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Statement of
Douglas L. McCullough
Deputy Director, Energy and Minerals Division

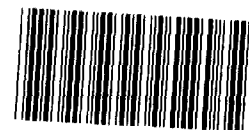
Before the
Subcommittee on the Panama Canal
and the Outer Continental Shelf
House Committee on Merchant
Marine and Fisheries

SUMMARY

Interior has done a more thorough job documenting its analyses and planning in support of its March 1982 Tentative Proposed Final OCS Leasing Program than what was done in support of the July 1981 program. Interior's March program is responsive to the concerns and recommendations in GAO's "Pitfalls" report. Interior has also developed what appears to be a most comprehensive analysis of the developmental, environmental, and economic impacts and tradeoffs of the program as required by Section 18 of the OCS Lands Act Amendments of 1978.

One area still of concern is the post-sale bid evaluation and acceptance process--the major question being how many tracts will require evaluation. Interior's ability to evaluate and award tracts receiving few bids in a timely manner is crucial to the success of the accelerated program.

Mid-Atlantic Sale 59 competition was comparable to or better than the previous mid-Atlantic sale, although not nearly as good as the initial sale in the mid-Atlantic leasing area. GAO has not determined why such an unusually high number of tract bids were rejected.



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Mr. Chairman and Members of the Subcommittee:

GAO welcomes the opportunity to appear before this Subcommittee to discuss the Administration's proposed 5-year offshore leasing program. In March 1981, we testified before you on two OCS reviews that were conducted at the request of Congressman Edwin B. Forsythe of this Subcommittee. 1/ Our reports and testimony described what we believed to be major problems in the Interior Department's offshore leasing and development program and what we thought could be done to improve the program's effectiveness.

THE ADMINISTRATION'S NEW
PROGRAM

In April 1981, the Administration announced proposed changes to the OCS program--changes designed to accelerate the

1/"Issues in Leasing Offshore Lands for Oil and Gas Development" EMD-81-59, March 26, 1981, and "Impact of Regulations--After Federal Leasing--On Outer Continental Shelf Oil and Gas Development" EMD-81-48, February 27, 1981.

leasing and development of offshore lands. Basically, the proposed changes focused on: (1) revising the existing 5-year leasing schedule to increase the number of sales, and (2) revising the administrative procedures and processes--called streamlining--for planning lease sales and conducting post-sale activities. Later, in July 1981, the Interior Department, as mandated in the OCS Lands Act Amendments of 1978, submitted a formal proposed program to the Congress for its review. Shortly thereafter, Chairman Walter B. Jones and 14 members of the full Committee asked us to review and present our views on the new program. Similar requests were also received from House Subcommittee Chairmen John D. Dingell and Toby Moffett. We reported the results of our review to the Chairmen in December 1981, which at this time, I would like to submit for the record as part of my testimony. 1/

GAO supports reasonable efforts to accelerate OCS leasing and development of hydrocarbons on offshore lands. We have made numerous recommendations in past reports to improve the efficiency and effectiveness of the program--many of which have been adopted by the Interior Department. While in favor of the overall thrust of the Administration's July 1981 proposed program, our view in December 1981 was that numerous pitfalls

1/"Pitfalls in Interior's New Accelerated Offshore Leasing Program Require Attention" EMD-82-26, December 18, 1981.

existed in implementing the program. As we discussed in our report, our immediate concerns were:

- the practical details, i.e., procedures and processes, of how the streamlining concepts were to be implemented;
- the potential impacts of the program; and
- the Department's capability to implement the program.

Our comments and recommendations were intended to raise questions as to the practicalities and problems involved in revising the offshore leasing program. Our message was that more detailed planning and analysis was needed to demonstrate that the concepts of the accelerated program could be implemented as planned.

On March 13, 1982, Interior submitted a Tentative Proposed Final Leasing Program to the Congress for its review. From what we have reviewed of it so far, it appears that Interior has done a much more thorough job documenting its analyses and planning in support of this proposal than what was done in support of the July 1981 program. And we believe Interior's March program is responsive to the concerns and recommendations in our "Pitfalls" report. For example, Interior's program submission to Congress contains more specific information as to how the streamlining

concepts will be implemented and provides details as to how tract bids will be evaluated to assure receipt of fair value for lands leased. The Secretary's December 15, 1981, decision to limit the sale areas to only those tracts thought to have hydrocarbon potential is also responsive to our report recommendation to trim down the acreage offerings in each sale. Offering only those acres having hydrocarbon potential should lead to greater efficiencies in prelease environmental and tract valuation analyses.

We commented in our report that Interior's funding and staffing estimates for the July 1981 program proposal were less than those for the prior Administration's program--even though leasing was to be accelerated significantly under the new program. We questioned the reliability of these estimates as there was little detailed supporting documentation showing how they were developed. Our quick look at the March 1982 program funding and staffing estimates shows an increase over what was submitted for the July 1981 program. The funding anticipated for the March 1982 program is still less than what was envisioned under the June 1980 leasing schedule, however, staffing needs are now more than what was anticipated under the June 1980 program.

