

OIL AND GAS LEASING ON THE OUTER CONTINENTAL SHELF



Bureau of Ocean Energy Management
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Background

The Bureau of Ocean Energy Management (BOEM) is a bureau in the United States Department of the Interior (DOI) that manages the offshore energy resources of the Outer Continental Shelf (OCS). BOEM manages approximately 1.7 billion acres containing about 8,000 active leases of this federally owned offshore area while protecting the human, marine, and coastal environments through advanced science and technology research. The almost 36 million leased OCS acres generally account for about 7 percent of America's domestic natural gas production and about 24 percent of America's domestic oil production.

The OCS Lands Act authorizes the Secretary of the Interior to grant mineral leases and to prescribe regulations governing oil and natural gas activities on OCS lands. The OCS Lands Act mandates the OCS be made available for expeditious and orderly development, subject to environmental safeguards while maintaining competition for the OCS resources. Federal ownership begins three nautical miles off most coastal states; the exceptions are Texas and the Gulf coast of Florida where the OCS starts at about nine nautical miles. Federal jurisdiction generally ends around 200 nautical miles from the coastline.

Revenues from OCS leases consist of bonuses, royalties, and rentals and are collected by the Office of Natural Resource Revenue (ONRR). These revenues are shared with coastal states, as directed by statute, and the remaining funds deposited in the U.S. Treasury.

OCS revenues provide annual deposits of nearly \$900 million to the Land and Water Conservation Fund and \$150 million to the Historical Preservation Fund. By statute, coastal states share a portion of the revenues from OCS leasing and production under three programs: 1) the Outer Continental Shelf Lands Act (OCS Lands Act) section 8(g) revenue sharing program that provides states with offshore federal leases located within the first three miles from the state's seaward boundary receive 27 percent of the revenue generated from those leases; 2) the Coastal Impact Assistance Program (CIAP) for Alaska, Alabama, California, Louisiana, Mississippi, and Texas; and, 3) the Gulf of Mexico Energy Security Act (GOMESA) for Alabama, Louisiana, Mississippi and Texas.

Reorganization

The Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE) recently underwent a reorganization that was completed in October 2011. BOEMRE replaced the previous Minerals Management Service (MMS) by separating out the revenue collection responsibilities to ONRR. BOEMRE was then further sub-divided into two independent agencies. The resource management roles, including leasing, economic analysis, resource evaluation and environmental analysis, reside with BOEM. The safety and enforcement responsibilities including operations, inspections, and environmental compliance are located

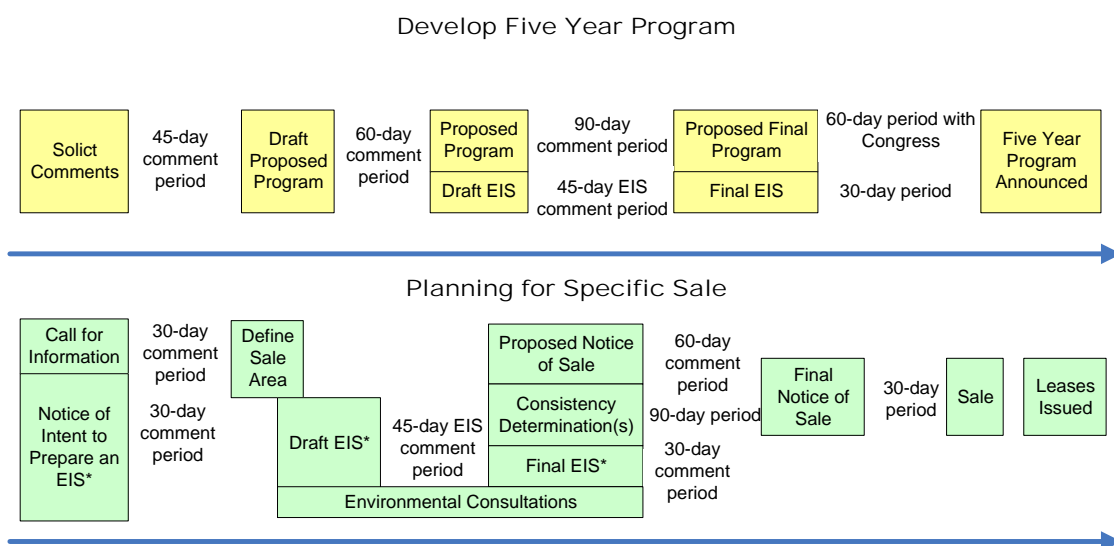
within the Bureau of Safety and Environmental Enforcement (BSEE). The reorganization of the former MMS and BOEMRE was intended to remove the perceived and real conflicting missions of these agencies by clarifying and separating missions across three agencies and providing each of the new agencies with clear missions and additional resources necessary to fulfill those missions.

The Oil & Gas Leasing Process

BOEM has start-to-finish oversight responsibility on oil and gas leasing activities within the OCS. Section 18 of the OCS Lands Act, requires the Secretary of the Interior to prepare an oil and gas leasing program that consists of a 5-year schedule of proposed lease sales that shows the size, timing, and location of leasing activity as precisely as possible. This Five Year Program must balance the priorities of meeting national energy needs, environmentally sound and safe operations, and fair market return to the taxpayer.

