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Outer Continental Shelf: Debate Over Oil and Gas Leasing and Revenue Sharing

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Outer Continental Shelf: Debate Over Oil and Gas Leasing and Revenue Sharing

Summary

Oil and gas leasing in the Outer Continental Shelf (OCS) has been an important issue in the debate over energy security and domestic energy resources. The Department of the Interior (DOI) released a comprehensive inventory of OCS resources in February 2006 that estimated reserves of 8.5 billion barrels of oil and 29.3 trillion cubic feet (tcf) of natural gas. Another 86 billion barrels of oil and 420 tcf of natural gas are classified as undiscovered resources. Congress has imposed moratoria on much of the OCS since 1982 through the annual Interior appropriation bills. Proponents of the moratoria contend that offshore drilling would pose unacceptable environmental risks and threaten coastal tourism industries.

Several bills related to oil and gas leasing in the OCS have been introduced in the 109th Congress. On June 29, 2006, the House approved H.R. 4761, the Deep Ocean Energy Resources Act of 2006, to allow states, using specified criteria, to petition the Secretary of the Interior to lease in the federal OCS offshore the state. The bill would also provide coastal states with a share of revenues generated from offshore oil and gas production. Currently, the affected states receive revenue indirectly from offshore oil and gas leases in federal waters. This is in contrast to states with onshore leases on federal lands, which receive a direct share of the oil and gas leasing revenues.

On February 16, 2006, the Senate Energy Committee held a hearing on Senator Domenici's bill, S. 2253, which would require controversial Lease Sale 181 in the eastern Gulf of Mexico to be offered within one year of passage. The Senate Energy panel passed S. 2253 by a vote of 16-5 on March 8, 2006. Lease Sale 181 has galvanized interest in a number of related concerns. Some Members of Congress argued for greater coastal revenue sharing based on offshore production, others to promote natural gas-only leases in areas now off-limits. Some Members are calling for much more limited access to offshore federal areas. Because of the various interests, Senate leaders agreed to new language on July 12, 2006, that would increase the amount of acreage made available for lease (about 8.3 million acres), provide coastal states with a share of the revenues generated from offshore leases (37.5%), and extend the buffer zone within which leasing would not be allowed to 125 miles from Florida. The new bill S. 3711, which passed the Senate August 1, 2006, is described below.

President George H.W. Bush, in 1990, responding to pressure from the states of Florida and California and others concerned about protecting the ocean and coastal environments, issued a presidential directive ordering the DOI not to conduct offshore leasing or preleasing activity in places other than Texas, Louisiana, Alabama, and parts of Alaska until 2000. In 1998, President Clinton extended the prohibition until 2012. Leasing procedures are specified by the Outer Continental Shelf Lands Act (OCSLA) of 1953, as amended.

This report replaces CRS Issue Brief IB10149, *Outer Continental Shelf: Debate Over Oil and Gas Leasing and Revenue Sharing*, by Marc Humphries.

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Most Recent Developments

Oil and gas leasing in the outer continental shelf (OCS) has been a major energy issue in the 109th Congress. On June 29, 2006, the House approved H.R. 4761, the Deep Ocean Energy Resources Act of 2006, by a vote of 232-187. The bill would allow states, using specified criteria, to petition the Secretary of the Interior to lease the OCS adjacent to state waters. The Secretary would amend the current five-year lease program to allow lease-sales to occur in areas covered by the petition unless there is less than one year remaining in the current five-year lease program. If that is the case, the Secretary would then include those lease sales in the next five-year program. The version of the bill approved by the committee is very similar to the measure as introduced by Representative Jindal (described under "109th Congress Legislation," below).

One significant difference involves royalty suspensions. The House -passed bill would allow lessees from the period 1995-2000 (those covered under the Deep Water Royalty Relief Act of 1995) to request and the Secretary of the Interior to agree to an amendment of their leases, containing royalty relief to include price thresholds in the amounts of $40.50 per barrel of oil and $6.75 per million BTU of natural gas. There were leases let in 1998 and 1999 without any price thresholds. In addition, a conservation of resources fee of $9/barrel of oil and $1.25 per million BTU for gas would be established and applied to producing deepwater leases (>200 meters) that do not contain price thresholds. A conservation of resources fee of between $1 and $4 an acre would also be established for all non-producing leases.

On February 16, 2006, the Senate Energy Committee held a hearing on S. 2253, which would require controversial Lease Sale 181 in the eastern Gulf of Mexico to be offered within one year of passage. The Senate Energy panel passed S. 2253 by a vote of 16-5 on March 8, 2006.

Lease Sale 181 has galvanized interest in a number of related concerns. Some Members of Congress argued for greater coastal revenue sharing based on offshore production, others to promote natural gas-only leases in areas now off-limits. Some Members are calling for much more limited access to offshore federal areas. Because of these various interests, Senate leaders agreed to new language on July 12, 2006, that would increase the amount of acreage (to about 8.3 million acres), provide coastal states with a share of the revenues generated from offshore leases (37.5%), and extend the buffer zone within which drilling will not be allowed to 125 miles from parts of Florida. On August 1, 2006, the Senate approved S. 3711 by a vote of 71-25. The bill, S. 3711, is described in more detail below. Also, for further discussion of the bill, see the Senate Committee on Energy and Natural Resources news release July 21, 2006, on their website at [http://energy.senate.gov/public/] and see [http://energy.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=235040&Month=7&Year=2006].

A conference agreement on the two very different OCS bills (H.R. 4761 and S. 3711) is expected to be difficult. Some Senators insist on maintaining the language of the Senate bill, more narrow in scope, as the final bill, whereas the House seeks to incorporate its language that would lift the leasing and drilling moratoria in the OCS and also offer natural gas-only leases. Both bills contain language that would significantly increase the share of revenues to the states from federal leases in the OCS.

Royalty relief, particularly for deep water projects, has come under closer scrutiny since it was revealed in a February 2006 *New York Times* article that leases issued during 1998 and 1999 did not contain price thresholds for royalty relief (above which royalties apply). As a result, those leaseholders continue to pay no federal royalties, even though oil prices are at an all-time high. An amendment contained in the House-passed FY2007 Interior and Environment appropriations bill (H.R. 5386) would require the holders of leases awarded in 1998 and 1999 to renegotiate their leases or not be eligible to bid on future offshore lease sales.

The Department of the Interior (DOI) conducted a comprehensive inventory of OCS oil and natural gas resources, as required by the Energy Policy Act of 2005 (P.L. 109-58, Section 357). In the inventory, the DOI provided mean estimates of 8.5 billion barrels of known oil reserves and 29.3 trillion cubic feet (tcf) of natural gas; 82% of the oil and 95% of the gas is in the Gulf of Mexico (GOM). In the undiscovered resource category, the DOI estimated about 86 billion barrels (51% in the GOM) and 420 tcf of natural gas (55% in the GOM).

