

**LEASING AND DEVELOPMENT
OF OIL AND GAS RESOURCES
ON THE OUTER CONTINENTAL
SHELF**

OVERSIGHT HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND
MINERAL RESOURCES

OF THE

COMMITTEE ON NATURAL RESOURCES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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OVERSIGHT HEARING ON “LEASING AND DEVELOPMENT OF OIL AND GAS RESOURCES ON THE OUTER CONTINENTAL SHELF.”

**Tuesday, March 17, 2009
U.S. House of Representatives
Subcommittee on Energy and Mineral Resources
Committee on Natural Resources
Washington, D.C.**

The Subcommittee met, pursuant to call, at 10:05 a.m. in Room 1324, Longworth House Office Building, Hon. Jim Costa [Chairman of the Subcommittee] presiding.

Present: Representatives Costa, Lamborn, Holt, Tsongas, Gohmert, Fleming, Chaffetz, and Hastings.

STATEMENT OF THE HONORABLE JIM COSTA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. COSTA. The Subcommittee on Energy and Mineral Resources will now come to order.

This is one of a continuum of oversight hearings that the Subcommittee is having in conjunction with the full Natural Resources Committee on how we best manage our energy resources on public lands, both onshore and offshore, and I appreciate the participation and the involvement of not only the Subcommittee but the full Committee as we continue to work with all of those interested parties that have a role to play in trying to properly, and in a balancing fashion, manage America’s energy resources in the 21st Century.

Today’s hearing is a continuum of that discussion on leasing and the development of oil and gas resources on the Outer Continental Shelf.

So let me first begin by wishing everyone Happy St. Patrick’s Day. I see some of you obliged in the true Irish tradition, my lads and lassies, and for you, all that be good. For the rest of you, you are in trouble.

Obviously we are going to be looking at the testimony from our panel of respected witnesses. As I have told the Subcommittee before, we have a few ministerial actions we have to take care of. Under Rule 4[g], the Chairman and the Ranking Minority Member can and may make opening statements. We will both do that. And if any other Members have statements, we are going to submit them for the record today—I hope you do not mind—because, under

unanimous consent, we would like to get to our witnesses' testimony and then to the question-and-comment period.

Additionally, under Rule 4[h], any material submitted for inclusion in the hearing record must be submitted no later than 10 business days following this hearing. We always ask folks to try to expedite that process. It makes it better for the staff, and we appreciate it very much.

Let me begin with my opening statement. As I noted, the Energy and Mineral Resources Subcommittee is taking a detailed look at the process and the data behind the leasing and the developing of oil and gas resources which are so critical to the United States economy as we talk about our resources—both onshore and offshore.

This is the second hearing of the Subcommittee. It is the fifth hearing that the Natural Resources Committee has held on the subject matter. I have been very pleased with the tone that has taken place thus far in the hearings in trying to find common ground among my colleagues, both Republican and Democratic, to determine how we in a common-sense fashion deal with what is not only a very important issue but an issue that has in the past been contentious. As we know, it has been politicized. Hopefully we can have a much more calm and cool-headed discussion.

One question that kept coming up last year that we heard in the debate was, with 68 million acres of nonproducing Federal oil and gas leases in the United States that are out there, why are they not being utilized?

One side argued that the energy companies were just sitting on these leases, and thus they should "Use It or Lose It." The other side argued that these leases had little oil or gas or carbon deposits beneath them, and therefore, we needed to provide new leases or acreage to the energy industries so they could, as it was put by some, "Drill, Baby, Drill."

Now I think many of you have heard my comment last month that I thought "Use It or Lose It" or "Drill, Baby, Drill" seemed to me to be nonsensical when you get into the details of the issues before us, and I truly feel that way.

Today, we have two watchdog groups that have looked at the question—the Government Accountability Office, and for those of my colleagues who have not read their report, "Oil and Gas Leasing: The Interior Department Could Do More To Encourage Diligent Development," I would urge you to look at it—and the Office of the Inspector General from the Interior Department—and look at their reports.

I think this much is clear: The answer to how we best use our energy resources on public lands, whether they be onshore or offshore, are not and cannot simply be reduced to sound bites. That may make political hay in some circles, but that does not get the job done.

Companies are not just sitting on their leases and refusing to drill, but at the same time, they also are not being blocked by lawsuits at every turn or stuck with land that has no resources.

There are many factors I think as I tried to examine and get into the details of these issues on why leases that have been provided

are not producing oil or gas, and I hope that the expert witnesses this morning will really detail what those complexities are.

