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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 change.

SUMMARY: The **Minerals Management Service** (MMS) has changed a criterion in its existing **bid adequacy** procedures for ensuring receipt of fair market value on Outer Continental Shelf (OCS) oil and gas leases. The change ensures consistency in the evaluation of tracts.

DATES: This modification is effective July 1, 1999.

FOR FURTHER INFORMATION CONTACT: Dr. Marshall Rose, Chief, Economics Division, at (703) 787-1536. The revised **bid adequacy** procedures are described below.

What Definitions Apply to These Procedures?

The MROV is a dollar measure of a tract's expected net present value, if that tract is leased in the current sale. The calculation of the MROV allows for exploration and economic risk, and includes tax consequences, e.g., depletion of the cash bonus.

The delayed MROV (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 foregone 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 leasing receipts 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 in which the MROV exceeds the high **bid**.

The Adjusted Delayed Value (ADV) is the minimum of the MROV and the DMROV.

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

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

Legal bids are those bids which comply with the MMS regulations (30 CFR 256) and the Notice of Sale, e.g., equal or exceed the specified minimum **bid**. Any illegal **bid** will be returned to the bidder.

Qualified bids are those bids that are legal and not anomalous.

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

Nonviable tracts or prospects are those geographic or geologic configurations of hydrocarbons that are estimated to be uneconomic to produce with the costs and anticipated future prices used in the analysis.

Within the context of our **bid adequacy** procedures, the term "unusual bidding patterns" typically refers to a situation in which two or more companies **bid** against each other more often than would normally be expected. Companies could agree to **bid** against each other on certain sets of tracts in a sale so that the number of bids rule would apply for **bid** acceptance. Other forms of unusual bidding patterns exist as well, and generally involve anti-competitive practices, e.g., if it appears that companies are attempting to avoid bidding against each other in a sale on a set of prospective tracts.

A confirmed tract is a previously leased tract having a well(s) which encountered hydrocarbons and may have produced. It contains some oil and/or gas resources whose volume may or may not be known.

A development tract is a tract which has nearby productive (past or currently capable) wells with indicated hydrocarbons and which is not interpreted to have a productive reservoir extending under the tract. There should be evidence supporting the interpretation that at least part of the tract is on the same general structure as the proven productive well.

A drainage tract is a tract which has a nearby well which is capable of producing oil or gas, and the tract could incur drainage if and when such a well is placed on production. The reservoir, from which the nearby well is capable of producing, is interpreted to extend under the drainage tract to some extent.

A wildcat tract is a tract which has neither nearby productive (past or currently capable) wells, nor is interpreted to have a productive reservoir extending under the tract. It has high risk in addition to sparse well control.

Water depth categories for **bid adequacy** purposes in the Gulf of Mexico are designated as (1) less than 800 meters and (2) 800 meters or more.

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If different water depth categories are used for a Gulf of Mexico sale, they will be specified in the sale's final notice. For areas other than the Gulf of Mexico, all tracts will be considered to be in the same water depth category, unless an alternative is specified in the final notice of sale.

What Problem Is Addressed by the Change?

In any OCS lease sale, a limited number of tracts may be reclassified from drainage or development (DD) in Phase 1 of the **bid** evaluation process to confirmed or wildcat (CW) in Phase 2. (The MMS reclassifies a tract if additional Phase 2 analysis supports a classification different than the one assigned the tract in Phase 1 of the evaluation.) However, under the old **bid adequacy** procedures, a tract classified as CW in Phase 1 was evaluated under different criteria than a tract that was reclassified as CW in Phase 2. This change ensures the consistent treatment of similarly classified tracts whether they are evaluated in Phase 1 or Phase 2.

What Change Is Being Made?

In Phase 1 of the **bid adequacy** procedures, the MMS classifies tracts as either CW or DD based on information available at the time of sale. Under the old (February 10, 1999) guidelines, tracts within designated water depth categories that were reclassified from DD to CW in Phase 2 only had to have a third largest **bid** within 50 percent of the high **bid** to be accepted. Now, DD tracts reclassified as CW tracts must satisfy the same criteria for acceptance that would have had to been met if they were classified as CW in Phase 1.