During the summer of 2005, the Minerals Management Service (MMS) introduced its proposed five-year leasing program for 2007-2012. Areas currently covered by OCS moratoria along the Atlantic coast, the North Aleutian Basin (Alaska), and the central GOM are included in the proposed leasing program. There would be no leases in the eastern GOM planning area, which has been redrawn to provide for more accuracy in boundaries between states and planning areas.[1]

Background and Analysis

Oil and gas leasing has been prohibited on most of the outer continental shelf (OCS) since the 1980s. Congress has enacted OCS leasing moratoria for each of fiscal years 1982-2006 in the annual Interior and Related Agencies Appropriations bill (now the Interior and Environment and Related Agencies Appropriations bill), allowing leasing only in the Gulf of Mexico (except near Florida) and parts of Alaska. President George H.W. Bush in 1990 issued a presidential directive ordering the Department of the Interior (DOI) not to conduct offshore leasing or preleasing

[1] *Federal Register*, vol. 71, no. 1, Jan. 3, 2006, Notices, p. 127.

activity in areas covered by the annual legislative moratoria until 2000. In 1998, President Clinton extended the offshore leasing prohibition until 2012.

Proponents of the moratoria contend that offshore drilling would pose unacceptable environmental risks and threaten coastal tourism industries, whereas supporters of expanded offshore leasing counter that more domestic oil and gas production is vital for the nation's energy security.

The possibility of oil and gas production in offshore areas covered by the moratoria has sparked sharp debate in Congress. A proposal to require the DOI to conduct a comprehensive inventory of OCS oil and natural gas resources drew heated opposition, although it was ultimately included in the Energy Policy Act of 2005 (P.L. 109-58, Section 357). Opponents of the OCS inventory saw it as a first step toward lifting the OCS leasing moratoria.

The Senate Energy and Natural Resources Committee passed a bill (S. 2253) to require that acreage within Lease Sale 181 (discussed later in this report) in the eastern GOM be available for lease. Industry analysts believe this area contains significant natural gas deposits. The area of interest, not included in the moratoria, was removed from the original lease sale by the DOI because it was considered too close to Florida's coastline, and was placed off-limits until after the current five-year leasing program (2002-2007). Most of the eastern GOM and the Pacific and Atlantic coasts are included in the OCS moratoria.

Offshore Leasing System

The Outer Continental Shelf Lands Act (OCSLA) of 1953, as amended, provides for the leasing of OCS lands in a manner that protects the environment and returns revenues to the federal government in the form of bonus bids, rents, and royalties.[2] OCSLA requires the Secretary of the Interior to submit five-year leasing programs that specify the time, location, and size of the areas to be offered. Each five-year leasing program entails a lengthy multistep process that includes environmental impact statements. After a public comment period, a final proposed plan is submitted to the President and Congress. The latest plan went into effect July 1, 2002. Public hearings for the 2007-2012 leasing program are underway. States and interest groups are filing comments on future lease sale areas for the 2007-2012 leasing program.[3]

The offshore leasing program is administered by the Minerals Management Service (MMS), an agency within the DOI. The MMS is scheduled to conduct 20 OCS oil and natural gas lease sales during the current five-year program from 2002-2007. Half of those sales will be in the western or central Gulf of Mexico (GOM), two in the eastern GOM and the remainder around Alaska. Alaska's lease sales will be held in the Beaufort Sea, Norton Basin, Cook Inlet, and the Chukchi Sea/Hope

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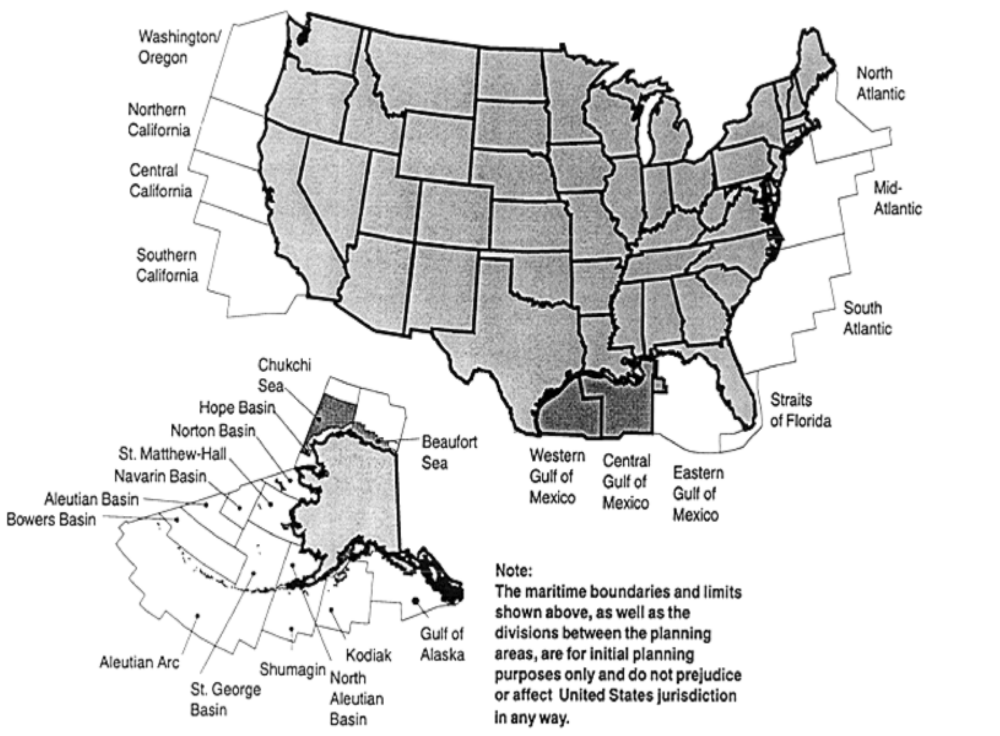
[2] 43 U.S.C. 1331 et seq.

[3] *Federal Registe*r Notice, 70 FR 49669.

Basin (see **Figure 1**). To date, 9 of the 12 GOM lease sales and 4 of the 7 Alaska lease sales have taken place. MMS defines the OCS as submerged lands, subsoil, and seabed between the seaward extent of states' jurisdiction and the seaward extent of federal jurisdiction.

Figure 1. MMS 5-Year Program Areas



Source: Minerals Management Service, 2002-2007-Year Leasing Program.