Our witnesses from the National Ocean Industries Association, I think, will also help us gain further insight into these various factors, and I would urge you to provide that information.

Understanding therefore the reasons in a more thoughtful manner I think will allow us to move forward intelligently and ultimately help us figure out where the balancing is between domestic production of oil and gas on our public lands, both onshore and offshore, as we try to do the transition that I continue to talk about on a comprehensive energy policy that uses all the energy tools in our energy toolbox—at the near term, which is defined as the next several years, the midterm, which is defined anywhere between the next five to 10 years, and the long term, which is suggested as we try to build a more robust, renewable energy portfolio over the next 10 to 20 years.

I think that is the challenge that this Subcommittee has and that the full Committee has. This hearing today is not solely about nonproducing leases, but it is also about the details of the entire offshore leasing and development program, in essence, what works well and maybe what is not working and where is there room for improvement.

I believe that the offshore leasing program generally speaking, and our first visit with myself and Chairman Rahall and Committee staff was last March—actually it would be about a year ago—into the Gulf of Mexico is generally being run quite well. We are looking forward to discussions today on how the lessons we have learned on offshore can also be put to good use onshore.

So, Members of the Subcommittee, I thank you for being here and your participation, and I would now like to recognize the Ranking Member, Mr. Doug Lamborn, from Colorado, the great State of Colorado, for his opening statement.

[The prepared statement of Mr. Costa follows:]

**Statement of The Honorable Jim Costa, Chairman,
Subcommittee on Energy and Mineral Resources**

Today the Subcommittee on Energy and Mineral Resources will take a detailed look at the process and the data behind leasing and developing oil and gas resources on the U.S. outer Continental Shelf. This is the second hearing by this subcommittee, and the fifth hearing in the Natural Resources Committee, on the topic of offshore drilling, and I have been very pleased with the tone that has been adopted so far throughout these hearings: a tone of cooperation and of trying to find the common ground on an issue that was far too contentious and politicized in the previous Congress.

Perhaps no single statistic was used more last year than the number “68 million”, as in “there are 68 million acres of non-producing federal oil and gas leases in the United States.” While an accurate number, by itself it told us very little. One side argued that oil companies were just sitting on these leases and they should “use it or lose it.” The other side argued that these leases had no oil and gas beneath them, and we needed to provide new acreage to the industry so they could drill, baby, drill. To me, both of these positions are nonsensical.

Privately, away from the glare of the tv lights and the blare of the pundits, Members of Congress would ask: why? What are the real reasons that 75% of the acres under lease are not producing? That is one of the questions that I hope we are able to address today. We have two watchdogs here, the Government Accountability Office and the Office of the Inspector General for the Interior Department, and they both have spent quite a bit of time looking at this question in recent months.

From their reports, this much is clear: the answers here are not solely on one side or the other. Companies are not just sitting on their leases and refusing to drill,

but they are also not being blocked by lawsuits at every turn, or stuck with land that has no resources. Many factors go in to why a lease is not producing oil and gas. There are regulatory delays, workforce shortages, equipment shortages, deliberate business decisions, and countless other complexities that we will hear about today. Our witness from the National Ocean Industries Association will also help us gain some insight into these various factors. Understanding these reasons in a more thoughtful manner will allow us to move forward more intelligently, and ultimately help us figure out how domestic oil and gas production will fit into our short term, medium term, and long term energy strategies.

But this hearing is not solely about non-producing leases. It is about the details of the entire offshore leasing and development program—how it works, where it succeeds, and where there is room for improvement. I believe that the offshore leasing program is being run quite well, particularly in the Gulf of Mexico, and I am looking forward to a discussion today about how the lessons we have learned offshore can also be put to good use onshore.

STATEMENT OF THE HONORABLE DOUG LAMBORN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO

Mr. LAMBORN. Mr. Chairman, thank you for holding this hearing. This is the fifth hearing on the Outer Continental Shelf this Congress. I believe these hearings have been very helpful in establishing a clear record of the challenges and opportunities we have in the OCS as we move forward with new development. Today's hearing will focus on the development of oil and gas resources in the OCS.

Last year, we had an extended debate on the issue of “nonproducing leases” and domestic development. The impetus for that debate was a report issued by the majority staff on this Committee. Unfortunately, that debate was held on the House Floor rather than in this Subcommittee. The result of that debate, as the Chairman has alluded to, was the dissemination of a tremendous amount of misinformation about the process and status of oil and gas development on our Federal lands and the OCS.

