U.S. POLICIES TOWARD OFFSHORE OIL & GAS: ACCESS AND GOVERNMENT TAKE

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Overview

The President and the Congress prohibited any exploration for oil and gas on the Outer Continental Shelf (OCS) off the East Coast, off the West Coast, and in a large section of the Gulf of Mexico in recent decades. However, the Presidential withdrawal has been rescinded and the Congressional moratoria lapsed at the end of September 2008. After almost two decades of relative stability, oil prices quintupled for U.S. consumers from the end of 2003 to mid-2008 then dropped by almost 50% in three months. Public support for drilling in restricted areas has increased dramatically, causing even Congressional opponents to consider compromise legislation that might open up some portion of these areas. At the same time, two related—and possibly counter—pressures have developed. First, the State of Louisiana charged in a recent lawsuit that the Federal Government had not adequately considered the environmental costs imposed on the State by Gulf of Mexico “areawide” lease offerings. Second, public anger at high oil company profits has risen, resulting in calls for an increased Government “take,” whether through higher taxes aimed specifically at oil and gas companies or through increased payments of other kinds, such as royalties on production. So, how does the U.S. system work? How is access to Federal OCS submerged lands determined, and how does the Government earn a return on the public oil and gas resources?

The first part of this paper describes the U.S. system for determining access, and granting rights, to offshore oil and gas resources. The paper discusses of what could happen to expand access to restricted areas, what must occur before production begins, and what the results might be. The second part of the paper focuses on Government determination of “fair market value” and OCS lease fiscal terms. Fair market value components include the competitive bidding system and bid adequacy procedures to determine the fair market value for the rights to explore and develop OCS tracts. Fiscal lease terms include bonus bids, rental payments, and royalty on production. The OCS Lands Act makes different bidding and fiscal term options available including fiscal terms such as profit sharing or sliding royalties to maintain a fair return to the taxpayer as industry profits increase.

Methods

The paper is largely descriptive with a background of the 5-Year Program leasing process and discussion of OCS lease term options. The background information will provide context necessary for understanding some of the current political issues surrounding the OCS oil and gas program as well as for the discussion of financial terms and conditions designed to assure receipt of fair market value in return for lease rights.

Results

The U.S. system for determining access to Federal submerged lands is a multi-stage process, beginning with a 2-3 year iterative process of analysis, decision, and public comment that leads to a 5-year schedule of proposed lease auctions, each specified by size, timing, and location. The iterative process continues, as the Government considers each proposed lease auction (“lease sale”) and then evaluates Exploration Plans and Development & Production Plans from winning bidders. However, opposition to lease auctions—and more recently, support for expanded sales in the Gulf of Mexico coupled with guaranteed revenues for nearby States—has led the Congress and the President to act outside the normal process to remove areas from, or add areas to, the 5-year schedule. Most recently, in 2006, Congress acted to require the U.S. Minerals Management Service (MMS) to auctions rights to certain portions of the Eastern and Central Gulf of Mexico, independent of the 5-year program development process required by the OCS Lands Act.

On the financial side, as prices have risen and technology has advanced, the Government has reduced incentives and increased its own take of the proceeds from offshore oil and gas operations. The MMS has three principal means of obtaining a fair return for the taxpayer on the use of public resources. First, companies must bid for the right to explore on 9-square-mile blocks of the OCS.

Second, winning bidders must pay annual rent to retain the leases until they begin production. Third, once production begins, the lessee pays a royalty on that production. While incremental changes to OCS lease fiscal terms were recently made in 2007 and 2008 for new leases to ensure a fair return to the taxpayer, U.S. OCS lease fiscal terms with flat royalty rates do not automatically adjust to volatile hydrocarbon prices such as with profit sharing or sliding royalties.

Conclusions

The U.S. has a very formalized system of determining where and when to make Federal submerged lands available for oil and gas activities. Considerations for leasing new areas outside of the Gulf of Mexico and Alaska include environmental and social impacts, public support, industry costs, and geologic potential of OCS provinces. The system allows for evaluation of these economic values, social & environmental costs, State laws, competing uses, and other factors. However, this system can be influenced heavily by local and national public attitudes. In addition, Congress has the rarely used authority to require MMS to circumvent the currently prescribed processes to expedite lease sales for any portion of the OCS at any time. Financial terms have incrementally beem adjusted in recent years to reflect concerns with with changing market conditions. Additional options for fiscal terms are available in the OCS Lands Act such as sliding royalties and profit sharing.

References