Interior has also developed what appears to be a most comprehensive analysis of the developmental, environmental, and economic impacts and tradeoffs of the program as required by

Section 18 of the OCS Lands Act Amendments of 1978. This latter analysis was in response to a court decision in October 1981 which found that the Section 18 requirements had not been met in formulating the June 1980 leasing program.

One area still of concern to us is the post-sale bid evaluation and acceptance process--the major question being how many tracts will require evaluation. Interior's bid acceptance process will focus on those tracts not receiving an adequate number of bids to assure fair value through competition. Without actual experience there is no way to predict how many tracts will not receive the requisite number of bids needed to assure adequate competition, and thus require a detailed tract specific evaluation. In our opinion, tract valuations and bid acceptance remains a "pitfall" to the program, in that a large number of one- and two-bid tracts requiring detailed evaluation could delay bid award decisions and could also impact on Interior's--and industry's--planning for follow on sales. Interior needs to continue close surveillance in this area.

MID-ATLANTIC OCS SALE 59

You also asked that we comment on mid-Atlantic OCS lease Sale 59 held in December 1981. This is the deepest deep-water sale that has been held in U.S. offshore waters. We are currently reviewing the sale, focusing our efforts on the areas of concern expressed by the Subcommittee--i.e., sale competition, fair market

value for the leases, the use of 10-year lease terms, industry capabilities in deep water, and the environmental considerations impacting on the sale. We have not concluded our review, however, we can offer some observations based on what we have done thus far.

We have compared various competition indicators and found that competition in Sale 59 falls between Sale 40, the first mid-Atlantic sale, and Sale 49, the second of the two previous sales. Overall, Sale 59 competition was more in line with the latter sale. For example:

In terms of companies participating in the sale

- 60 companies participated in Sale 40;
- 16 companies participated in Sale 49; and
- 20 companies bid on Sale 59.

In terms of tracts bid on

- 66 percent of the Sale 40 tracts received bids;
- 40 percent of the Sale 49 tracts received bids; and
- 39 percent of the Sale 59 tracts were bid on.

There were an average of

- 4.06 bids per tract in Sale 40;
- 1.68 bids per tract in Sale 49; and
- 2.40 bids per tract in Sale 59.

And, the average bid per acre was about

- \$2,130 for Sale 40;
- \$180 for Sale 49; and
- \$761 for Sale 59.

The high bids accepted by BLM in Sale 59 totaled \$321,981,000 for 50 tracts out of 98 tracts bid on. This makes the rejection rate 49 percent which is significantly higher than the past norm of about 10 percent. As a result, Interior is in the process of re-evaluating the fair market values established for Sale 59 tracts.

We have not completed our analysis of the original tract values established by DOI's Mineral Management Service (MMS) nor why there were such large differences between industry bids and those values. However, we have discussed Sale 59 with officials at MMS and BLM, and with several oil company officials who were involved in this sale. Various opinions have been offered from both groups about why the differences occurred. It appears to us that the primary differences relate to the risk factors used in determining fair market values and to geological interpretations of hydrocarbon potential.

One observation I would like to share with you at this time is that as of June 1981, Interior, for budgetary purposes, was predicting sale receipts of only \$168 million for Sale 59. In October 1981, Interior increased the revenue estimate to \$3.6 billion. OMB reduced these estimates in November to about \$1.6 billion. Sale budgetary estimates are not the same as the estimates used in making tract specific bid acceptance decisions. However, we think it is interesting that earlier budgetary bonus estimates made for the sale, as far back as 1979, are closer to industry's actual bidding in the sale

than the budgetary estimates made in the months just preceding the sale. We plan to pursue this further in our review to determine why Interior increased the budget estimate. There may be a connection between the increase in these estimates and Interior's high tract values for the sale.

A 10-year lease term was used for all 50 of the accepted high bid tracts. Because of the water depths involved, both Interior and industry officials have indicated that this longer than the normal 5-year term was needed in order to explore and to achieve production if hydrocarbons are found.

We do not question the total time needed by industry to explore and develop these deep-water leases. Industry has not yet produced hydrocarbons in the water depths which face them in the Sale 59 leases. However, industry officials have told us that they believe they can develop the required technologies if something worth producing is found. And, the probable adaptability of tension leg platforms, subsea completion systems, and a new submerged tower design appear to support these claims.

There are a limited number of drill ships which can, or could by refitting, drill in these depths. Industry believes that these ships will be available as needed for this sale area. Our preliminary analysis is that industry is capable of exploring the deep waters of Sale 59. However, production technology has yet to be developed and more time will be needed by industry to develop deep-water leases than shallow water ones.

Interior has concluded that any environmental concerns will be taken care of by lease stipulations. We have not completed our review in this area and cannot offer any additional information at this time.

This concludes my prepared statement, and I will be pleased to answer any questions you may have.