I quote one majority member from last year, who said, “It is outrageous that oil companies are sitting idle on what could be vast reserves of oil.”

Now we all know that there are no domestic companies just sitting idle on vast reserves of oil. There are, however, many state-run oil companies overseas that are part of the OPEC cartel who are committed to hoarding oil to drive up prices, but that is not an option for American companies who only make money by bringing oil out of the ground.

More disturbing than the statements about our domestic companies are the new policies proposed by the President, who clearly relied on the information presented in that majority report. Last year, it was the “Use It or Lose It” legislation. This year, it is the President's budget, which includes a billion dollars in new taxes just on operations in the Gulf of Mexico. These new “nonproducing fees” will charge companies while they wait for Federal permits, evaluate seismic data or spend billions to build the infrastructure needed to produce oil from deep beneath the ocean floor.

These fees will not make companies develop any faster. In fact, the fees constitute a purely punitive proposal designed for what appears to be cheap political gain.

New fees will, however, harm domestic development by discouraging companies from investing in marginal leases, thus reducing investments in new development and ultimately leaving us more dependent on foreign sources of oil.

The development of the deepwater Gulf of Mexico is one of the greatest technological challenges in the world. There is a reason that in the movie, *Armageddon*, when they wanted to drill on an asteroid hurtling toward earth, they picked some roughneck oil drillers.

Just one example of the challenges is the Chevron Buckskin Prospect, which recently had a significant discovery. This block is approximately 190 miles southeast of Houston. This lease was issued in December of 2003. It is a 10-year lease covering nine square miles located in 6,700 feet of water.

The Buckskin No. 1 discovery well is located in approximately 6,900 feet of water and was drilled to a depth of more than 29,000 feet. It has taken five years to get to the successful discovery well and will likely take another five years to bring this discovery to development, all before Chevron and its partners receive any income from their investment. By the time Buckskin goes online, it is not unreasonable to expect Chevron and its partners to have spent between four and six billion dollars to develop this field.

I highlight this example of the challenge of OCS development because tomorrow the Department of the Interior will conduct Lease Sale 208 for oil and gas exploration in the Central Gulf of Mexico. One of the most important pieces of that sale will be the congressionally mandated sale of the area known as "181 South." What is most amazing is that this area, like much of the remainder of our Coastal Zone, has been off limits for more than 20 years.

Do we know exactly what lies beneath these areas? Do we know exactly how much oil and gas the companies will find? Do the companies that tomorrow will spend millions or billions of dollars know exactly what their return will be?

The answer to all these questions is no. We do not know exactly what resources these lands hold, which is why critical exploration work must be done before any of these lands can be tested by drilling, but that exploration and inventory work will be done by private companies at no expense to the American taxpayer.

This new exploration will create jobs, creating new investment, and should these companies find commercial quantities of oil and gas, then we will see development of these resources creating even more jobs and revenue for the American taxpayer.

I am focusing on this lease sale because, while it will be a great benefit to the American people, it continues the trend that we have had in the OCS for decades. America continues to place nearly all of our OCS development within the Gulf of Mexico. This hurricane-rich area currently provides America with 25 percent of our oil and 15 percent of our natural gas. Having nearly all of our eggs in this one fragile basket cannot be the best energy policy for America.

At our last hearing, the administrator for the Energy Information Administration told us that, by 2030, America will still be 80 percent reliant on oil for our transportation needs. Meanwhile, the Interior Department has decided to delay the planning process for

the 2010 OCS Five-Year Plan, pushing back the plan to 2011 or later, yet we need these resources today.

I want to submit for the record, Mr. Chairman, an article from the Washington Times which highlights the efforts China is undergoing to ensure that they have a steady supply of oil for their economy. These actions by the Chinese government will ensure that when the world economy starts to grow, they will have the resources available to fuel their economic growth while our lack of development means we could very well see \$4 or \$5 gasoline again, which is one of the causes of the current economic shock we are in.

To emphasize that point, I want to submit for the record also some research by Professor James Hamilton from California.

Mr. COSTA. Without objection.

Mr. LAMBORN. And to close, Mr. Chairman, I believe in American excellence, and I know that everyone in this body is committed to the best for America, but we cannot continue to dawdle while our competitors get it.

