

**OUTER CONTINENTAL SHELF
LEASE SALES: EVALUATION OF
BIDDING RESULTS**

**ANNUAL REPORT TO CONGRESS
FISCAL YEAR 2004**

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

**Herndon, Virginia
February 2005**

Introduction

This report analyzes the three Gulf of Mexico (GOM) Outer Continental Shelf (OCS) oil and gas lease sales held in Fiscal Year (FY) 2004 pursuant to section 8 of the OCS Lands Act (OCSLA) [43 U.S.C. 1337]. In addition to the GOM sales, a sale was also scheduled for the lower Cook Inlet OCS, but that sale received no bids due to lack of industry interest in the area at this time.

The report's objectives are to review bidding results in FY 2004 and to present the schedule of lease sales for FY 2005. Cash bonus bidding was used in the Central GOM (CGOM) and Western GOM (WGOM) sales with a 1/6-royalty rate and \$25 per acre minimum bid requirement in water depths less than 400 meters and a 1/8-royalty rate and \$37.50 per acre minimum bid in water depths of 400 meters or more. In the Eastern GOM (EGOM) lease sale, only a 1/8-royalty rate was used along with a \$37.50 per acre minimum bid because all blocks offered were in water depths of 1,600 meters or more.

In the CGOM and WGOM sales, potential royalty suspension volumes for leases by water depth category and subject to price thresholds were set as follows:

- (1) in water depths less than 200 meters, 30 CFR 203.40 through 203.47 specifies applicable volumes on deep gas production or unsuccessful wells where a new deep gas reservoir (15,000 feet or greater subsea) produces or drilling of a certified unsuccessful well commences before May 3, 2009;
- (2) 5 million barrels of oil equivalent per lease in water depths of 400 to 799 meters;
- (3) 9 million barrels of oil equivalent per lease in water depths of 800 to 1,599 meters; and
- (4) 12 million barrels of oil equivalent per lease in water depths of 1,600 meters or more.

In the EGOM sale, because all blocks offered were in water depths of 1,600 meters or more, the potential royalty suspension volume, subject to price thresholds, for all leases awarded was 12 million barrels of oil equivalent per lease.

Review of FY 2004 Lease Sales and Bidding Systems

Four OCS lease sales were held in FY 2004: Sale 189, EGOM; Sale 190, CGOM; Sale 192, WGOM; and Sale 191, Cook Inlet – Alaska OCS, which was scheduled to be held on May 19, 2004, however no bids were received prior to the May 18th deadline.

The sales in the CGOM and WGOM were a continuation of the annual areawide sales that have been held in those areas since 1983. The sale in the EGOM was the second in that planning area since 2001.

In the three GOM sales, 8,369 tracts (about 45 million acres) were offered, and 922 tracts

(about 4.9 million acres) received bids. Of the tracts receiving bids, 97.8 percent (902 tracts) were leased. Sale results for the fiscal year are summarized in Table 1.

Table 1. Bidding Results for FY 2004 Lease Sales

	Sale 189 – EGOM (12/10/03)	Sale 190 – CGOM (3/17/04)	Sale 192 – WGOM (8/18/04)	Total – FY 2004 (3 Sales)
Tracts Offered	138	4,324	3,907	8,369
- Receiving Bids	14	557	351	922
- Leased	14	542	346	902
- Rejected ¹	0	15	5	20
Bids Received	16	829	421	1,266
Average Bids/Tract	1.14	1.49	1.20	1.37
Sum of All Bids	\$9,081,842	\$638,819,534	\$197,395,164	\$845,296,540
Sum of High Bids	\$8,376,765	\$368,763,482	\$171,387,285	\$548,527,532

Overall bidding results by royalty rate and water depth zone for the GOM sales held in FY 2004 are shown in Table 2. As in previous GOM sales, a water-depth criterion was used to assign royalty rates. In the sales, 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. In water depths less than 200 meters, a royalty suspension volume, subject to a price threshold, was offered on deep gas production or certified unsuccessful wells where a new deep gas reservoir (15,000 feet or greater subsea) is drilled or starts production prior to May 3, 2009. The procedure for assigning royalty suspension volumes for deep gas in shallow water can be found in 30 CFR 203.40 through 203.47. For water depths of 400 meters or more, the following royalty suspension volumes, subject to a price threshold, were offered: (1) 5 million barrels of oil equivalent per lease in water depths of 400 to 799 meters; (2) 9 million barrels of oil equivalent per lease in water depths of 800 to 1,599 meters; and (3) 12 million barrels of oil equivalent per lease in water depths of 1,600 meters or more.

