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United States General Accounting Office
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Statement of
Douglas L. McCullough
Deputy Director, Energy and Minerals Division
Before the
Subcommittee on Mines and Mining
House Committee on Interior and Insular Affairs
on
[Federal Leasing Policy]

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to appear before this Subcommittee to discuss questions and issues raised in our two recent reports 1/ on proposed expansion of the competitive onshore oil and gas leasing system. With your permission, I would like to submit copies of both reports for the record.

We also have underway a comprehensive review of the impacts which access to Federal lands and delays in the permitting process are having on the onshore leasing system. Our previous work on the oil and gas issue, in addition to the work we are testifying on here today, also includes a March 1970 report on the use of competitive versus noncompetitive leasing and an April 1979 report on aspects of the lottery system.

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1/ "Impact of Making the Onshore Oil and Gas Leasing System More Competitive," EMD 80-60, March 14, 1980; and "Impact of an All Competitive Onshore Oil and Gas Leasing System," EMD 80-79, June 2, 1980.

My remarks today will address our views on the use of competitive and noncompetitive lease methods and raise some issues that we think are important in the context of the timely and orderly development of onshore oil and gas resources.

USE OF DUAL LEASING METHODS CONTROVERSIAL

The present Federal leasing system for onshore oil and gas has been criticized over the years. Generally, the controversy has centered around the merits of a competitive leasing system. A more competitive system has been viewed as a way to increase Federal receipts and also to correct other problems perceived in the present lottery-type system. At the same time, there has been concern that an all-competitive system might be detrimental to independent oil producers who have dominated the development of the small onshore tracts.

Under authority of the Mineral Leasing Act of 1920, as amended, onshore Federal oil and gas lands are required to be leased both competitively and noncompetitively. The lease method employed is determined by the proven geologic significance of the tract. If a prospective lease area is located within the U.S. Geological Survey's (USGS) boundaries for a known geologic structure (KGS), i.e., land with proven oil and gas production, it must be leased competitively. If not, the land must be leased noncompetitively.

Once a producible well is "completed," the land around the well, according to certain USGS criteria, is designated a KGS.

The next time that such land is nominated and made available for lease, it is leased competitively to the bidder offering the highest cash bonus. All tracts offered for competitive bidding are evaluated beforehand by Interior. The estimated value placed on the tract is then compared with the highest bid received. If the highest bid received falls too far below the appraisal, the bid may be rejected. Available statistics indicate only about 2 percent of Federal oil and gas land is leased competitively.

Noncompetitive oil and gas leases are awarded by the Federal Government using either the "over-the-counter" or the "simultaneous" lease procedure. The method employed is, for the most part, determined by the prospective lease area's previous lease status and associated degree of visibility. Lands not leased before are made available over-the-counter to the first qualified applicant (i.e., U.S. citizen, 21 or over) who submits an application together with the first year's \$1.00/acre rental and \$10 filing fee. As these leases expire, or are otherwise terminated, they are made available by the Bureau of Land Management for noncompetitive re-lease using the simultaneous system.

Prior to 1960, re-lease of these tracts was also handled on a first-come, first-serve basis, but mob scenes that eventually ensued from increasing interest in highly visible listings of available tracts resulted in implementation of the simultaneous or lottery lease system. Under this system

a monthly drawing is used to determine which of the hundreds and sometimes thousands of applicants for each tract should be awarded the lease. The over-the-counter system is still used for noncompetitive lands not leased before and for re-offered lands not re-leased under the simultaneous system.

Much of the best prospective onshore areas are already under lease, having been awarded either competitively or noncompetitively. For example, it is estimated that the Overthrust Belt, an area considered of limited potential for years and now one of the Nation's most promising new areas, is already as much as 90 percent under lease in the four-State area of Idaho, Montana, Utah and Wyoming. Interior Department data indicates that the vast majority of the approximately 117,000 existing onshore oil and gas leases--as much as 98 percent--were awarded noncompetitively. Most of these noncompetitive leases (e.g., about 85 percent of Federal oil and gas lands in Wyoming) have been awarded through use of the lottery system which allegedly has been manipulated to the detriment of the public's interest.