For any specific lease sale to be held, it must be included in an approved Five Year Program. A lease sale cannot be added later to an existing Five Year Program without an act of Congress. Whether a lease sale is held depends on sale-specific analyses.

The Five Year Program preparation process includes three separate comment periods, two separate draft proposals, a final draft proposal, final secretarial approval, and development of an environmental impact statement (EIS). This statutory mandated process usually takes about two and a half years. The Five Year Program includes coordination with multiple federal agencies, state, local and tribal input. After the Secretary of the Interior approves the Program, the Proposed Final Five Year Program is sent to the President and Congress. After a minimum of 60 days, the Secretary may approve the program.



* Level of appropriate National Environmental Policy Act documentation to be determined based on the actual project proposed

Abbreviation: EIS – Environmental Impact Statement

The durations of comment periods are the minimum time frames required.

Figure 1: Leasing Process

The Sale Process

After adoption of a Five Year Program, the usual first step in the sale process for an individual area is to publish a Call for Information and Nominations and a Notice of Intent to Prepare an EIS in the *Federal Register*. The entire process from the Call to the sale may take two or more years (see Figure 1). Some proposed sale areas may include an additional first step — a request for industry to express their interest in the specific area before BOEM proceeds with the sale process. The lease sale process is described below. Note: the timeframes listed represent the minimum required by law and may be longer in some cases. For example, the Draft EIS has a 45-day comment period but sometimes a policy decision is made to provide 60 days because it can be a lengthy document.

- Call for Information/Notice of Intent to Prepare an EIS is published – This is the initial request for industry to identify those blocks within an OCS planning area in which they potentially have interest in leasing. Additionally, the public may comment on areas that should or should not be considered for leasing as well as issues pertinent to the EIS.
 - Scoping Meetings – These are public meetings conducted in the vicinity of the area proposed for leasing consideration in order to receive public comments regarding issues related to developing an EIS.
- Define Proposed Sale Area – BOEM analyzes comments and considers resource potential and environmental effects and recommends the geographic area to be analyzed in an EIS (called Area Identification).
- Draft EIS Published – The area identified undergoes a full NEPA analysis and a draft EIS is published with a 45-day public comment period.
 - Public Hearings – Public meetings are held inviting constituents and stakeholders to submit written or oral comments on the draft EIS; these meetings are held in selected localities near the proposed lease sale area.
- Final EIS is published – After considering comments on the draft EIS, a Final EIS is published with a 30-day comment period.
- Proposed Notice of Sale (NOS) Published – This is the first public document stating the proposed time and location of the proposed lease sale with the terms and conditions as well as the recommended mitigating measures. The Proposed Notice is sent to the Governor of the affected state(s) and the Governor has 60 days to comment on the proposed sale.
- Consistency Determination to affected states – BOEM prepares a consistency determination in accordance with the Coastal Zone Management Act (CZMA) to determine if the proposed lease sale is consistent with the affected state(s)' coastal zone policies. The state has 60 days to agree or disagree with the Federal consistency determination. There is an additional 15 days for an extension if the State requests it. After that, there is an additional 15 days for internal review, providing a total of 90 days for the consistency determination process.
- Final NOS Published – This Final NOS states the final terms and conditions of the lease sale and must be published in the *Federal Register* at least 30 days prior to the sale date. The Record of Decision for the EIS is typically issued concurrent with the Final NOS.

- **Sale** – No less than 30 days after the Final NOS is published in the *Federal Register*, sealed bids submitted by qualified bidders along with one-fifth of the bonus bid amount are publicly opened and read at the lease sale. The sale is conducted by the appropriate Regional Director, usually in the city in which the OCS regional office is located. Qualified bidders may submit bids on each available block listed in the Final NOS.
- **Leases Issued** – The lease sale is a transparent process. Bids are not accepted or rejected at that time of lease sale. BOEM accepts or rejects all bids within 90 days, although the time may be extended if necessary. The DOI reserves the right to reject any and all bids, regardless of the amount offered, if the bid does not meet BOEM's fair market value criteria. If a bid is rejected, any money deposited will be refunded with the bid plus any interest accrued. If the bid is accepted, the remaining four-fifth's bonus and first year rentals are due no more than 11 days after BOEM approves the bid.

Acquiring a Lease

BOEM places some restrictions on who may acquire a lease. In order to become a lease holder, a qualified bidder must be a legal entity under United States law. This includes being an American national, resident alien, corporation, or partnership, or any combination of the above. Prior leaseholders may be barred from acquiring new leases if they failed to exercise due diligence or have unacceptable operating performance. Additionally, a restricted bidder list prohibits major oil companies from jointly bidding on a lease, under certain conditions.

A lease conveys the right to explore for, develop, and produce the oil and gas contained within the lease area. Leases are offered as blocks which are nine square miles (3 miles on a side). No lease may be sold, exchanged, assigned, or otherwise transferred except with the approval of BOEM. Before BOEM issues a lease or approves an assignment of an existing lease, the high bidder or assignee must provide either a lease-specific or area-wide general bond.

