

Equitable Sharing

There is no equitable sharing. MMS is running the program as a coastal program as opposed to a national program. My children's soccer field was paid for by revenues from the OCS program via the Land and Water Conservation Fund. That soccer field is about a thousand miles from the nearest OCS well. Do the soccer moms at the field know this? No, because MMS is not running the OCS program as a national program. The OCS program is important to citizens of Vermont, Iowa, and Tennessee as it is to Alaska, Texas and Louisiana.

Look at Destin Dome 56 as an example of the failure of equitable sharing. This is a large natural gas field off the coast of Florida. Due to the opposition of Florida, most of the leases in the production unit were bought back at a cost of 115 million dollars. Destin Dome 56 may contain 1.3 TCF of Natural Gas (http://www.etf.energy.gov/pdfs/chevron_11_13_01.pdf). That volume expressed in terms of MCF is 1.3 Billion MCF. Assume conservatively natural gas at \$6 an MCF with a 1/6th royalty, that is a loss of 1.3 billion dollars in foregone royalty payments. This is a loss of about 1.4 billion dollars to the people of the US, of which about 94% live outside of Florida. The 1.4 billion dollars is just from the federal budget perspective. What is the economic cost of not having 1.3 TCF of natural gas working through the economy with its multiplier effect? Economist have Input-Output Models which can measure these impacts. What are the air quality/health impacts of the Destin Dome 56 buy back? Coal fire generation will probably be the method for generation of electricity instead of natural gas.

The status quo is the coastal state like Florida and California gets the "benefits" of not having OCS activity in its back yard. All the other states incur the "costs". A real equitable sharing process would have Florida compensating the rest of the nation for the buy back of Destin Dome 56. A footnote to the Destin Dome 56 story. Because Florida needs natural gas so much, a natural gas pipeline on the OCS was constructed from Mobile Bay in Alabama to Tampa Bay in Florida. This pipeline passes near Destin Dome 56.

Fair Market Value

There has considerable out cry to the large number of leases for which there are not being produced. For example based on data extracted in February 2010 there are 8,035 active leases of which 1,738 are in PROD and UNIT status in the Gulf of Mexico. That is about 22% of the active leases in a production status. A major cause of the excess leasing is acceptance of bids on non-viable tracts. For example in Western Gulf of Mexico Sale 210 there were 162 tracts bid on. In the tract evaluation process had 20 tracts accepted in Phase I as nonviable (Rule A). In Phase II 110 non-viable tracts were accepted (Rule E). So MMS has determined about 80% of the tracts bid are not a viable from a geologic prospective. MMS has invested millions in Geoscientific Interpretive Tools (GIT) to make such determinations. Given the large number of non-viable tracts accepted, the large majority of leases are never produce. This has been the history in the Gulf of Mexico.

Now consider the non-viable decision by MMS.

First assume the MMS is correct that tract is non-viable based on currently available data. What public propose does leasing a tract which does not contain hydrocarbons? Why are scarce public and public resources being funnel into support of lease which will not produce? Oil and Gas exploration is a high risk process. Obtaining a non-viable tract is comparatively cheap and have long lease terms. There is a chance that the lease owner could get lucky, sometime during the lease term new information is revealed, such as a discovery nearby the lease. The lease owner has

a windfall. The MMS does share in the gain from this windfall.

Second case assume MMS is wrong on the non-viable determination. Private sector GIT is likely to be better than MMS GIT. So private sector has significant information advantage. In this case MMS is unlikely to obtain fair market value.

Consider lease G14205 with a bid of \$412,000 which MMS accepted on non-viable in Phase I. On this lease is Nansen Field which MMS estimated to have 191 million BOE of reserves. That means the Nansen field lease was purchased with a bid of 1/5 of a penny per BOE of reserve. Most observers would not consider of 1/5 of penny a barrel as fair market value.

This is not the only example. G15604 was accepted in Phase I as non-viable with bid of \$391,500. G15604 is part of the Atlantis field. Atlantis is the 5th largest field in Gulf of Mexico. More recently BP announce a major discovery on G25782. It was accepted in Phase II as non-viable with a bid of \$406,060. MMS does not a published reserves estimate for this field.

Summarizing the situation with non-viable leases. There are a lot of them. Those leases which have a correct label as non-viable don't serve a public purpose. If MMS is wrong about the non-viable determination then MMS is at information disadvantage and can not effectively insure fair market value. This is demonstrated by the discovery of very large fields on non-viable leases.

I recommend that non-viable tracts be rejected. The bidder can appeal the decision by demonstrating to MMS that the tract is viable.

This change to fair market value procedure has the following benefits over the status quo:

- It cures the current problem of many leases which are never drilled.
- Public and private investments are applied to only viable tracts.
- Enables MMS to have a better understanding of how the private sector evaluates tracts via the appeals process of rejected non-viable tracts.
- Only after additional information becomes available, then the tract transforms from non-viable to viable MMS will be able to effectively determine fair market value.
- The benefits of the OCS leasing program retains the benefits, since they accrue from viable leases, while the public and private costs are eliminated.

Gulf of Mexico Sale Schedule

The Gulf of Mexico Sale schedule has been in rut with Central Sale after Mardi Gras and Western Sale evaluation completed prior to Christmas. I am not aware of any analysis showing that is paradigm is optimal. There are several factors pushing for a rethinking of the sale schedule:

- Increase of the size of the Central planning area and shrinking of the Western & Eastern due to revision of administrative boundaries.
- Pending splitting of MMS into 3 parts.
- Opening up the Atlantic to Leasing.
- The growth of wind farms on the OCS.

- The pressure of balancing the federal budget, which means agencies will need to downsize.

Options that should be consider:

- Separate shallow & deep sales.

- A rotation of sales such as Central Shallow, Western, Eastern, Central Deep, Atlantic

- Gas only in Eastern and Atlantic.

- Sales have very little impact on production rates in the near term. As example looking at production in 2008. Lease issued in the 5 years prior (2003-2007) contributed well below 0.2% of the total production in the Gulf of Mexico region.

The EIS must consider multiple scheduling options.