Response to Public Comments on BOEM's Revised Bid Adequacy Procedures

On January 19, 2023, the Bureau of Ocean Energy Management (BOEM) published its proposed revised bid adequacy procedures in the *Federal Register* ("Modifications to the Bid Adequacy Procedures for Offshore Oil and Gas Lease Sales," 88 Fed. Reg. 3433 (Jan. 19, 2023)) and requested public comments on the proposed revisions. The comment period closed on March 6, 2023. A total of 15,537 comments were received from three individuals and four organizations, including one submission with 15,531 signatures. Thus, seven distinct comment submissions were received and reviewed by BOEM.

BOEM reviewed all comments received, grouped them by topical area, and provides responses to those comments directly related to the revised bid adequacy procedures below. BOEM acknowledges receiving and reviewing other comments submitted, which covered a range of issues, including but not limited to: historical bid acceptance, BOEM's bid acceptance/rejection timeline, lease sale competition and anti-competitive bidding, lease sale fiscal terms, tract valuation adjustment, option value, climate impacts and associated social and environmental costs, and future leasing efforts. These comments are outside the scope of BOEM's revised bid adequacy procedures, which BOEM developed as a direct response to a specific recommendation included in the Government Accountability Office (GAO) October 2019 report entitled, "Offshore Oil and Gas: Opportunities Exist to Better Ensure a Fair Return on Federal Resources" (GAO-19-531) regarding BOEM's delayed valuation methodology (i.e., Recommendation 2).[1]

BOEM did not make any changes to its revised bid adequacy review process based on the relevant feedback received, but did update its bid adequacy procedures document to provide additional detail on the Lower Bound Confidence Interval calculation. BOEM intends to assess bids using the revised procedures beginning with the first lease sale held pursuant to the 2024 – 2029 National Outer Continental Shelf (OCS) Oil and Gas Leasing Program.

I. Lower Bound Confidence Interval (LBCI) Computation Formula and Transparency

Several commenters requested additional details on BOEM's proposed changes to its bid adequacy procedures. Commenters noted that it would be helpful to better understand the issues that the revised procedures are designed to address and how the revised procedures will address those issues. Commenters stated that BOEM should provide a summary of the alternative approaches that the agency considered, the results of the testing performed on historical lease sale results, and the rationale for why BOEM selected its proposed approach. Finally, a commenter requested a description of how the LBCI would be computed.

BOEM Response

[1] BOEM's revised bid adequacy procedures also discontinue the use of tract classification to streamline the bid review process, and include other minor revisions to simplify the document and ensure clarity, as outlined in its *Federal Register* notice requesting comments on the proposed revised procedures (88 Fed. Reg. 3433 (Jan. 19, 2023)).

In response to comments received on its proposed revised bid adequacy procedures, BOEM published an addendum on its website to supplement the information included in its *Federal Register* notice. The addendum provided the public with the proposed equation for the calculation of LBCI at a 90 percent confidence level, along with definitions of the specific terms in the equation. BOEM also provided additional detail on the Lower Bound Confidence Interval calculation in Appendix 1 of *Procedures for Determining Bid Adequacy at Outer Continental Shelf Oil and Gas Lease Sales.* The modifications to BOEM's bid adequacy procedures along with the LBCI equation provide all stakeholders with a clear and transparent description of the process that BOEM intends to use for assuring that fair market value (FMV) is received for each OCS oil and gas lease issued.

In its October 2019 report entitled, "Offshore Oil and Gas: Opportunities Exist to Better Ensure a Fair Return on Federal Resources," GAO provided four recommendations to BOEM. In its Recommendation 2, GAO provided, in part, that BOEM should, "*…examine the extent to which the bureau's use of delayed valuations assures the receipt of fair market value, and make changes - such as terminating the use of delayed valuations or amending its model's assumptions - as appropriate.*" In response, BOEM committed to examine its use of delayed valuation and to identify any appropriate changes.

BOEM's revised bid adequacy procedures are a direct response to GAO's concerns regarding BOEM's delayed valuation methodology. In response to GAO's recommendation, BOEM initiated a comprehensive review of its FMV evaluation process, focusing on the delayed valuation methodology. A multidisciplinary review team ("team") was formed and reviewed the existing delayed valuation methodology, including the use of a social discount rate, and explored changes to modeling the delay period.

The team also investigated two alternative approaches (LBCI and Expected Value) to replace the Adjusted Delayed Value (ADV[2]) currently in use for the analysis of OCS lease tracts. While LBCI is a statistical approach that signifies the confidence that the true unknown value of a tract will fall within a given confidence level, the Expected Value approach incorporates a venture success factor that recognizes and monetizes the risk to the government that a tract rejected in a lease sale may not be sold in a future sale. The team conducted rigorous analyses of both approaches using historical lease sale data and determined that the Expected Value approach cannot provide appropriate characterization of tract valuation and quantification of the expected outcome. The use of the LBCI methodology provides an analytical tool that allows for the capture of the range of values encompassing the true unknown mean of the risked present worth (RPW) of the resources at the time of the lease sale. The team recommended using the LBCI as a potential replacement for the delayed valuation methodology, which is reflected in the modifications to the bid adequacy procedures.