Table 2 indicates that the majority of tracts receiving bids in FY 2004 GOM sales were shallow water tracts with 1/6-royalty rates. These tracts received a higher average number of bids per tract than deepwater tracts with 1/8-royalty rates. However, the average high bid per tract for the 1/8-royalty tracts was about 28 percent higher than that observed for the 1/6-royalty tracts.

The 1/6-royalty tracts (less than 400 meters) accounted for 57.2 percent of tracts receiving bids, 57.1 percent of tracts leased, and 51.0 percent of high bids received in the three FY 2004 GOM lease sales. Conversely, the 1/8-royalty tracts (400 meters or more) accounted for 42.8 percent of tracts receiving bids, 42.9 percent of tracts leased, and 49.0 percent of high bids received. As shown in Table 3, the mean high bid of \$0.59 million per tract receiving a bid was an increase of 13.5 percent compared to the FY 2003 sales.

¹ Two high bids, one in Sale 190 and one in Sale 192, were rejected because the amounts submitted were below the minimum required level.

Table 2. GOM Lease Sale Bidding Results for FY 2004 by Royalty Rate

FY 2004 (3 Lease Sales)	Fixed 1/6-Royalty		Fixed 1/8-Royalty			Total
	Less than 200 meters	200 to 399 meters	400 to 799 meters	800 to 1,600 meters	1,600 meters or more	
Tracts Receiving Bids	475	52	61	174	160	922
Tracts Leased	464	51	57	170	160	902
Bids Received	692	66	71	214	221	1,264
Average Bids/Tract	1.46	1.27	1.16	1.23	1.38	1.37
Tracts with Multiple Bids	26.11 %	19.23 %	13.11 %	14.94 %	21.25 %	21.91 %
Sum of High Bids (\$MM)	\$246.39	\$33.26	\$31.22	\$148.09	\$89.56	\$548.52
Mean High Bid (\$MM)	\$0.52	\$0.64	\$0.51	\$0.85	\$0.56	\$0.59

Table 3 compares the bidding results for GOM sales since FY 1995 by royalty rate. In Table 3, you can also observe the effects of alternative leasing policies over the years. The Minerals Management Service began offering royalty relief for deep gas wells in shallow water in 2001. In the 1/6-royalty column, the mean high bid increased in FY 2001 compared to FY 2000, declined in FY 2002 and then increased in FY 2003 and FY 2004. The MMS began offering deep water royalty relief in 1996. In the 1/8-royalty column, the mean high bid began increasing in FY 1996 and reached a peak in FY 2000. Starting in 2001, lower amounts of deep water royalty relief were offered and the mean high bids continued to be relatively high before declining in FY 2003 and FY 2004.

Table 3. Mean High Bid (\$ millions) per Tract (FY 1995 - FY 2004), GOM Sales

Fiscal Year	Fixed 1/6-Royalty	Fixed 1/8-Royalty	Total (Both Rates)
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
FY 2000	\$ 0.42	\$ 1.37	\$ 0.80
FY 2001	\$ 0.47	\$ 1.18	\$ 0.77
FY 2002 ²	\$ 0.39	\$ 1.48	\$ 0.93
FY 2002 ³	\$ 0.39	\$ 0.92	\$ 0.62
FY 2002 ⁴	\$ 0.00	\$ 3.58	\$ 3.58
FY 2003	\$ 0.50	\$ 0.54	\$ 0.52
FY 2004	\$ 0.53	\$ 0.68	\$ 0.59

Bidding Systems

For sales in FY 2004, MMS continued to offer deepwater royalty relief on blocks in water depths of 400 meters or more. As was the case in the FY 2003 sales, the amount of royalty relief was specified by MMS at the time of sale and applied on a lease basis. Previously, for sales between 1996 and 2000, royalty relief reflected suspension volumes specified in the Deep Water Royalty Relief Act of 1995 (DWRRA), which were applied on a field basis.⁵ Therefore, a lease was not assured royalty relief because, for example, other leases that comprise a field could produce the entire volume before all leases on the field began production. With the change to lease-specific royalty suspension volumes, each lease in water depths of 400 meters was assured some level of

² Includes results from all three GOM sales held in FY2002.