To ensure consistency in evaluations, the following change is being made. In Phase 1, for CW tracts receiving three-or-more qualified bids, acceptance under the number of bids rule will apply only if the third largest **bid** is within 50 percent of the high **bid**, and if the high **bid** is in the top 75 percent of high bids on a per acre basis for all three-or-more-**bid** tracts within designated water depth categories. In Phase 2 of the **bid** evaluation process, DD tracts that have been

reclassified as CW will be subject to the same screening criteria that the CW tracts with three-or-more bids had to meet in Phase 1.

How Are Bids Evaluated?

During the **bid** review process, we conduct evaluations in a two-phased procedure for **bid adequacy** determination. We also review bids to ensure that they are for at least the minimum amount specified in the notice of sale and that unusual bidding patterns are not present.

What Happens in Phase 1 of the **Bid Adequacy** Procedures?

In Phase 1, we partition the tracts receiving bids into three general categories:

1. Those tracts with three-or-more bids, on which competitive market forces can be used to assure fair market value;
2. Those tracts which we identify as being nonviable based on adequate data and maps; and
3. Those tracts which we identify as being viable and on which we have the most detailed and reliable data, including tracts classified as DD.

What Phase 1 Rules Are Applied to All Tracts Receiving Bids?

Six Phase 1 rules are applied to all tracts receiving bids:

1. We accept the highest qualified **bid** on viable CW tracts receiving three-or-more qualified bids if the third largest **bid** on the tract is at least 50 percent of the highest qualified **bid** and if the high **bid** per acre ranks in the top 75 percent of high bids for all three-or-more-**bid** tracts within a specified water depth category.
2. We accept the highest qualified **bid** on CW tracts that we determine to be nonviable.
3. We pass to Phase 2 all tracts that require additional information to make a determination on viability or tract type.
4. We pass to Phase 2 all viable CW tracts receiving one or two qualified bids.
5. We pass to Phase 2 all viable CW tracts receiving three-or-more qualified bids if either the third largest such **bid** is less than 50 percent of the highest qualified **bid** or if the high **bid** per acre ranks in the lowest 25 percent of high bids for all three-or-more-**bid** tracts in the specified water depth category.
6. We pass to Phase 2 all DD tracts.

How is the Percentile Ranking of a Tract's High **Bid** Calculated?

The percentile ranking of a tract's high **bid** is calculated by

multiplying 100 times the ratio of the numerical ordering of the three-or-more-**bid** tract's high **bid** to the total number of all three-or-more-**bid** tracts in the designated water depth. For example, suppose there are 21 total tracts identified in Phase 1 as receiving three-or-more-bids in the designated water depth category of at least 800 meters. All tracts in this set having a high **bid** among the top 15 high bids would satisfy the 75 percent requirement; the 15th ranked high **bid** would represent the 71st percentile, i.e., $(100 \cdot (15/21) = 71)$.

Can any Other Procedures be Used in Phase 1 to Ensure the Receipt of Fair Market Value?

In ensuring the integrity of the bidding process, the Regional Director may identify an unusual bidding pattern at any time during the **bid** review process, but before a tract's high **bid** is accepted. If the finding is documented, the Regional Director has discretionary authority, after consultation with the Solicitor, to pass those identified tracts to Phase 2 for further analysis. The Regional Director may eliminate all but the largest 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**.

How Long Does it Take To Complete the Phase 1 Procedures?

These procedures are generally completed within 3 weeks of the **bid** opening. All the leases that will be awarded as a result of the Phase 1 analysis are announced at the end of this period.

How Long do the Phase 2 Procedures Take?

The Phase 2 **bid adequacy** determinations are normally completed sequentially over a period ranging between 21 and 90 days after the sale. Leases are awarded as the analysis of bids is completed over this time period. The total evaluation period can be extended, if needed, at the Regional Director's discretion (61 FR 34730, July 3, 1996).