Lease sales are conducted through a competitive, sealed bonus bidding process, and leases are awarded to the highest bidder. Successful bidders make an up-front cash payment, called a bonus bid, to secure a lease. A minimum acceptable bonus bid is determined for each tract offered. During the past 13 years, annual bonus revenues have ranged from $85 million in 1992 to $1.4 billion in 1997. Bidding on deepwater tracts in the mid-1990s led to a surge in bonus revenue.[4] Offshore bonus bids totaled $565 million in FY2005. In addition to the cash bonus bid, a royalty rate of 12.5% or 16.66% is imposed on the value of production, depending on location factors, or the royalty is received "in-kind."[5] The rate could be higher than 16.66% depending on the lease sale. Annual rents are $3-$5 per acre, with lease sizes generally ranging from 2,500-5,760 acres. Initial lease terms of 5-10 years are standard, and leases continue as long as commercial quantities of hydrocarbons are being produced. Bonding requirements are $50,000 per lease and as much as $3 million for an entire area. The Secretary of the Interior may reduce or eliminate the royalty established by the lease in order to promote increased recovery.

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[4] Department of the Interior, FY2002 Budget Justifications, p. 63.

[5] A royalty-in-kind payment would be in the form of barrels of oil or cubic feet of natural gas.

Federal Distribution of OCS Revenues

Federal revenues from offshore leases were estimated at $6.3 billion in FY2005 by the MMS. During the previous 10 years (1995-2004), revenues from federal OCS leases reached as high as $7.5 billion in 2001. Revenues were as low as $3.2 billion in 1999. Higher prices for oil and gas are the most significant factors in the revenue swings. Of the $6.3 billion revenue in FY2005, $5.5 billion was from royalties.

These revenues are split among various government accounts. Revenues from the offshore leases are statutorily allocated among the coastal states, the Land and Water Conservation Fund, the National Historic Preservation Fund, and the U.S. Treasury. For distribution of all revenue from federal leases, see **Figure 2**. States receive 27% of OCS receipts closest to state offshore lands (drainage tracts) under section 8(g)[6] of the OCSLA amendments of 1985 (P.L. 99-272). In FY2005, this share was $72.3 million out of $1,705 million in total state on-shore and offshore receipts. A dispute over what was meant by a "fair and equitable" division of the 8(g) receipts was settled by the 1985 OCSLA amendments.[7]

For onshore public domain leases, states generally receive 50% of rents, bonuses, and royalties collected. Alaska, however, receives 90% of all revenues collected on public domain leases.[8]

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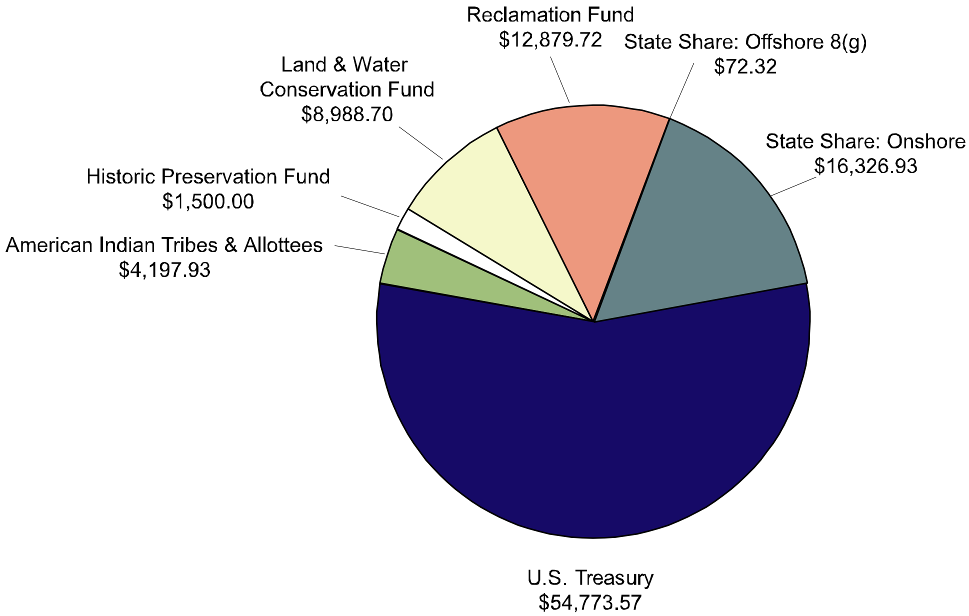
[6] The 8(g) revenue stream is the result of a 1978 OCSLA amendment that provides for a "fair and equitable" sharing of revenues from section 8(g) common pool lands. These lands are defined in the amendments as submerged acreage lying outside the three-nautical mile state-federal demarcation line, typically extending to a total of six nautical miles offshore but that include a pool of oil common to both federal and state jurisdiction. The states' share of the revenue (27%) was established by the OCSLA amendments of 1985 (P.L. 99-272) and is paid directly to the states. Payments to the states previously had been placed in escrow, which were then paid out between 1986 and 2001.

[7] Department of the Interior, Minerals Management Service, *Mineral Revenues 2000,* p. 95.

[8] However, the manner is which royalties are split between states and the federal government differs. For all states except Alaska, direct royalties under the Mineral Leasing Act (MLA) are divided equally (50-50) between the state in which the deposits are located and the federal government. The MLA also provides that all states except Alaska get back 40% from the Reclamation Fund (established by the Reclamation Act of 1902), in effect giving each state 90% of the royalties and the federal government 10%. Alaska does not receive allocations from the Reclamation Fund, so to equalize royalty treatment among the states, the Alaska Statehood Act and the Federal Land Policy and Management Act provide that Alaska's royalty share is 90% of the direct royalties (rather than 50%).

Figure 2. Distribution of Revenue from Federal and Indian Leases, FY2005 (millions of dollars)



Source: MMS, Minerals Revenues Management, 2006.

Coastal Impact Assistance

States with energy development off their shores in federal waters[9] have been seeking a larger portion of the federal revenues generated in those areas. They particularly want more assistance for coastal areas that may be most affected by onshore and near-shore activities that support offshore energy development. Proponents of these proposals look to the rates at which funds are given to jurisdictions where onshore energy development occurs within those jurisdictions on federal lands. Coastal destruction has received more attention in Louisiana, where many square miles of wetlands are being lost to the ocean each year. One of the causes of this loss is thought to be widespread energy-related development. Currently, the affected states receive revenue indirectly from offshore oil and gas leases in federal waters. This is in contrast to the direct revenues to states that have onshore federal leases within their boundaries, as noted above. On the other hand, opponents point out the budget implications as a result of the loss of federal revenues.