BOEM may determine that the prospective lessee (or an existing lessee, as activities on the lease or the lessee's financial situation changes) needs to provide a supplemental bond as security in addition to the requirements for general bonds. BOEM may call for forfeiture of all or part of the bond or pledged security or performance by the guarantor if the high bidder refuses or fails, within the timeframe, to comply with any term or condition of the lease.

Fair Market Value

In administering the offshore oil and gas leasing program, BOEM is required by law to see that the Government receives a fair return for the lease rights granted and the minerals conveyed. BOEM uses a two-phased system of bid evaluation to assess the adequacy of bids based on multifaceted criteria.

Immediately after the bids are read publicly, BOEM begins the process of determining whether a bid can be accepted and a lease issued. Each high bid is first examined for technical and legal adequacy. Before any bid is accepted, the bidding results of the sale also are reviewed by the

Attorney General and the Federal Trade Commission to determine if awarding a lease would create a situation inconsistent with antitrust laws.

Each valid high bid resulting from these determinations is then analyzed from a fair market value perspective. It is important to note that the fair market value at the time of lease award is not based on the value of the oil and gas eventually discovered or produced; instead it is related to the value of the right to explore and, if there is a discovery, to develop and produce hydrocarbons. This value is therefore based on the expected, not actual, activities and results that are anticipated to occur after the sale.

Lease Terms and Conditions

An oil and natural gas lease grants the exclusive right to explore, develop, and produce oil and/or natural gas for a specific initial period (minimum of five and maximum of ten years) from a specific block of OCS land. All exploration, development, and production plans are carefully reviewed by BOEM to ensure that they will be performed in an environmentally sound and safe manner. If a discovery is made within the initial term of the lease, the lease is extended for as long as oil and/or natural gas is produced in paying quantities or approved drilling operations are conducted. The term of the lease may also be extended if a suspension of production or suspension of operations has been granted or directed. Examples of when a suspension of operations may be granted include weather delays such as hurricanes or other circumstances beyond the lessee's control. Examples of a suspension of production may include unforeseen delays in retrieving a drilling rig once a schedule and commitment to production has been demonstrated.

The lease is a contractual agreement and thus further spells out requirements for surety bonds, royalty payments, rental payments, and assignment or other transfers of the lease or any partial interest. No lease may be sold, exchanged, assigned, or otherwise transferred except with the approval of BOEM.

Appropriate stipulations are included in the OCS oil and natural gas leases in response to concerns raised by coastal states, federal agencies, tribes and other stakeholders. Examples of stipulations include required biological surveys of sensitive seafloor habitats, procedures for the protection of endangered and protected species, environmental training for operations personnel, special operating procedures near military bases or their zones of activity, visual impacts mitigation and other restrictions on OCS oil and natural gas operations. Lease stipulations are legally binding, contractual provisions designed as mitigating measures to address specific concerns pertinent to the lease.

In addition, the lease requires that the lessee comply with additional rules and regulations that may be issued after the lease is awarded. The Notice to Lessees and Operators (NTL) is used by BOEM to notify operators quickly within a particular OCS Region or nationwide concerning changes in administrative practices or procedures for complying with rules, regulations, and lease stipulations and/or to clarify requirements or to convey information.

When the lease is acquired, a bonus bid is paid. The bonus bid is the winning highest dollar amount paid at the time of lease sale. This acquisition cost reflects the opportunity cost of exploring and producing those minerals resources. During the initial term of a lease and before royalty on production is paid, the lessee pays annual rentals, in an amount prescribed in the Final Notice of Sale. Rentals reflect the holding cost of the lease during the initial term, prior to production in paying quantities. In recent sales, BOEM has imposed rentals that escalate over time to encourage faster exploration and development of leases.

The government receives a royalty payment once production starts. The royalty rate is a percentage of production. The royalty rate is used to calculate the royalty payment, that is, the dollar amount paid based on value of the amount of production. Under certain conditions, the royalty payment might be temporarily waived. Known as royalty relief, this generally occurs when an economic incentive is needed to spur additional production such as in a frontier area or deeper depth. Price thresholds or triggers suspend royalty payments if market prices are low but do not suspend royalty payments if market prices are high. Price thresholds provide an incentive when production might not otherwise occur. Additionally, they provide protection when market prices are high and the incentive is no longer needed.

Exploration, Development, and Production

The leasing and operations activities on the OCS are subject to the requirements of some 30 federal laws administered by numerous federal departments and agencies. In addition to the OCS Lands Act, other laws that may apply to OCS exploration, development, and production include, but are not limited to the:

- National Environmental Policy Act (NEPA)
- Endangered Species Act
- Coastal Zone Management Act
- Federal Water Pollution Control Act
- Ports and Water Safety Act
- Marine Mammal Protection Act
- Clean Air Act
- National Historic Preservation Act
- Oil Pollution Act
- Federal Oil and Gas Royalty Management Act

BOEM takes seriously its responsibilities to develop our nation's oil and gas resources in an environmentally sound and safe manner and to obtain fair market value for the American people. Our agency is committed to being responsive to the public's concerns and interests by maintaining a dialogue with all affected parties.