China is locking up mineral and oil resources. They are converting from bicycles to nuclear and building a new coal power plant each week. Reports are that Cuba is coordinating with Russia to drill exploration wells in the second quarter of this year not 60 miles from the Florida coast. Canada is moving to open its OCS resources to develop more domestic energy. Brazil has had more major OCS finds this decade than nearly anywhere else in the world.

Meanwhile, Americans are worried about our standard of living. They are worried about the ability to pay for their kids' college and if they can keep their homes, and they are worried about paying bills for everyday expenses, including energy.

We know that the resources are there in the OCS, and yet we continue to take steps to delay and block development. I believe in our ability to bring hope to the entire world, and I believe this Committee can help America solve the energy problems we face and provide the fuel necessary for economic growth and prosperity.

I thank you, and I look forward to hearing from our witnesses.

[The prepared statement of Mr. Lamborn follows:]

**Statement of The Honorable Doug Lamborn, Ranking Member,
Subcommittee on Energy and Mineral Resources**

Mr. Chairman, thank you for holding this hearing. This is the 5th hearing on OCS development this Congress. I believe these hearings have been very helpful in establishing a clear record of the challenges and opportunities we have in the OCS as we move forward with new development.

Use or Lose

Today's hearing will focus on development of oil and gas resources in the OCS. Last year, we had an extended debate on the issue of "non-producing leases" and domestic development. The impetus for that debate was a report issued by the Majority staff on this Committee. Unfortunately, that debate was held on the House Floor and not in this subcommittee. The result of that debate was the dissemination of a tremendous amount of misinformation about the process and status of oil and gas development on our federal lands and the OCS.

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¹ Rep. Gabrielle Giffords, Press Release

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Lease Sale

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At our last hearing, the Administrator for the Energy Information Administration told us that by 2030 America will still be 80% reliant on oil for our transportation needs. Meanwhile the Interior Department has decided to delay the planning process for the 2010 OCS 5-year plan, pushing back the plan to 2011 or later. Yet we need these resources today.

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or \$5 dollar gas again, which is one of the causes of the current economic shock we are in. To emphasize that point I want to submit for the record some research by Professor James Hamilton from California.

Closing

Mr. Chairman, I believe in American excellence and I know that everyone in this body is committed to the best for America. But we cannot continue to dawdle, while our competitors get it, China is locking up mineral and oil resources; they are converting from bicycles to nuclear and building a new coal power plant each week. Reports are that Cuba is coordinating with Russia to drill exploration wells in the second quarter of this year, not 60 miles from the Florida Coast. Canada is moving to open its OCS resources to develop more domestic energy. Brazil has had more major OCS finds this decade than nearly anywhere else in the world.

Meanwhile, Americans are worried about our standard of living. They are worried about the ability to pay for their kids' college, and if they can keep their homes. And they are worried about paying bills for everyday expenses, including energy. We know that the resources are there in the OCS and yet we continue to take steps to delay and block development.

I believe in our ability to bring hope to the entire world, and I believe this Committee can help America solve the energy problems we face and provide the fuel necessary for economic growth and prosperity.

I thank you and look forward to hearing from our witnesses.

Mr. COSTA. Thank you very much.

We will now begin with our panel. We have a good group of folks here. We have Mr. Chris Oynes, the Associate Director for the Offshore Energy and Minerals Management Program for the Minerals Management Service. We have Ms. Mary Kendall, the Acting Inspector General for the U.S. Department of the Interior; Mr. Frank Rusco, Director of Natural Resources and the Environment, the U.S. Government Accountability Office, I made reference to the report that the GAO did; and Mr. Tom Fry, the President of the National Oceans Industry Association; and finally, last but certainly not least is Mr. James Farnsworth, the President of Cobalt International Energy.

Members of the panel, I told you that the light there before you gives you five minutes to make your oral testimony. It is green for four minutes, it is yellow for one minute, and you can test the Chair's patience on how long it is red, but I urge you not to do that. Also make sure that your microphone is activated.

So why don't we begin the testimony with Mr. Chris Oynes, who is speaking on behalf of, as I noted, the Offshore Energy and Minerals Management Program.

I would urge Members of the Subcommittee if you have not done so to take an opportunity, and they will help arrange it for you, to go down to the Gulf of Mexico either off the coast of Texas or Louisiana. There are a number of places there where they have offices. You can spend a morning looking through their lease process and then go out and visit one of the facilities that are out there. There is a multitude of facilities actually.

Mr. Chris Oynes, please begin on your testimony.

