

authority, what regulatory changes would be most appropriate?

#### *IV. Increased Flexibility in Length of Lease Terms, With Possible Changes in Rental Rates and Minimum Bids*

Several industry respondents to the December 1993 **Federal Register** Call for Public Comment requested increased flexibility involving Suspensions of Operations (SOOs), Suspensions of Production (SOPs), and similar provisions, particularly for leases on deep-water tracts. Some lessees also have asked for more flexibility where sub-salt prospects exist. Lessees have complained that technical data and information developed for a prospect cannot always be evaluated in time to identify optimal drill sites and commence drilling to better develop exploratory targets within the primary lease term. There may be some benefit to providing industry more time for analysis or other tasks leading to exploration or development where adverse or unusual conditions exist.

However, there is an inventory of 3,000 undrilled tracts in industry hands. Most leases in the GOM are either explored early in their primary lease term or held undrilled until the end of their term. Less than 1 percent of the deep-water leases that were issued for \$50 per acre or less since 1982 have been drilled. The MMS would like to grant additional flexibility where it is needed but also, where possible, to encourage earlier drilling or relinquishment so that tracts are not kept off the market by lessees who are unlikely to undertake exploration activity. Changes in minimum bid and rental policies, in combination with other new policies, may be an effective way to achieve this.

Currently, leases are issued with 5-year, 8-year, and 10-year terms for water depths of 400 meters or less, 400–900 meters, and greater than 900 meters, respectively. The 8-year leases require that an exploratory well be drilled within the first 5 years. With a few exceptions, the lessee must demonstrate a qualifying discovery to hold a lease beyond the primary term. Undrilled leases will be continued in effect if the lease is part of a unit agreement with other leases with a discovery, where there is continuous drilling, or as long as the leases in the unit are under a SOO or an SOP. No regulation specifically allows suspensions for the purpose of conducting analysis.

At present, the MMS is considering several options to increase flexibility and/or to encourage diligence:

A. Offer 7- or 8-year leases on some tracts in less than 400 meters of water

based on pre-sale identification or post-sale evidence of "adverse conditions," such as sub-salt prospects. Higher rental rates (e.g., \$25–\$50 per acre, per year) could be charged in years 6–8.

B. Amend 30 CFR 250.13(b), by deleting the words "where environmental conditions warrant," to authorize MMS Regional Directors to approve a period of time greater than 180 days between termination of production, drilling, or well-reworking operations and the commencement of production, new drilling, or well-reworking operations in cases that are in the national interest. Escalating rental rates could be imposed for the additional years.

C. Develop general guidelines for escalating rentals that would apply to broad categories of tracts (e.g., 5-year lease term, 8-year lease term, etc.) in combination with a reduced minimum bid level (e.g., \$10 per acre) so that the net present value of the reduced minimum bid and escalating rentals would be about equal to the present value of a \$25 per acre minimum bid and \$5 per-acre, per-year rental during the first 2–3 years of the lease. In addition, the escalating rental provision could substitute for the rigid requirement to initiate exploration drilling by the fifth year of leases with an 8-year term.

If escalating rental rates are imposed, another option would be to allow the additional rental payments to be applied to future royalty obligations from the same lease.

#### *Possible Rulemaking*

The MMS may issue a Notice of Proposed Rulemaking to delete the words "where environmental conditions warrant" from 30 CFR 250.13(b) and insert language specifically granting the Regional Director authority to require higher rental (or minimum royalty) rates during the additional time requested by, and granted to, the lessee under this regulation. Other appropriate changes to 30 CFR 250.13 and to 30 CFR 250.10 may be considered as well.

#### *Specific Information Requested*

Respondents may wish to consider the following questions.

1. What flexibility not now available to lessees would help increase production and develop or maintain infrastructure? In what cases should the flexibility be available? In what cases should it not be available (e.g., where it merely allows delays that deprive other companies the opportunity to lease and expeditiously develop the resources)?
2. Are there cases where this need might be temporary? For example, will

new technology and additional experience make it possible to evaluate sub-salt prospects in less time?

3. What can the MMS do to provide flexibility where needed without ignoring its responsibility to enforce statutory diligence requirements? Should the MMS be considering other changes in its regulations?

4. When combined with additional flexibility, would rentals of \$25–\$50 per acre for additional years be appropriate? Would they provide incentives for diligence or would they be too low to influence timing decisions? Would they defeat the purpose of providing the flexibility?

5. Would a lower minimum bid, combined with an increasing rental rate help increase production without imposing undesirable timing constraints? If so, what levels of minimum bid and rentals would be effective and appropriate?

#### *V. Bid Adequacy Procedures*

The Bid Adequacy decision procedures have essentially remained the same since the advent of the area-wide leasing program in 1983. In recent years, it has been shown that rejected tracts, on average, receive much higher bids in subsequent sales. (This finding takes into account the foregone original bids for those few rejected tracts not receiving bids in subsequent sales.) Use of the 3-Bid Rule and the Bid Averaging Rule occasionally has resulted in the acceptance of some tracts that were highly valued by the MMS but received relatively low bids. The Office of the Inspector General has expressed concern that the Bid Averaging Rule places too much emphasis on losing bids in determining whether to accept the high bid on tracts about which the MMS has relatively good information.

In Phase 1 of the two-phased bid adequacy procedures, a high bid on a wildcat or confirmed tract can be accepted without further MMS evaluation if the tract receives three or more bids. The 3-Bid Rule was originally adopted to place reliance on the market to ensure receipt of fair market value when there was a sufficient number of competitive bids. Also, the rule was adopted to devote scarce tract evaluation resources on those cases where competition was weakest (i.e., tracts receiving one or two bids) or where MMS data were considered most reliable and some bidders might have an informational advantage over the rest of the market (i.e., drainage and development tracts).

Possible changes in Phase 1 procedures that are being considered include eliminating the 3-Bid Rule and