There are two fundamental purposes for revenue sharing programs, according to the Coastal Impact Assistance Working Group (an MMS advisory group): (1) to

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[9] State jurisdiction is typically limited to three nautical miles seaward of the baseline from which the breadth of the territorial sea is measured. However, the state jurisdiction off the Gulf Coast of Florida and Texas extends nine nautical miles and for Louisiana, three imperial nautical miles. Federal jurisdiction extends, typically, 200 nautical miles seaward of the baseline from which the breadth of the territorial sea is measured.

fund projects that will mitigate the environmental and economic impact of OCS energy development, including the need for infrastructure and public services, and (2) to help sustain development of nonrenewable energy sources.[10]

Two federal revenue sharing programs addressed coastal impacts from OCS energy development: (1) the now-expired Coastal Energy Impact Program (CEIP), established as an amendment to the Coastal Zone Management Act, and (2) the Section "8(g)" zone program, established under OCSLA. A third program, the Land and Water Conservation Fund, has also provided state funding from the OCS revenue stream, but the distribution of those revenues has no connection with OCS activities. Even the CEIP program was not considered a true revenue-sharing program because its funding levels were not based on the amount of leasing activity in the OCS.

A new Coastal Impact Assistance Program is established under the Energy Policy Act of 2005 (P.L. 109-58) as an amendment to Section 31 of the OCSLA (43 U.S.C. 1356a). Under this program, the Secretary of the Interior is to disburse, without further appropriation, $250 million per year during FY2007-FY2010 to producing states and political subdivisions according to specified allocations. The states must submit plans on how they will spend these funds for approval by the Secretary of the Interior. Among other things, the funds are designated for the restoration of coastal areas, mitigation of damage to natural resources, the implementation of federally approved conservation management plans, and for infrastructure projects.

Several legislative proposals (discussed below) would require that a percentage of revenue generated from offshore federal leases go to coastal states.

Offshore Leasing Moratoria

The offshore leasing moratoria began with the FY1982 Interior Appropriations Act (P.L. 97-100), which prohibited new leases off the shore of California. The imposition of other moratoria came about after many coastal states and environmental groups contended that leasing tracts in environmentally sensitive areas might lead to activities that could cause economic or irreversible environmental damage. Eventually, the moratoria were expanded to include New England, the Georges Bank, the mid-Atlantic, the Pacific Northwest, much of Alaska, and a portion of the eastern Gulf of Mexico. Because of environmental and economic concerns, Congress for the past two decades has supported annual moratoria on leasing and drilling in the OCS. Congress enacted the moratoria for each of fiscal years 1982-2006 through the annual Interior Appropriations bill.

President George H.W. Bush, in 1990, responding to pressure from the states of Florida and California and others concerned about protecting the ocean and coastal environments, issued a presidential directive ordering the Department of the Interior (DOI) not to conduct offshore leasing or preleasing activity in places other than

[10] Coastal Impact Assistance, Report to the OCS Policy Committee from the Coastal Impact Assistance Working Group, October 1997.

Texas, Louisiana, Alabama, and parts of Alaska until 2000 — prohibiting leasing in the same areas covered by the annual moratoria. In 1998, President Clinton extended the presidential offshore leasing prohibition until 2012.

The FY2006 Interior and Environment Appropriations Act (P.L. 109-54) continued the leasing moratoria in other areas, including the Atlantic and Pacific Coasts. An amendment to lift the moratorium in the eastern Gulf of Mexico was offered (House Amendment 174, Representative Istook) on the House floor during debate but was rejected on a point of order. An amendment (Representative Peterson) that would have lifted the moratoria on offshore natural gas was defeated (see Roll Call vote no. 192, May 19, 2005).

However, the FY2006 Interior Appropriations Act did not include language to prohibit oil and gas leasing in the North Aleutian Basin Planning Area. The FY2004 law (P.L. 108-108) and FY2005 law (P.L. 108-447) similarly omitted this language. There is reportedly some industry interest in eventually opening the area to oil and gas development as an offset to the depressed fishing industry in the Bristol Bay area. Environmentalists and others oppose this effort. The North Aleutian Basin Planning Area, containing Bristol Bay, is not in the current MMS five-year leasing plan (2002-2007) but is contained in the proposed leasing program for 2007-2012.

Despite the current Bush Administration's interest in increasing the nation's energy supply, Interior Secretary Norton announced in December 2001 that it would be up to the states to reconsider the leasing moratoria off their coasts. That position was viewed as leaving the door open to leasing in areas now under the moratoria, even though the Bush Administration officially supports the moratoria.

Natural Gas-Only Proposals

Under current law, all OCS lease sales include both oil and gas, and a lessee is required to develop the gas or the oil once it is discovered. Natural gas-only leases have been met with much skepticism by many experts in geology, who note that most of these offshore fields are likely to contain both oil and gas. Further, industry might be reluctant to bid on leases that did not transfer ownership of all discovered resources. Proponents argue that production of natural gas only would lessen states' concerns. Legislative proposals on natural gas-only leasing are summarized below.

Budget reconciliation provisions approved by the House Resources Committee on October 26, 2005, would have required the Secretary of the Interior to offer natural gas-only leases, allowed states to opt out of the OCS leasing moratoria, and given states that allowed such leasing a larger share of royalty revenues. The House Resources Committee appears to be interested in reviving that proposal (see H.R. 4241, below).

In addition, the bill would have imposed a statutory leasing prohibition through June 30, 2012, on the OCS areas currently under moratoria and revoked the 1998 Clinton leasing prohibition that covers the same period. After June 30, 2012, the proposal would have allowed states to petition for five-year moratorium extensions for OCS areas within 125 miles of their coastlines.

Lease Sale 181 — Revisited

Sales in the eastern Gulf of Mexico (GOM) have been especially controversial. A Bush Administration plan (originating in the Clinton Administration) to lease 5.9 million acres in the eastern GOM (Lease Sale 181) sparked considerable debate, although the area was not under a leasing moratorium. No eastern GOM lease sale had taken place since 1988. The Lease Sale 181 area was considered by opponents to be too close to the shore and to environmentally sensitive areas. Some tracts were as close as 17 miles from the Florida and Alabama coastline. The major concern of those in Florida opposing the sale was impairing the value of tourism to the state. If an accident were to occur, causing an oil spill, it could damage the state's beaches and thus the tourist industry. It also could severely affect the marine environment, opponents contended.

The original area of 5.9 million acres, estimated to contain nearly 8 trillion cubic feet (tcf) of natural gas and 396 million barrels of oil, was reduced to 1.47 million acres after intense pressure from environmentalists and state officials. The reduced Lease Sale 181 offered 256 blocks containing an estimated 1.25 tcf of natural gas and 185 million barrels of oil. The sale took place December 5, 2001.

