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DEPARTMENT OF THE INTERIOR

Minerals Management Service

Modifications to the **Bid Adequacy** Procedures

AGENCY: **Minerals Management Service** (MMS), Interior.

ACTION: Notification of procedural changes.

SUMMARY: The **Minerals Management Service** (MMS) has modified its existing **bid adequacy** procedures for ensuring receipt of fair market value on Outer Continental Shelf (OCS) oil and gas leases. In Phase 1 these procedures establish a new number of bids rule for acceptance of selected tracts. In Phase 2 these procedures expand the scope of tract evaluation; replace the geometric average evaluation of tract with a revised arithmetic average measure of the tract; eliminate the one-eighth rule for anomalous bids; and clarify the treatment of tracts identified as having unusual bidding patterns.

These changes were made following a review of bidding activity in OCS sales. The new number of bids rule relies more on market-determined factors to ensure receipt of fair market value. This new rule, along with expansion of evaluation procedures beyond only tract specific assessments, will allow for earlier acceptance on tracts that would be accepted later in the evaluation process. The revised average measure is designed to generate a better estimate of tract value when all bids fall below the Government's original estimate of tract value. The stricter screening rules associated with the revised average measure eliminate the need for the one-eighth rule. The Regional Director's expanded authority to handle

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documented instances of unusual bidding patterns provides flexibility to modify certain acceptance rules and allows for a decision to reject

the high **bid** on identified tracts.

DATES: This modification is effective July 14, 1997.

FOR FURTHER INFORMATION CONTACT: Dr. Marshall Rose, Chief, Economics
Division, at (703) 787-1536.

SUPPLEMENTARY INFORMATION: The following set of **bid adequacy** procedures
incorporates the most recent changes. During the **bid** review process, MMS conducts evaluations in a two-phased process for **bid adequacy** determination. In Phase 1 we review the **bid** for legal sufficiency ¹ and anomalies ² to establish the set of qualified bids ³ to be evaluated.

\1\ Legal bids are those bids which comply with MMS regulations (30 CFR 256) and the Notice of Sale. Any illegal high **bid** will be returned to the bidder.

\2\ Anomalous bids include all but the highest **bid** submitted for a tract by the same company, parent or subsidiary (bidding alone or jointly). Such bids are excluded when applying the number of bids rule or any **bid adequacy** measure.

\3\ Qualified bids are those bids which are legal and not anomalous.

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(1) Phase 1 partitions the tracts receiving bids into three general categories:

<bullet> Those tracts which the MMS identifies as being nonviable ⁴ based on adequate data and maps;

\4\ Nonviable tracts or prospects are those geographic or geologic configurations of hydrocarbons whose risk weighted most probable resource size is below the minimum economic field size for the relevant cost regime and anticipated future prices. The risk used is below the lowest level anticipated for any tract or prospect in the same cost regime.

<bullet> Those tracts where competitive market forces can be relied upon to assure fair market value; and

<bullet> Those tracts where opportunities for strategic underbidding, information asymmetry, collusion, and other

noncompetitive practices are greatest and where the Government has the most detailed and reliable data.

Based on these categories, four Phase 1 rules are applied to all tracts receiving bids:

<bullet> Pass directly to Phase 2 for further evaluation all tracts t that require additional information to make a determination on viability or tract type and all drainage and development tracts.

<bullet> Accept the highest qualified **bid** on confirmed and wildcat tracts receiving three or more qualified bids where the third highest such **bid** on the tract is at least 50 percent of the highest qualified **bid**.

<bullet> Pass to Phase 2 confirmed and wildcat tracts receiving either one or two qualified bids, or three or more qualified bids where the third highest such **bid** is less than 50 percent of the highest qualified **bid**.

<bullet> Accept the highest qualified **bid** on confirmed and wildcat tracts determined to be nonviable.

In assuring the integrity of the bidding process, the Regional Director (RD) may identify an unusual bidding pattern ⁵ at any time during the **bid** review process, but before a tract is accepted. If the finding is documented, the RD has discretionary authority, after consultation with the Solicitor, to pass those tracts so identified to Phase 2 for further analysis. The RD may eliminate all but the highest of the unusual bids from consideration when applying any **bid adequacy** rule, may choose not to apply a **bid adequacy** rule, or may reject the tract's highest qualified **bid**.

\5\ Within the context of our **bid adequacy** procedures, the term ``unusual bidding patterns'' typically refers to a situation in which there is an excessive amount of coincident bidding by different companies on a set of tracts in a sale. Other forms of unusual bidding patterns exist as well, and generally involve anti-competitive practices, e.g., when there is an uncommon absence of competition among companies active in a sale on a set of prospective tracts.