The competitive/noncompetitive imbalance resulting from the present leasing system, the ease with which leases can be acquired, and abuse of the freedoms associated with lease ownership have resulted in apparent inconsistency with Interior's mineral management goals. These goals include the orderly and timely development of the resource, the recovery of its fair market value,

and protection of the environment. Recent administrative, regulatory and proposed legislative changes have been made by the Administration to correct the problems and make the system more competitive. Others have introduced legislation to make the system all competitive which eliminates any perceived abuse by doing away with the present system's noncompetitive component.

Based on the results from our work to date on onshore oil and gas leasing, we would like to discuss key issues which we believe must be thoroughly considered when evaluating recommended changes aimed at making the onshore oil and gas leasing system more or all competitive, namely--leasing delays that can reduce production and fair market value realization. In addition, our prior work has pointed out the need to correct real or potential abuses in the current lottery-type system. It appeared to us that certain changes recently made by Interior were steps in the right direction and that improvements could be made administratively without a major overhaul of the present system.

LEASING DELAYS AT THE EXPENSE OF PRODUCTION

GAO has long advocated a systematic approach to leasing Federal resources in a manner which encourages exploration and development of the most prospective lands. Achieving this through an onshore oil and gas leasing system, however, may be difficult at best for various

reasons. These include the vast amount of leases and acreage already under lease with varying expiration dates of up to 10 years; the absence of geophysical and geological data; and scattered Federal, State and private ownership patterns. On that note, we believe it is important to recognize that the present system, while certainly having flaws and inequities pointed out in our prior work, has basically succeeded in making an important contribution to domestic oil and gas production--mainly by making a good deal of land available and continually accessible for exploration and development. Therefore, we believe caution should be exercised before making any sweeping changes to such a system.

The impact of the proposed changes on production is difficult to forecast confidently because there are a great many interacting variables, most of which depend on the responses of individuals to as yet unspecified actions to be taken in implementing these changes. It is our opinion, however, that the more competitive and all competitive leasing systems proposed could very likely result in considerably less land under lease, delays in making lands available for leasing, and less incentive and opportunity for independent oil companies and others to continue their traditional role of searching out and exploring lands for prospective oil and gas. In addition, the offering of larger competitive lease tracts coupled with the use of bonus bidding or other alternatives

could significantly alter the dynamics and structure of participation in the system in favor of the major oil companies.

A fully competitive system could work a hardship on the independent oil developer because (1) tracts which will be obtained through cash bidding may be of greater interest to the majors than the present system of small leases that have to be methodically consolidated into an efficiently-sized unit and (2) a high-per-acre bid, combined with the potential for the larger tracts, might create some financial hardships for many independent producers in meeting the bonus bid competition. Our work has pointed out that independent oil producers are responsible for the vast majority of oil and gas produced onshore and that they are also an integral part of the drilling and exploration operations of many major and non-major oil companies. If the independent is not able to compete successfully under the proposed system, is denied access to lands now available to him, or experiences delays in leasing potentially productive lands, production could be sacrificed.

Another problem associated with the type of competitive leasing systems being proposed is the potential for delays due to the lack of requisite data for tract selection or consolidation.

The Interior Department has little information on existing leases, including those it has leased competitively.

Interior generally has not required the industry to share exploratory data with the Government as is required for the OCS. In fact, the Department of the Interior does not even know what specific Federal land areas have been studied by industry, and the results of these studies. Without data on which areas have the best potential, Interior could have a difficult time identifying "favorable oil and gas lands" within "producing geologic provinces," or selecting the best tracts to offer for competitive lease in a manner consistent with the orderly and timely development of the resource. It would appear that Interior has the option of purchasing the needed data from industry to determine when, where, and how much land to lease, which could prove to be a very costly and time consuming alternative, or continue to rely on industry to take the initiative in identifying and securing the best potential tracts--which is basically what makes the present system work.

Even a system which requires that all onshore Federal oil and gas lands be leased competitively may result in delays due to the tract consolidation process. For most leased areas, Interior does not have the type of data on which to base tract selection decisions or a management system which could provide for more systematically planning and scheduling onshore leasing. It might, therefore, require putting a freeze on a good portion of any future leasing in order to allow time

for assembling, organizing and then scheduling the tracts to be leased. This would do little to help stimulate exploration and development in the short-term.

