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DEPARTMENT OF THE INTERIOR

Minerals Management Service

Modifications to the **Bid Adequacy** Procedures

AGENCY: **Minerals Management Service** (MMS), Interior.

ACTION: Notification of procedural changes.

SUMMARY: The **Minerals Management Service** (MMS) is modifying one element

of its existing **bid adequacy** procedures for ensuring receipt of fair market value on Outer Continental Shelf (OCS) oil and gas leases. The modification establishes a new criterion for acceptance under the number of bids rule for selected tracts in Phase 1. Specifically, for viable confirmed and wildcat (C&W) tracts receiving three or more qualified bids, where the third largest **bid** is within 50 percent of the high **bid**, acceptance under the number of bids rule will apply only to those viable C&W tracts having high bids that are in the top 75 percent of high bids on a per acre basis for all three-or-more-**bid** C&W tracts within designated water depth categories. Unless stated otherwise, usually in the final notice of sale, the designated categories in the Gulf of Mexico are: water depths of less than 800 meters and water depths of 800 meters or more.

This change has been made following a review of bidding activity in recent OCS sales. The new criterion for the number of bids rule was developed in part because in these sales a disproportionately large number of the three-**bid** confirmed and wildcat tracts with relatively low high bids were accepted in Phase 1, while tracts of this type with much larger high bids tended to be passed to Phase 2 in the evaluation process. Yet, in sales held without a number of bids rule for Phase 1 acceptance, it was found that of the set of tracts receiving three or more bids, the ones that tended to get rejected were those receiving relatively small high bids. Thus, this new criterion will allow the MMS

to better ensure receipt of fair market value through more efficient targeting of its tract evaluation resources.

Another reason for the change is that the previous three-**bid** rule provided an incentive to submit lower bids. By doing so, a bidder could raise the chance that if it was the high bidder, the third largest **bid** would fall within the required 50 percent of its high **bid**. Under the proposed change, bidders would be discouraged from adopting this strategy because attempts to implement it would likely cause the potential high **bid** to fall below the new requirement that an acceptable high **bid** in Phase 1 must be in the top 75 percent of all high bids in the tract's class. Indeed, the 75 percent parameter was chosen, in part, because in recent sales, there were no cases in which a high bidder could have successfully implemented this strategy with the proposed change in the rule in place.

DATES: This modification is effective February 4, 1999.

FOR FURTHER INFORMATION CONTACT: Dr. Marshall Rose, Chief, Economics Division, at (703) 787-1536.

SUPPLEMENTARY INFORMATION: The following set of **bid adequacy** procedures incorporates the most recent changes. During the **bid** review process, MMS conducts evaluations in a two-phased process for **bid adequacy** determination. We also review the **bid** for legal sufficiency \1\ and anomalies \2\ to establish the set of qualified bids \3\ to be evaluated.

\1\ Legal bids are those bids which comply with MMS regulations (30 CFR 256) and the Notice of Sale. Any illegal high **bid** will be returned to the bidder.

\2\ Anomalous bids include all but the highest **bid** submitted for a tract by the same company, parent or subsidiary (bidding alone or jointly). Such bids are excluded when applying the number of bids rule or any **bid adequacy** measure.

\3\ Qualified bids are those bids which are legal and not anomalous.

Phase 1

The tracts receiving bids are partitioned into four general categories:

- Those tracts where competitive market forces can be relied upon to assure fair market value;
 - Those tracts which the MMS identifies as being nonviable \4\ based on adequate data and maps;
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\4\ Nonviable tracts or prospects are those geographic or geologic configurations of hydrocarbons whose risk weighted most probable resource size is below the minimum economic field size for the relevant cost regime and anticipated future prices. The risk used is below the lowest level anticipated for any tract or prospect in the same cost regime.

- Those tracts where the Government has the most detailed and reliable data;
- Those tracts where opportunities are greatest for strategic underbidding, information asymmetry, collusion, and other noncompetitive practices.

Based on these categories, six Phase 1 rules are applied to all tracts receiving bids:

- Accept the highest qualified **bid** on viable confirmed and wildcat tracts receiving three or more qualified bids where the third largest such **bid** on the tract is at least 50 percent of the highest qualified **bid** and where the high **bid** per acre ranks in the top 75 percent of high bids for all three-or-more-**bid** confirmed and wildcat tracts that reside within a specified water depth category.\5\
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\5\ The water depth categories usually will be specified in the final notice of sale.

- Accept the highest qualified **bid** on confirmed and wildcat tracts determined to be nonviable.
- Pass to Phase 2 all tracts that require additional information to make a determination on viability or tract type.
- Pass to Phase 2 all viable confirmed and wildcat tracts receiving one or two qualified bids.
- Pass to Phase 2 all viable confirmed and wildcat tracts receiving three or more qualified bids where either the third largest such **bid** is less than 50 percent of the highest qualified **bid** or where the high **bid** per acre ranks in the lowest 25 percent of high bids for all three-or-more-**bid** confirmed and wildcat tracts in the specified water depth

category.

--Pass to Phase 2 all drainage and development tracts.

The percentile ranking of a tract's high **bid** is calculated by multiplying 100 times the ratio of the numerical ordering of the three-or-more-**bid** confirmed and wildcat tract's high **bid** to the total number of all viable and nonviable three-or-more-**bid** confirmed and wildcat tracts in the designated water depth. For example, suppose there are 21 total confirmed and wildcat tracts identified in Phase 1 as receiving three-or-more-bids in the designated water depth category of at least 800 meters. All viable tracts in this set having a high **bid** among the top 15 high bids would satisfy the 75% requirement; the 15th ranked high **bid** would represent the 71st percentile.