What are the Initial Steps of the **Bid Adequacy** Process that are Followed in Phase 2?

Activities to assess bids are undertaken by analyzing, partitioning, and evaluating tracts in two steps:

1. Further mapping and/or analysis is performed to review, modify, and finalize viability determinations and tract classifications.
2. Tracts we identify as being viable must undergo an evaluation to determine if fair market value has been received.

What Decision Rules are Applied in Phase 2 of the **Bid** Evaluation Process?

After completing the initial two steps, a series of rules and procedures are followed.

1. We accept the highest qualified **bid** on newly classified CW tracts having three-or-more qualified bids if its third

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largest **bid** is at least 50 percent of the highest qualified **bid** and if its high **bid** per acre ranks in the top 75 percent of high bids for all three-or-more-**bid** tracts that reside within its specified water depth category.

2. We accept the highest qualified **bid** on all tracts determined to be nonviable.

3. We determine whether any categorical fair market evaluation technique(s) will be used.

If so we:

A. Evaluate, define, and identify the appropriate threshold measure(s) for **bid** acceptance.

B. Accept all tracts whose individual measures of **bid adequacy** satisfy the threshold categorical requirements.

4. We conduct a full-scale evaluation, which could include the use of MONTCAR, on all remaining tracts passed to Phase 2 and still awaiting an acceptance or rejection decision.

What Subset of Tracts Comprise the ``Remaining Tracts" That Still Need a Phase 2 Acceptance or Rejection Decision?

The remaining tracts include tracts not accepted by a categorical rule that we classify as:

1. DD tracts, or

2. CW tracts that are viable and received:

A. One or two qualified bids, or

B. Three-or-more qualified bids, if either its third largest **bid** is less than 50 percent of the highest qualified **bid** or the high **bid** is in the bottom 25 percent of all three-or-more-**bid** CW tracts within a designated water depth category.

What Procedures are Followed for Evaluating the **Adequacy** of Bids on These Tracts?

For these tracts we:

1. Accept the highest qualified **bid**, if it equals or exceeds the

tract's ADV.

2. Reject the highest qualified **bid** on DD tracts receiving three-or-more qualified bids, if the high **bid** is less than one-sixth of the tract's MROV.

3. Reject the highest qualified **bid** on DD tracts receiving one or two qualified bids and on CW tracts receiving only one qualified **bid**, if the high **bid** is less than the tract's ADV.

What Happens Next to the Tracts Still Awaiting an Acceptance or Rejection Decision?

At this stage of the process, the tracts still awaiting a decision consist of those having a highest qualified **bid** that is less than the ADV that are either:

1. DD tracts receiving three-or-more qualified bids with the highest **bid** exceeding one-sixth of the tract's MROV or
2. Viable CW tracts that receive two-or-more qualified bids.

From these tracts, we select the following:

- A. DD tracts having three-or-more qualified bids with the third largest **bid** being at least 25 percent of the highest qualified **bid**, and
- B. CW tracts having two-or-more qualified bids with the second largest **bid** being at least 25 percent of the highest qualified **bid**.

We then compare the highest qualified **bid** on each of these selected tracts to the tract's RAM. For all these tracts, we:

1. Accept the highest qualified **bid**, if the high **bid** equals or exceeds the tract's RAM, or
2. Reject the highest qualified **bid**, if the high **bid** is less than the tract's RAM.

Finally, we identify those tracts that are still awaiting a decision, but did not meet the requirements for comparison to the RAM and we reject the high **bid** on these tracts.

At this point, the acceptance or rejection decisions are made on all the high bids in the sale. The successful bidders are notified and their leases are awarded after the full payment of the high **bid** is received. The unsuccessful bidders are notified as well and their **bid** deposits are returned. Unsuccessful bidders may appeal a **bid** rejection decision as described in 30 CFR 256.47(e)(3).

Dated: July 1, 1999.

Carolita U. Kallaur,
Associate Director for Offshore **Minerals Management**.

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