Another potential problem associated with an all competitive system is the likelihood that many rank wildcat lands will not be leased competitively and potential production will be lost. In certain instances--particularly in wildcat areas--noncompetitive leasing could be preferable to competitive leasing. It is a fairly widespread practice for individuals to seek out and acquire over-the-counter leases and assign them to producers for development. Identifying this land is a laborious process involving searching through literally thousands of maps and related data in BLM state offices. Our work showed a significant amount of land still being leased in this way. If the reward for this searching is merely the opportunity to nominate the tract for competitive bidding, rather than to acquire the lease, there will probably be little incentive to continue the research process.

An additional potential source of delay is the time it will take to promulgate the rules, regulations, and standards required under the various competitive leasing schemes proposed. Suspension of leasing until the requisite rules, regulations and standards are in

place is explicit or implied in most of the changes proposed and resultant delays could be lengthy. For example, it took well over a year for the Interior Department to issue revised regulations covering noncompetitive onshore oil and gas leasing procedures.

REALIZATION OF FAIR MARKET VALUE

The expanded use of competitive leasing is also sometimes advocated as a means of helping discourage speculation, and as a means of assuring that the Government (and, therefore, the American people) will receive the fair market value of the oil and gas being leased if true competitive forces are working. These advocates feel that a truly competitive situation will also guarantee equal access to the land by eliminating actual or potential abuses of the lottery system or the regular over-the-counter system. We believe, however, that while it is true that the all competitive systems proposed will correct any abuse or irregularities in the noncompetitive system through its elimination, these systems will not necessarily ensure a competitive situation or fair market value recovery.

Fair market value is often defined as either what could be realized in a competitive market, or realization of an assessed presale and/or postsale value. The proposed changes calling for an expanded competitive system do not assure this happening. The changes apparently allow

any one qualified bidder to be awarded the lease offered regardless of the amount bid. There is no assurance of a competitive situation, and thus there is no assurance that fair market value will be received by the Government. Also, the use of presale or postsale evaluations to assess the adequacy of a bid are explicitly ruled out in the Administration's proposal and are presumably ruled out in the other proposals, which are silent on the matter, because of the apparent requirement that any one high bid be accepted regardless of the amount bid. This presents some serious questions regarding the assurance of fair market value being realized, given the fact we noted bids as low as a nickel an acre in our prior work.

Evaluations could be used to measure fair market value, but the workload would be substantial. In recent years, there have been an average of about 280 competitive leases compared to 12,000 noncompetitive leases. The Interior Department conducts sale evaluations on the competitive leases but not the noncompetitive ones. Thus, a major increase in competitive leasing could cause a considerable expansion of the Department of Interior's casework and certainly would require more time to issue leases if recovery of fair market value through evaluations is attempted.

While not directly related to the receipt of fair market value, it should be pointed out that a more competitive system will likely increase competitive bid receipts with or without a system of fair market value appraisal. Also, filing

fee receipts will be reduced or totally eliminated and royalties may be reduced through possible reduction in oil production. According to Interior, bonus bids brought in \$12.7 million in 1978, land rentals \$55.7 million, royalties \$308.7 million, and filing fees \$29.7 million.

GAO's past work suggests that a great deal of land presently leased may not be leased under a more competitive system and we could see a reduction of independent involvement. If these things happened, rental, royalty and bonus bids would be adversely affected.

We believe the onshore oil and gas leasing system has resulted in the production of significant amounts of oil and gas. We suggest that caution be exercised in any major revamping of the system until there is a better understanding of its impact and a clear statement of its objective.

There are no doubt several ways in which the present leasing system could be modified using only administrative or regulatory changes to achieve a close approximation of fair market value and/or greater production. One which we believe may warrant greater consideration involves raising the royalty and perhaps land rentals, along with instituting stricter diligence requirements. Present onshore oil and gas royalties exceed \$300 million a year and rentals exceed \$50 million a year. A modest increase in royalties and/or rentals (such as raising the present noncompetitive lease rentals

and royalties to an amount comparable to that obtained on competitively leased land) would bring in significant revenues and, if accompanied by corresponding reductions in overriding royalties, may eliminate many of the possible undesirable aspects of a non-competitive-type system. Speculator profit would be reduced, Federal and State receipts would increase and therefore production should not decrease, and the independent would not be hurt.

In closing, we believe that the Congress should not adopt major changes to the present system. We conclude that our previously recommended changes to the existing system are the preferred course of action.

Mr. Chairman, this concludes my statement. We will be happy to answer any questions the Subcommittee may have.