To ensure the technical validity of the LBCI methodology and its suitability as a tool for FMV assessment, the team performed comprehensive testing using the LBCI as a decision criterion for bid adequacy and the acceptance or rejection of a high bid on a sale tract. BOEM used existing tract analysis from five recent Gulf of Mexico (GOM) lease sales (Sale 251 to Sale 256) and

[2] ADV is the lesser of the MROV (mean range of values) and DMROV (delayed mean range of values).

evaluated the tracts using the LBCI approach. Specifically, for each sale, the team identified the number of tracts that were rejected using the ADV as the decision criterion and compared that to the number of tracts that would have been rejected using the LBCI approach at the 80 percent, 85 percent, 90 percent and 95 percent confidence levels. Based on these results, BOEM determined that the LBCI at a 90 percent confidence level would be the most appropriate substitute for the delayed valuation methodology. Modeling the use of LBCI at a 90 percent confidence level resulted in approximately 14 percent more total rejected tracts for the five GOM lease sales compared to using the ADV.

Unlike the delayed valuation methodology, the LBCI methodology would not require BOEM to estimate the delay period between the current OCS oil and gas lease sale and the projected next lease sale, thus eliminating the uncertainties associated with the delayed value calculation.

II. Removal of Delayed Mean Range of Values (DMROV)

Several commenters explicitly stated that they do not support removal of DMROV and recommended the continued use of a measure that accounts for a potential delay in leasing. One commenter stated that delayed valuation is especially relevant when there are large gaps between lease sales. Commenters also indicated that in keeping a delayed valuation measure, BOEM should modify or reduce the amount of depreciation in the calculation.

BOEM Response

BOEM recognizes the complexity of the existing DMROV calculation and thus proposes to replace the DMROV with the more transparent LBCI statistical methodology. The DMROV does not represent "depreciation" of a tract's value from one sale to the next; rather the DMROV calculation allows BOEM to compare the value of the bonus and royalties from leasing the tract in the current sale to the value of the bonus and royalties after rejecting the tract and potentially leasing it in the next available sale. That is, the DMROV accounts for the time interval between the current sale and the next available sale, and the delay in leasing revenues if the tract is not sold in the current sale. This value is discounted to present time and compared with the value of the bonus and royalties associated with accepting the highest qualified bid on the tract in the current sale. The DMROV is heavily dependent on the sale-specific price forecast and in some cases can be greater than the Mean Range of Values (MROV).

BOEM believes that the use of delayed valuation can assure the receipt of FMV, but recognizes that opportunities exist to improve the process. As a result of its review, BOEM determined that given the uncertainties in estimating the delayed values, the LBCI approach would be preferable as it better captures the range in values surrounding the unknown mean value. A key advantage of the LBCI methodology is its simplicity and well-defined formula, which provides the public with a transparent, widely accepted, and consistent methodology for tract valuation. The LBCI relies on established statistical practices to capture a range of values that encompass the true unknown mean of the risked present worth of the resources contained in an OCS tract. The inclusion of the standard deviation in the LBCI equation ensures that the LBCI captures the impact of the range of uncertainty from input parameters during FMV assessment of a prospect.

III. Unusual Bidding Patterns

One commenter noted that in the Phase 1 analysis of the proposed revisions to the bid adequacy procedures, the Regional Director (RD) can reject a bid if it is determined there are unusual bidding patterns, and requested more information on what constitutes an unusual bidding pattern.

BOEM Response

An unusual bidding pattern includes opportunities for strategic underbidding, information asymmetry, collusion, and other noncompetitive practices. These unusual bidding patterns are most easily identified in situations in which the Government has the most detailed and reliable data.

Within the context of BOEM's bid adequacy procedures, unusual bidding patterns can include anti-competitive practices; for example, if it appears that companies are attempting to avoid bidding against each other in a sale on a set of prospective tracts. Additionally, unusual bidding patterns may refer to a situation in which two or more companies bid against each other more often than would normally be expected.

IV. Tract Viability

One commenter noted that BOEM's current process could result in a situation where it accepts the highest bid on nonviable tracts while rejecting bids on viable tracts. The commenter further suggested that BOEM could ensure it is receiving FMV for viable tracts by raising the minimum bid on tracts determined to have higher value rather than evaluating bids once they are received. A commenter also suggested that BOEM reject all high bids for nonviable tracts and allow the high bidder an opportunity to appeal the decision and explain why the tract is viable.

BOEM Response

Fiscal terms for all OCS tracts, including the minimum bid per acre, are published in a Final Notice of Sale at least 30 days prior to each lease sale. Under BOEM's previous and revised bid adequacy procedures, a specific tract viability determination is only generated on tracts that receive a bid. As a critical component of this evaluation, BOEM uses a discounted cash flow analysis to calculate the tract's MROV, which is the mean of a tract's net present value of the oil and gas resources adjusted for the geological risks of not finding hydrocarbons and the uncertainties associated with the tract's development and economic parameters at the time of the lease sale. The MROV is a single value that represents the maximum cash payment that a bidder can offer for acquiring the tract's drilling and development property rights and expect to make a normal rate of return on its investment.

The revisions to BOEM's bid adequacy procedures require that BOEM accept the highest qualified bid in Phase 1 for each tract that it determines is a nonviable tract. BOEM will pass to Phase 2 for further analysis each tract that it determines is a viable tract, or where viability is unknown. A viable tract is a tract considered by BOEM to have the potential capability of being

explored, developed, and produced profitably under economic conditions present at the time of the lease sale. To ensure that its analysis is accurate and up to date, BOEM routinely performs lookback studies after a well is drilled on a tract and utilizes these findings to update future analyses.