (at 64 FR 14751) and revised April 19, 1999 (at 64 FR 19193)[1], for the bidding period May 1, 1999, through October 31, 1999.

The four companies and subsidiaries identified were:

Group I. Exxon Corporation, Exxon San Joaquin Production Co.

Group II. Shell Oil Company, Shell Offshore Inc., Shell Western E&P Inc., Shell Frontier Oil & Gas Inc., Shell Consolidated Energy Resources Inc., Shell Land & Energy Company, Shell Onshore Ventures Inc., Shell Deepwater Development Inc., Shell Deepwater Production Inc., Shell Offshore Properties, and Capital II Inc.

Group III. Mobil Oil Corporation, Mobil Oil Exploration and Producing Southeast Inc., Mobil Producing Texas and New Mexico Inc., Mobil Exploration and Producing North America Inc.

Group IV. BP America Inc., The Standard Oil Co., BP Exploration and Oil Inc., BP Exploration (Alaska) Inc., BP Amoco Corporation, and Amoco Production Co.

[1] The April 19, 1999, revision added BP Amoco Corporation and Amoco Production Co. to Group IV because of the BP merger with Amoco.