Toward the end of the first session of the 109th Congress, Senator Pete Domenici, Chairman of the Senate Energy and Natural Resources Committee, expressed an interest in opening up offshore areas now under the moratoria in a push to ease the "natural gas crisis."[11] The legislation he introduced (S. 2253) would be limited to offering for lease a portion (3.6 million acres) of Lease Sale Area 181 within a year of enactment (see **Figure 3**). Based on revised MMS estimates provided to the committee, there are about 6 tcf of natural gas and 930 million barrels of oil (mbo) in the area to be leased under S. 2253. An alternative bill (S. 2239/Martinez) would extend a buffer zone around Florida's coast out 150 miles and would thus make available a much smaller area for Lease Sale Area 181 — about 740,000 acres.

The MMS's proposed five-year leasing program includes a Lease Sale 181 area that is smaller than the Domenici version but larger than the Martinez proposal. The area recommended by the MMS is 2 million acres and estimated to contain 3.4 tcf of natural gas and 530 mbo.

The Senate Energy Committee bill seeks a lease sale within one year of enactment to make additional natural gas available and put downward pressure on prices. This is unlikely to have any immediate impact on price by itself but may contribute to a price decline in the long run. Even without Lease Sale 181, MMS estimates that GOM production will increase from 3.7 tcf/year in FY2006 to 4.66 tcf/year in FY2010. Further, the Office of Management and Budget (OMB) estimates that natural gas prices will fall from $9.13/Mcf in FY2006 to $6.25/Mcf in 2010.[12]

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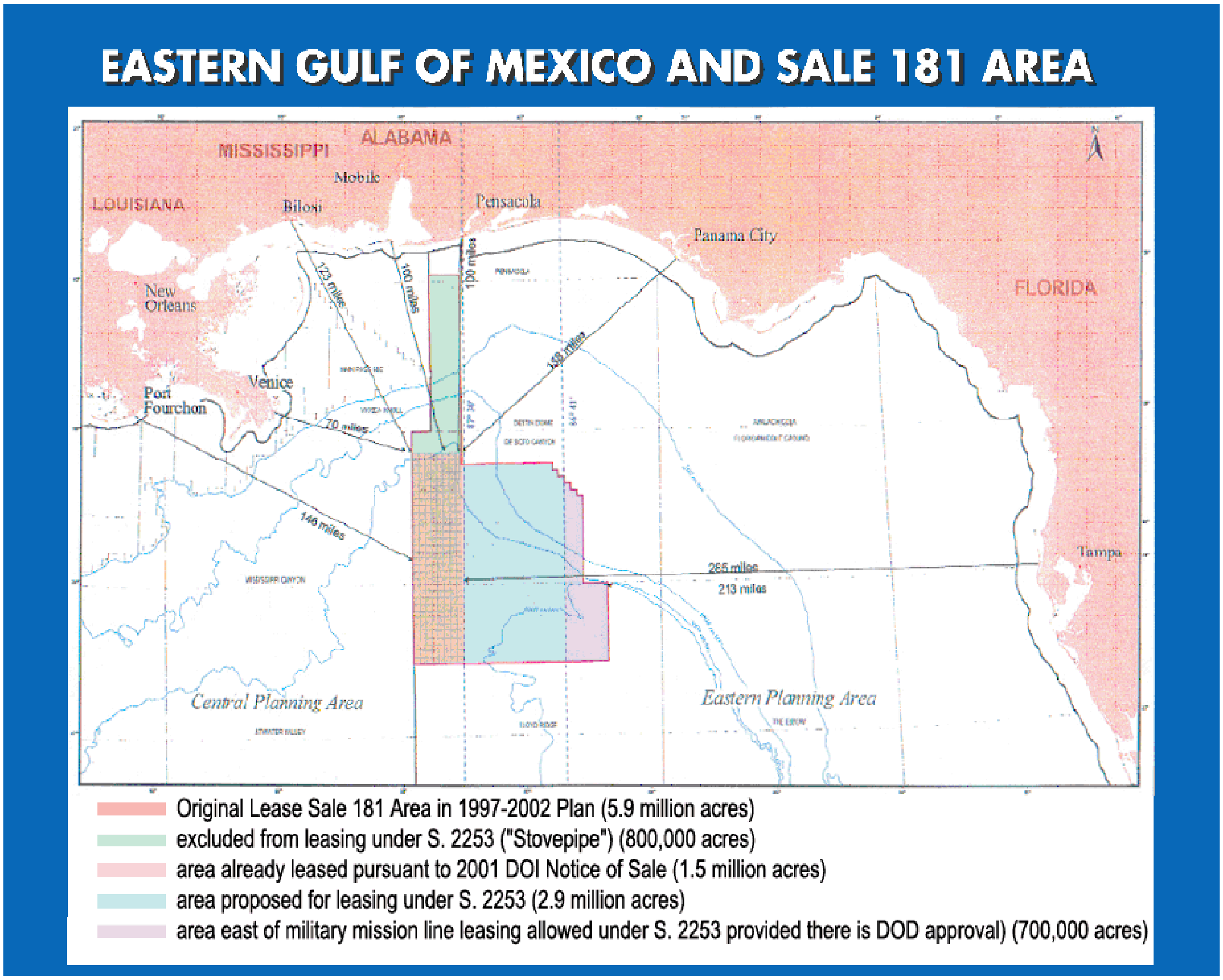
[11] *Inside Energy Extra*, October 6, 2005.

[12] DOI, MMS Budget Justifications FY2007, table 51, Federal Offshore Royalty Estimates, p. 169.

Figure 3. Eastern Gulf of Mexico and Sale 181 Area



Source: MMS U.S. Department of Interior, Minerals Management Service, Gulf of Mexico OCS Region.

Several blocks removed by the Administration from eastern GOM Lease Sale 181 could become available for re-lease after 2007 as part of the Administration's new five-year leasing program. Industry groups contend that eastern GOM sales are too limited, given what they say is an enormous resource potential, whereas environmental groups and some state officials argue that the risks of development to the environment and local economies are too great.

California Leases

Congress has banned additional drilling in the Santa Maria Basin and Santa Barbara Channel areas where there are leased tracts. Companies unable to develop their existing California lease holdings are seeking compensation from the federal government. The companies contend that more than a billion dollars has already been spent to obtain the leases.[13] In previous buyback settlements, firms have recouped their bonus bid payments but lost possible future returns that would have been earned if commercial production were achieved.[14] In the case of the offshore California leases, the Clinton Administration continued to extend the leases (through suspensions) that were granted between 17-33 years ago, before the moratoria were imposed.

The last suspension by MMS, in 1999, extended 36 of the 40 existing offshore California leases at issue. This action was taken to give lease holders more time to "prove up" oil reserves and for MMS to show consistency with state coastal zone management plans, as required by 1990 amendments to the Coastal Zone Management Act (P.L. 92-583). A state's objection could prevent development of the oil and gas leases.