Phase 1 procedures are generally completed simultaneously within three weeks of the **bid** opening.

(2) Phase 2 applies criteria designed to resolve **bid adequacy** assessments by analyzing, partitioning, and evaluating tracts in two steps:

<bullet> Further mapping and/or analysis is done to review, modify and finalize viability determinations and tract classifications.

<bullet> Tracts identified as being viable must undergo an

evaluation to determine if fair market value has been received.
After completing these two steps, the following rules and procedures are used in Phase 2.

<bullet> Accept the highest qualified **bid** on all tracts determined to be nonviable.

<bullet> Accept newly classified confirmed and wildcat tracts having three or more qualified bids where the third highest such **bid** is at least 50 percent of the highest qualified **bid**.

<bullet> Determine whether any categorical fair market evaluation technique(s) will be used. If so:

<bullet> Evaluate, define and identify the appropriate threshold measure(s).
<bullet> Accept all tracts whose individual cash flow values, if estimated by MMS and used in the **bid adequacy** procedures, would result in satisfaction of the threshold categorical requirements.

<bullet> Conduct a full-scale evaluation, which could include the use of MONTCAR ⁶, on all remaining tracts ⁷ passed to Phase 2 and still awaiting an acceptance or rejection decision. Compare the highest qualified **bid** on each of these remaining tracts to two measures of **bid adequacy**: the Mean Range of Values (MROV) ⁸ and the Adjusted Delayed Value (ADV).⁹

\6\ MONTCAR is a probabilistic, cash flow computer simulation model designed to conduct a resource-economic evaluation that results in an estimate of the expected net present value of a tract (or prospect) along with other measures.

\7\ These include tracts not accepted by a categorical rule that are classified as drainage and development tracts and those classified as confirmed and wildcat tracts that are viable and received (a) one or two qualified bids, or (b) three or more qualified bids where the third highest such **bid** is less than 50 percent of the highest qualified **bid**.

\8\ The MROV is a dollar measure of a tract's expected net present private value, given that the tract is leased in the current sale, allowing for exploration and economic risk, and including tax consequences including depletion of the cash bonus.

\9\ The ADV is the minimum of the MROV and the Delayed MROV (DMROV). The DMROV is a measure used to determine the size of the high **bid** needed in the current sale to equalize it with the discounted sum of the bonus and royalties expected in the next sale, less the forgone royalties from the current sale. The bonus for the next sale is computed as the MROV associated with the delay in leasing under the projected economic, engineering, and geological

conditions, including drainage. If the high **bid** exceeds the DMROV, then the leasing receipts from the current sale are expected to be greater than those from the next sale, even in cases where the MROV exceeds the high **bid**.

--Accept the highest qualified **bid** for those tracts where such a **bid** equals or exceeds the tract's ADV.
--Reject the highest qualified **bid** on drainage and development tracts receiving three or more qualified bids where such a **bid** is less than one-sixth of the tract's MROV.
--Reject the highest qualified **bid** on drainage and development tracts receiving one or two qualified bids and on confirmed and wildcat tracts receiving only one qualified **bid** where the high **bid** is less than the tract's ADV.

<bullet> Select from the outstanding tracts ¹⁰ those (a) drainage and development tracts having three or more qualified bids with the third highest such **bid** being at least 25 percent of the highest qualified **bid** and (b) confirmed and wildcat tracts having two or more qualified bids with the second highest such **bid** being at least 25 percent of the highest qualified **bid**. Compare the

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highest qualified **bid** on each of these selected, outstanding tracts to the tract's Revised Arithmetic Average Measure (RAM).¹¹ For all these tracts:

\10\ These consist of those tracts having a highest qualified **bid** that does not exceed the MROV or the ADV, and are either (a) drainage or development tracts receiving three or more qualified bids with the highest such **bid** exceeding one-sixth of the tract's MROV, or (b) confirmed and wildcat tracts that are viable and receive two or more qualified bids.

\11\ The RAM is the arithmetic average of the MROV and all qualified bids on the tract that are equal to at least 25 percent of the high **bid**.

--Accept the highest qualified **bid** where such a **bid** equals or exceeds the tract's RAM.
--Reject the highest qualified **bid** where such a **bid** is less than the tract's RAM.

<bullet> Reject the highest qualified **bid** on all leftover tracts, i.e., those that were in the ``outstanding'' set above but not selected

for comparison to the RAM.

The Phase 2 **bid adequacy** determinations are normally completed sequentially over a period ranging between 21 and 90 days after the sale. The total evaluation period can be extended, if needed, at the RD's discretion (61 FR 34730, July 3, 1996).

Dated: July 7, 1997.
Carolita U. Kallaur,
Associate Director for Offshore **Minerals Management**.
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