In ensuring the integrity of the bidding process, the Regional Director (RD) may identify an unusual bidding pattern \6\ at any time during the **bid**

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review process, but before a tract is accepted. If the finding is documented, the RD has discretionary authority, after consultation with the Solicitor, to pass those tracts so identified to Phase 2 for further analysis. The RD may eliminate all but the largest of the unusual bids from consideration when applying any **bid adequacy** rule, may choose not to apply a **bid adequacy** rule, or may reject the tract's highest qualified **bid**.

\6\ Within the context of our **bid adequacy** procedures, the term ``unusual bidding patterns'' typically refers to a situation in which there is an excessive amount of coincident bidding by different companies on a set of tracts in a sale. Other forms of unusual bidding patterns exist as well, and generally involve anti-competitive practices, e.g., when there is an uncommon absence of competition among companies active in a sale on a set of prospective tracts.

All of these procedures are generally completed within 3 weeks of the **bid** opening, and the results are announced simultaneously at the end of this period.

Phase 2

The Phase 2 **bid adequacy** determinations are normally completed sequentially over a period ranging between 21 and 90 days after the

sale. The total evaluation period can be extended, if needed, at the RD's discretion (61 FR 34730, July 3, 1996).

Activities designed to resolve **bid adequacy** assessments are undertaken by analyzing, partitioning, and evaluating tracts in two steps:

- Further mapping and/or analysis is done to review, modify, and finalize viability determinations and tract classifications.
- Tracts identified as being viable must undergo an evaluation to determine if fair market value has been received.

After completing these two steps, a series of rules and procedures are followed.

- Accept newly classified confirmed and wildcat tracts having three or more qualified bids if the third largest such **bid** is at least 50 percent of the highest qualified **bid**.
- Accept the highest qualified **bid** on all tracts determined to be nonviable.
- Determine whether any categorical fair market evaluation technique(s) will be used. If so:
 - Evaluate, define, and identify the appropriate threshold measure(s).
 - Accept all tracts whose individual measures of **bid adequacy** satisfy the threshold categorical requirements.
 - Conduct a full-scale evaluation, which could include the use of MONTCAR, \7\ on all remaining tracts \8\ passed to Phase 2 and still awaiting an acceptance or rejection decision.

\7\ MONTCAR is a probabilistic, cash flow computer simulation model designed to conduct a resource-economic evaluation that results in an estimate of the expected net present value of a tract (or prospect) along with other measures.

\8\ These include tracts not accepted by a categorical rule that are classified as drainage and development tracts and those classified as confirmed and wildcat tracts that are viable and received (a) one or two qualified bids, or (b) three or more qualified bids where either the third largest such **bid** is less than 50 percent of the highest qualified **bid** or the high **bid** is in the bottom quartile of all three-or-more-**bid** confirmed and wildcat tracts for a designated water depth category.

-Compare the highest qualified **bid** on each of these remaining tracts to two measures of **bid adequacy**: the Mean Range of Values (MROV) \9\ and the Adjusted Delayed Value (ADV) \10\.

\9\ The MROV is a dollar measure of a tract's expected net present private value, given that the tract is leased in the current sale, allowing for exploration and economic risk, and including tax consequences including depletion of the cash bonus.

\10\ The ADV is the minimum of the MROV and the Delayed MROV (DMROV). The DMROV is a measure used to determine the size of the high **bid** needed in the current sale to equalize it with the discounted sum of the bonus and royalties expected in the next sale, less the foregone royalties from the current sale. The bonus for the next sale is computed as the MROV associated with the delay in leasing under the projected economic, engineering, and geological leasing receipts conditions, including drainage. If the high **bid** exceeds the DMROV, then the leasing receipts from the current sale are expected to be greater than those from the next sale, even in cases where the MROV exceeds the high **bid**.

-Accept the highest qualified **bid** for those tracts where such a **bid** equals or exceeds the tract's ADV.

-Reject the highest qualified **bid** on drainage and development tracts receiving three or more qualified bids where such a **bid** is less than one-sixth of the tract's MROV.

-Reject the highest qualified **bid** on drainage and development tracts receiving one or two qualified bids and on confirmed and wildcat tracts receiving only one qualified **bid** where the high **bid** is less than the tract's ADV.

At this stage of the process, the outstanding tracts consist of those having a highest qualified **bid** that is less than the MROV of the ADV, and are either (a) drainage or development tracts receiving three or more qualified bids with the highest such **bid** exceeding one-sixth of the tract's MROV, or (b) viable confirmed and wildcat tracts that receive two or more qualified bids.

From these outstanding tracts, MMS selects the following ones:

-Drainage and development tracts having three or more qualified bids with the third largest such **bid** being at least 25 percent of the highest qualified **bid**;

-Confirmed and wildcat tracts having two or more qualified bids with the second largest such **bid** being at least 25 percent of the highest qualified **bid**.

The MMS then compares the highest qualified **bid** on each of these selected, outstanding tracts to the tract's Revised Arithmetic Average Measure (RAM).\11\ For all these tracts:

\11\ The RAM is the arithmetic average of the MROV and all qualified bids on the tract that are equal to at least 25 percent of the high **bid**.

-Accept the highest qualified **bid** where such a **bid** equals or exceeds the tract's RAM.

-Reject the highest qualified **bid** where such a **bid** is less than the tract's RAM.

Finally, the MMS identifies those tracts that were in the "outstanding" set above but not selected for comparison to the RAM.

-Reject the high **bid** on all of these leftover tracts.

Dated: February 4, 1999.

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