On June 20, 2001, the U.S. District Court for the Northern District of California struck down the MMS suspensions, potentially allowing the leases to expire, because it held that MMS failed to show consistency with the state's coastal zone management plan. The Bush Administration appealed this decision to a three-judge panel of the Ninth Circuit of Appeals in San Francisco on January 9, 2002, and has proposed a more limited lease development plan that involves 20 leases, using existing platforms and other necessary infrastructure. However, on December 2, 2002, the Ninth Circuit panel upheld the District Court decision.[15] The Department of the Interior did not appeal this decision and is currently working with lessees to resolve the issue. A breach-of-contract lawsuit was filed in the U.S. Federal Court of Claims against MMS on January 9, 2002, by nine oil companies seeking $1.2 billion in compensation for their undeveloped leases (*Amber Resources et al. v. United States*).

After the lawsuit was filed, several oil and gas lessees involved in the dispute submitted a new round of suspension applications to prevent lease termination and loss of development rights. In response, the MMS prepared six environmental assessments and found no significant impact for processing the applications. However, under the Coastal Zone Management Act, a consistency review by MMS and the state's response to that review must occur before a decision is made to grant or deny the requests. The State Coastal Commission ruled unanimously on August 11, 2005, that the lease suspensions should not be renewed. Following that decision, on August 12, a U.S. District Court ordered the MMS to conduct additional studies under the National Environmental Policy Act (NEPA) of the 36 leases under suspension. MMS argued that it had presented sufficient evidence for the judge to reach a decision on whether to allow MMS to grant further suspensions. Senator

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[13] Inside Energy with Federal Lands, Sept. 3, 2001.

[14] Estimating future revenues with limited drilling is difficult at best because it is not possible to determine the extent (if any) or quality of hydrocarbons. According to the MMS, the leased area contains an estimated 1 billion barrels of oil and 500 billion cubic feet of unproved reserves.

[15] Ninth U.S. Circuit Court of Appeals, *California v. Norton*, 01-16637.

Diane Feinstein of California has urged that the MMS conduct additional studies or, if not, allow the leases to terminate.[16]

In the meantime, on November 17, 2005, the U.S. Federal Court of Claims made a determination in the *Amber Resources* lawsuit that the federal government breached its contract with the lessees regarding the 36 offshore California leases. Although the government was ordered to repay the lessees $1.1 billion, the judge deferred a final judgment until additional claims (such as recovery of sunk costs) are resolved. If a settlement is reached, the MMS would automatically terminate the leases. This action would then negate any further action on the consistency determinations. Thus, no further action will be taken by the Department of the Interior to address the concerns of the California Coastal Commission until a final judgment is reached.

Royalty Relief

Royalty relief is commonly granted to assure full production of offshore oil and gas. OCSLA authorizes the Secretary of the Interior to grant royalty relief in order to promote increased oil and gas production. There are generally four royalty relief categories in the GOM: Deepwater, Shallow Water Deep Gas, End-of-Life, and Special Case. Royalty relief under the End-of-Life and Special Case categories was already in place under OCSLA before the Deep Water Royalty Relief Act of 1995 (DWRRA). The DWRRA expands the Secretary's authority to use royalty relief as an incentive for leasing federal OCS Gulf of Mexico deepwater. Under DWRRA, the Secretary of the Interior may reduce royalties if production would otherwise be uneconomic.[17] Threshold price levels were established in 1995, above which the relief is discontinued. In 2004, the threshold price was $33.55 per barrel for deepwater oil and $4.19 per million BTUs for deepwater natural gas. The threshold price levels are adjusted annually for inflation.[18]

Royalty relief for OCS oil and gas producers has been debated during consideration of FY2007 Interior appropriations. On February 13, 2006, the New York Times reported that the MMS would not collect royalties on leases awarded in 1998 and 1999 because no price threshold was included in the lease agreements during those two years. Without the price thresholds, lease holders may produce oil and gas up to specified volumes without paying royalties no matter what the price. The MMS asserts that placing price thresholds in the lease agreements is at the discretion of the Secretary of the Interior. However, according to the MMS, the price

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[16] Inside Energy, Aug. 22, 2005

[17] A brief description of royalty relief programs offered by the MMS can be found on its website at [http://www.gomr.mms.gov/homepg/offshore/royrelef.html]. A more detailed analysis of the royalty relief programs is contained in the following report: Department of the Interior, MMS, *Guidelines for the Application, Review, Approval, and Administration of the Deepwater Royalty Relief Program for Pre-Act Leases and Post-2000 Leases*, appendix 1 to NTL no. 2002-No2, February 2002.

[18] Price threshold levels for deepwater oil and gas can be found on the MMS website.

thresholds were omitted by mistake from 576 offshore leases during 1998 and 1999.[19] The House Government Reform Subcommittee on Energy and Resources, as well as the MMS, is investigating how the omission occurred.

A House committee amendment to the FY2007 Interior appropriations bill would require the Secretary of the Interior to include price thresholds in all leases with royalty relief provisions (based on $34.71/barrel of oil and $4.34/thousand cubic feet of natural gas) and require the Secretary to renegotiate leases to conform with current price threshold levels. The committee language, however, was removed from the bill on a point of order during the House floor debate. Subsequently, the House agreed to an amendment that would prohibit funds in the bill from being used to issue new leases to current lessees that do not have price thresholds in their leases under royalty relief. This provision would not affect the shallow water deep-gas leases with price threshold levels currently around $9.90/thousand cubic feet. Opponents of the amendment argue that the companies with valid leases, even though without price thresholds, should not be penalized and that the provision could result in breach-of-contracts lawsuits by the companies.

According to the MMS, production from the deep gas-shallow water wells is estimated to account for about 70% of the royalty-free production from 2006-2012, whereas production from leases signed in 1998 and 1999 is estimated to account for 30% of the total royalty-free production during the six-year period. The total value of foregone royalties over the six-year period is estimated by MMS at about $9.5 billion.

Lease Development in the Gulf of Mexico

The MMS reports that there is great potential in the central and western Gulf of Mexico (GOM) deepwater regions (> 400 meters).[20] Spurred by the Royalty Relief Act of 1995, significant investment has been made, including bonus bids and annual rents by major and independent oil and gas companies. Overall, since 1995, deepwater production of oil has increased from 16% of total GOM production to nearly 70% in 2005. Deepwater natural gas has risen from 3.8% of total GOM production to 38% during the same period. The deepwater production in the GOM is expected to continue growing over the next 20 years. There are, however, a limited number of rigs available to drill, and there are prospects elsewhere that could make any area available for leasing less likely to get developed in the short-term.[21] Moreover, very little exploration and development have yet to occur within some of the deepwater regions that were leased since 1995.