³ Excludes results from Sale 181 in the EGOM to provide better comparison with previous years in which sales were held only in the CGOM and WGOM.

⁴ Includes results only from Sale 181 in the EGOM. In Sale 181, only blocks with a fixed 1/8-royalty rate were offered. Clearly, the bidding results in Sale 181 – the first time tracts had been offered for lease in the EGOM since 1988 – differ significantly from other recent C&W GOM sales.

⁵ A January 8, 2003, United States District Court ruling in Santa Fe Snyder Corporation, et al. v. Norton, et al. (U.S.D.C., W.D. La, Docket No.2:00-CV-1641) held invalid MMS regulations at 30 CFR 260.112 – 260.117. The 5th circuit affirmed the district court's judgment and the U.S. did not appeal the 5th circuit's affirmation Santa Fe Snyder Corporations, et al. v. Norton, No. 03-30648 (5th circuit, October 4, 2004). Under the Court's ruling, the leases issued under the DWRRA in sales held from 1996 – 2000 have lease-specific rather than field-based royalty suspension volumes.

royalty relief, subject to a price threshold. In addition, under the current bidding system, a new deepwater lease can apply for additional, discretionary royalty relief prior to production, if needed, to supplement the sale-specific royalty relief. The discretionary relief alternative was not available to leases under the DWRRA.

The specific bidding systems used in GOM FY 2004 sales were:

- (1) cash bonus bid with a 1/6-royalty rate and royalty suspension volumes on deep gas production or unsuccessful wells where a new deep gas reservoir (15,000 feet or greater subsea) produces or drilling of a certified unsuccessful well commences before May 3, 2009, in water depths less than 200 meters as specified in 30 CFR 203.40 through 203.47;
- (2) cash bonus bid with a 1/6-royalty rate in water depths of 200 – 399 meters;
- (3) cash bonus bid with a 1/8-royalty rate and a royalty suspension volume of 5 million barrels of oil equivalent per lease in water depths of 400 – 799 meters;
- (4) cash bonus bid with a 1/8-royalty rate and a royalty suspension volume of 9 million barrels of oil equivalent per lease in water depths of 800 to 1,599 meters; and
- (5) cash bonus bid with a 1/8-royalty rate and a royalty suspension volume of 12 million barrels of oil equivalent per lease in water depths of 1,600 meters or more.

Schedule of FY 2005 Lease Sales

Lease sales scheduled for FY 2005 under the 5-Year Leasing Program and the bidding systems expected to be used in those sales are listed in the table below. For CGOM Sale 194 and WGOM Sale 196, royalty relief will be offered in shallow water for natural gas production from deep wells, but the quantity will depend on the type of drilling and depth as specified in 30 CFR 203.40 through 203.47 as opposed to the fixed amount of relief (20 billion cubic feet) offered from 2001-2003.

<u>Lease Sale (Date)</u>	<u>Bidding Systems</u>
Sale 194 - CGOM (March 16, 2005)	Cash bonus, fixed 1/6-royalty Cash bonus, fixed 1/6-royalty with classes of royalty suspension volume for drilling to and production of natural gas from deep depth wells Cash bonus, fixed 1/8-royalty with classes of royalty suspension volume dependent on oil and gas production from deepwater categories
Sale 197 - EGOM	Cash bonus, fixed 1/8-royalty with royalty

(March 16, 2005)	suspension volume
Sale 195 – Beaufort Sea (March 30, 2005)	Cash bonus, fixed 1/8-royalty with royalty suspension volume
Sale 196 - WGOM (August 17, 2005)	Cash bonus, fixed 1/6-royalty Cash bonus, fixed 1/6-royalty with classes of royalty suspension volume for drilling to and production of natural gas from deep depth wells Cash bonus, fixed 1/8-royalty with classes of royalty suspension volume dependent on oil and gas production from deepwater categories