[19] This information is from discussions with Walter Cruickshank, Deputy Director of MMS, during April, 2006.

[20] Department of the Interior, MMS, *Deepwater Gulf of Mexico 2004: America's Expanding Frontier*, OCS Report, MMS2004-021.

[21] Ibid, p. 107.

The amount of development of leases is significantly different in shallow and deep regions. In the West and Central Gulf region, at less than 400 meters deep, about 40% of the leased tracts have been producing since the 1990s, whereas a small and declining fraction of currently leased tracts have been explored but did not produce. About 40% of the active leases at this depth have not been explored.

In the narrow region between 400 and 800 meters, most of the relatively few leases have not been explored, but a small and increasing number have begun production. This pattern is even clearer in the region deeper than 800 meters, where a large number of leases have been let, especially since 1995, and only a small fraction of them have been explored.

A major stimulus to exploration and development of a promising lease is the approach of the end of the lease term. MMS officials contend they are allowing leases to expire and putting them up for reletting. MMS officials point out that, with a 10-year lease period, the many deepwater leases let in the mid-1990s will be running out in the next few years, which may stimulate increased activity in that region.

Barriers to Development

The high proportion of deepwater leases that have not been explored, in light of the high productivity of those that have been developed, raises questions of barriers that may be impeding full development of the region's potential. Although even developed regions have many leases that are not explored, the fact that more than 90% of deepwater leases have not been explored stands out.

According to MMS officials interviewed by CRS,[22] the major factor in determining exploration is the high cost of activity in the deepwater region, and also the relatively few rigs that are available to operate there. Financing oil exploration and development is an extremely complex process, frequently involving secondary markets for leases and farming out development to obtain financing. According to MMS, no barriers exist to discourage or penalize innovative and flexible financing schemes.

109th Congress Legislation

S. 726 (Alexander)

Natural Gas Price Reduction Act. Several provisions focus on the OCS: a coastal state can request an estimate of the oil and natural gas lying seaward of the state; a state can opt out or consent to the current OCS moratoria; states or lessees would have the option to restrict OCS development to natural gas; states would receive at least 12.5% of all qualified production revenues, which would be distributed to those states with an approved Coastal Impact Assistance Plan; and

[22] CRS analysts held frequent telephone conversations with MMS official and, on January 18, 2005, met in person for a conference of several hours.

royalty relief would be provided for lessees producing in deep water. Introduced April 6, 2005; referred to Committee on Energy and Natural Resources.

S. 1765 (Landrieu)

Louisiana Katrina Reconstruction Act. Chapter 1, Domestic Offshore Reinvestment Act of 2005, Title VI, would give 50% of the revenue generated from an OCS lease sale to the adjacent coastal state. From the state's share, 35% would be paid directly to the political subdivisions in that state. The funds would be deposited into a trust fund, used for identified purposes, and allocated according to an established formula. Chapter 2, Offshore Fairness Act of 2005, would, among other things, extend the seaward boundaries of Louisiana from three geographical miles to three marine leagues, contingent on the state meeting certain conditions within five years after the date of enactment of this law. Introduced September 22, 2005, referred to the Committee on Finance.

S. 2239 (Martinez)

Permanent Protection for Florida Act of 2006. A "Florida Exclusion Zone" would be established 150 miles off the coast of Florida within which no leases could be offered and would thus be withdrawn and excluded from any MMS five-year leasing program. Certain leases in the eastern Gulf of Mexico (GOM) planning area would be relinquished in exchange for royalty forgiveness from producing leases in the central and western GOM planning areas. Nothing in the bill would preclude the Department of Commerce from designating the Florida Exclusion Zone a marine sanctuary, preclude inspection and repair of subsea pipelines, affect recreational activities, or limit any military activities. Certain leases would be subject to NEPA review. The executive branch OCS moratoria would be extended through June 30, 2020. Referred to the Committee on Energy and Natural Resources.

S. 2253 (Domenici)

To require the Secretary of the Interior to offer the Lease Sale Area 181 of the Gulf of Mexico for oil and gas leasing. The lease sale "181 Area" defined in the bill would be offered for sale for oil and gas leasing within one year after the date of enactment. Areas excluded would be any area within 100 miles from the Florida coastline and areas east of the "Military Mission Line," unless otherwise agreed to by the Secretary of Defense. This act would make as much as 3.6 million acres available for leasing. Approved by the Committee on Energy and Natural Resources on March 8, 2006, by a vote of 16-5, S.Rept. 109-240.

S. 2290 (Pryor)

Reliable and Affordable Natural Gas Energy Reform Act of 2006. S 2253 would amend Section 8 of the Outer Continental Shelf Lands Act (43 U.S.C. 1337). Under this amendment, the Secretary of the Interior would have the option to offer natural gas leases in the moratoria areas as part of the 2007-2012 leasing program. Regulations would be written to allow for the conversion of a natural gas lease to an oil and gas lease with consent of the adjacent state governor and the lessees. The Secretary of the Interior would amend the 2007-2012 leasing program to include the original Lease Sale 181 area and conduct such sales before June 30, 2007. The governor could petition the Secretary for an extension of the areas withdrawn from leasing or an adjacent area 125 miles from the coastline of the state for a period initially not longer than five years. An additional five years may be added. The governor could also petition to open areas now off limits for natural gas leases or oil and gas leases. The Secretary would weigh environmental issues before issuing a decision. States would receive 50% of the revenue stream from the leases (bonus bids, royalties, and rents) off their coastline. The revenue sharing would apply to all offshore leases. Existing offshore California or Florida leases located completely within 100 miles of their coastlines would have the option of exchanging the lease for a natural gas lease elsewhere. Referred to the Committee on Energy and Natural Resources.

S. 2384 (Lott)
Gulf Coast Protection and Restoration Act of 2006. This bill would make Area 181 available for lease, as identified in the Final OCS Leasing Program for 2002-2007, within one year of enactment of the legislation. Producing states would receive 50% of the qualified revenue generated from the leases in Area 181 each year. The bill specifies how that money is to be used by the producing states. Introduced March 8, 2006. Referred to the Committee on Energy and Natural Resources.

S. 3711 (Domenici)
Gulf of Mexico Energy Security Act of 2006. S. 3711 would direct the Secretary of the Interior to offer lease sales within the 181 Area, primarily in the Central Gulf of Mexico as defined in the bill, within one year after enactment of this legislation. The 181 Area (defined in the bill) is part of the original Lease Sale 181 contained in the Outer Continental Shelf (OCS) 1996-2001 5-Year Leasing Program before the area was scaled back by the Secretary of the Interior. The 181 Area, as defined in the bill, covers about 2.5 million acres. In addition, the bill would direct the Secretary to offer for lease, as soon as practicable, an area south of the 181 Area known as 181 South Area. This area covers about 5.8 million acres. 181 South Area is currently under the OCS leasing moratoria but is under consideration by the Minerals Management Service (MMS) in its proposed 2007-2012 5-Year Leasing Program. The MMS estimates that together, these two areas covered by the bill contain 5.8 trillion cubic feet of natural gas and 1.26 billion barrels of recoverable oil. Senate passed S. 3711 on August 1, 2006 by a vote of 71-25.

Areas where preleasing and leasing activity would be excluded under the bill and placed under moratorium until 2022, would be east of the Military Mission Line (about 230 miles from Florida's west coast), within 125 miles of Florida in the New Eastern Gulf of Mexico Planning Area, and within 100 miles of the State of Florida in the New Central Gulf of Mexico Planning Area. Current lessees within the prohibited areas in the New Eastern and Central Gulf of Mexico Planning Areas could exchange those leases for bonus or royalty credits (valued at the amount paid in bonuses and rents on existing leases) for another lease in the Gulf of Mexico.

Revenue sharing provisions in the bill would allow for Gulf producing states (defined as Alabama, Mississippi, Louisiana, and Texas) to receive 37.5% of revenues generated from leases held in the 181 Area and 181 South Area beginning FY2007. Beginning in FY2017 and thereafter, the Gulf producing states would also receive 37.5% of the revenues generated from leases awarded within the 2002-2007 planning area, including historical leases (described in Sec. 5(b)(2)(C) of the bill). Distribution among the Gulf producing states would be determined by the Secretary of the Interior according to a formula to be developed that would accomplish a distribution inversely proportional to the respective distances from the coastlines to the center of the lease tracts. The minimum amount available to any of the Gulf producing states would be 10% of the qualified revenues. The Secretary would pay 20% of the state's share to its coastal political subdivisions. The Land and Water Conservation Fund (currently funded from OCS revenues) would receive 12.5% of the qualified revenues and the Federal General Treasury would receive 50% of those revenues. An annual net spending cap of $500 million (on revenues shared with the states) above receipts in the newly opened areas is included in this bill.

H.R. 4241

Budget Reconciliation. Ocean State Options Act of 2005. Included in Title VI of the House Resources Committee recommendation to the House budget reconciliation package. Coastal states could opt out of the OCS leasing moratoria and consider natural-gas-only or oil and gas leases, and receive a larger share of OCS revenues. The proposal would repeal the comprehensive inventory of OCS oil and gas passed earlier in the Energy Policy Act of 2005 (P.L. 109-58). Approved by the Resources Committee October 26, 2005, by a vote of 24-16.

An amendment to the House budget reconciliation bill removed the Ocean States Options Act of 2005 from the bill.

H.R. 4318 (Peterson)

Outer Continental Shelf Natural Gas Relief Act. All provisions to prohibit preleasing and leasing natural gas in the OCS would be revoked. The presidential withdrawal of certain OCS areas would also be revoked with respect to natural gas. The governors of affected states could reject any lease within 20 miles of the coastline of their state. The OCSLA would be amended to require in each five-year leasing program at least 75% of the unleased acreage be offered for natural gas leasing in each planning area. A revenue-sharing plan on new federal natural gas leases would give 40% of the revenue stream to the states. Natural-gas-only leases could be issued by the Secretary of the Interior subject to regulations established by the Secretary. Existing oil and gas leases could be restricted to the development of gas-only, and the Secretary could issue such a lease prior to the end of the current five-year leasing program (2002-2007) without amending the program. The Secretary could also include natural gas-only leases in the next (2007-2012) leasing program. Introduced November 15, 2005. Referred to the Committees on Resources, Energy, and Commerce and Education and the Workforce.

H.R. 4761 (Jindal)

Domestic Energy Production Through Offshore Exploration and Equitable Treatment of State Holdings Act of 2006. The Outer Continental Shelf Lands Act (OCSLA, 43 U.S.C. 1331 et seq.) would be amended by this bill. The Secretary of the Interior would establish regulations for natural gas-only leases in the OCS. The value of the leases for bidding purposes would exclude the value of any potential crude oil. However, oil could be produced if the adjacent state government did not object. Phased-in revenue sharing plans for the adjacent states would be established for tracts within 100 miles of their coastlines and for tracts that lie beyond 100 miles of their coastlines. The states' share would eventually reach 42.5% of the revenues generated from offshore leases under the phased-in plan. Leases not under the phased-in plan would immediately receive 42.5% of the revenues generated from offshore leases between 4 marine leagues and 100 miles off the states' coastlines. Using specified criteria, the state may petition the Secretary to lease in the OCS within the state's adjacent zone. The Secretary would amend the current five-year lease program to allow lease-sales to occur in areas covered by the petition unless there is less than one year remaining in the current five-year lease program. If that is the case, the Secretary would then include those lease sales in the next five-year program. The OCS leasing program would offer at least 75% of "available unleased acreage" in each OCS planning area. The state may also petition the Secretary to extend the withdrawal up to five years for each petition.

Lessees would submit a development and production plan to the Secretary for review. The bill would establish a Federal Energy Natural Resources Enhancement Fund to monitor wildlife and fish habitats and air and water quality. The federal law that bars leasing and pre-leasing activity for oil and gas leasing in the OCS would no longer apply. The Minerals Management Service would be called the National Ocean Resources and Royalty Service.

A Federal Energy and Mineral Resources Professional Development Fund would be established and funded to carry out the Energy and Mineral Schools Reinvestment Act (see Section 23), which would amend P.L. 98-409 (30 U.S.C. 1221 et seq.) — Maintenance and Restoration of Historic and Petroleum and Mining Engineering Programs. Introduced February 15, 2006. Referred to the Committee on Resources. Committee Hearings held on June 14, 2006.

Approved by the House Resources Committee on June 21, 2006, by a vote of 29-9, and by the House on June 29, 2006, by a vote of 232-187. Significant amendments to the original Jindal bill (H.R. 4761) include provisions on royalty suspensions and a fee on non-producing leases. The Committee-passed bill would allow lessees from the period 1995-2000 (those covered under the Deep Water Royalty Relief Act of 1995) to request and the Secretary of the Interior to agree to an amendment of their leases to include price thresholds in the amounts of $40.50 per barrel of oil and $6.75 per million BTU of natural gas. There were leases let in 1998 and 1999 without the price thresholds. In addition, a conservation of resources fee of $9/barrel of oil and $1.25 per million BTU for gas would be established and applied to producing deepwater leases (>200 meters) that do not contain price thresholds. A conservation of resources fee of $3.75 per acre would also be established for all non-producing leases.