STATEMENT OF CHRIS OYNES, ASSOCIATE DIRECTOR, OFFSHORE ENERGY AND MINERALS MANAGEMENT PROGRAM, MINERALS MANAGEMENT SERVICE

Mr. OYNES. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear today to discuss the Minerals Management Service's role in pro-

moting environmentally responsible energy and mineral development on the OCS.

The MMS's offshore responsibilities as defined by the OCS Lands Act extend over about 1.7 billion acres on the Federal OCS. These responsibilities range from initial resource assessments and lease sale offerings through the oversight of exploration, development, production and ultimately the decommissioning of facilities on the OCS.

The MMS is charged with managing access to and the development of energy and mineral resources on the OCS in a manner that is environmentally sound and operationally safe, prevents waste and provides a fair return for the public's resources. This mission is accomplished through our Offshore Energy and Minerals Management Office's implementation of three major program areas: oil and gas, renewable energy, and marine minerals.

The MMS also administers an environmental studies program that has invested about \$840 million in research to support our environmental stewardship role in the OCS. MMS has conducted environmental studies on discharges, biology, physical oceanography, chemical effects and other elements of the human, marine and coastal environments.

MMS currently administers about 8,124 offshore leases, covering just a little over 43 million acres, and oversees 3,795 production facilities. In 2008, 1,439 new leases were issued in four OCS lease sales for bonus bids that totaled nearly \$6.9 billion. About one-quarter of the leased acreage on the OCS is producing, accounting for about 1.4 million barrels of oil per day and 8 billion cubic feet of natural gas production per day.

As was mentioned earlier, the OCS contributes roughly 27 percent of the domestic oil supply and about 14 percent of the domestic natural gas supply.

The bulk of the Federal OCS offshore production occurs in the Gulf of Mexico, illustrating the need to consider the diversifying of types of energy we use.

Significant oil and gas potential remains as both reserves, that is, in known fields, and as resources, that is, yet-to-be-discovered fields. About 64 percent of the nation's estimated undiscovered, technically recoverable oil and about 39 percent of the undiscovered, technically recoverable natural gas are expected to underlie the OCS.

In 2006, MMS conducted a National OCS Assessment that estimated there were technically recoverable OCS resources of about 85 billion barrels of oil and 419 trillion cubic feet of gas, though not all of this was economically recoverable at today's prices. This 2006 assessment it should be noted was based on information as of January 1, 2003.

Figure 4 of my testimony, my prepared testimony—let us see if we can get it to come up here—shows the pace of leasing in the last several years, and it is from 2002 through 2008, and it shows a cumulation of lease sales in those years and how many leases were issued, the amount of acreage and where those lease sales were held.

OCS oil and gas lease sales held in Fiscal 2008 contributed significantly to the inventory of the acreage leased on the OCS. In

fact, Sale 2006 held last year in March set the record for both high bids, that is, the total number of bids received, and the dollar amount as the largest in U.S. leasing history.

Let me now explain a little bit how oil and gas development proceeds under the OCS program. Oil and gas companies cannot begin operations once a lease is granted without additional approvals. Before drilling begins, a company must provide a detailed exploration plan and a development plan explaining how its operations will be safely conducted and how potential environmental issues will be mitigated. The MMS also has an extensive, detailed inspection program to ensure the safety of oil and gas operations. In 2008, MMS conducted over 26,000 inspections.

The Subcommittee should be aware that not all leases have the same amount of oil and gas, and indeed, some leases may never have oil and gas, but it may also take time to reach that conclusion. Some leases in shallow water, which have only a five-year lease term, may take a short period of time either to evaluate the lease or to bring it on production. In deeper water, as some of the Committee Members noted, it may take 10 years or longer before that lease is potentially in production.

In the interest of time, let me jump to the end here. In conclusion, Mr. Chairman, thank you for this opportunity to provide this testimony for the Committee, and I am certainly open to any questions that you may have.

[The prepared statement of Mr. Oynes follows:]

Statement of Chris Oynes, Associate Director, Offshore Energy and Minerals Management, Minerals Management Service, U.S. Department of the Interior

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear here today to discuss the Minerals Management Service's (MMS) role in promoting environmentally responsible energy and mineral development on the Outer Continental Shelf (OCS). The Department of the Interior (Department) and its agencies, including the MMS, are public stewards for much of our nation's energy resources; about 1/3 of the nation's domestic oil and gas production comes from Federal resources managed by the Department. The MMS's responsibilities, as defined by the OCS Lands Act, extend over about 1.7 billion acres of the Federal OCS and range from initial resource assessments and lease sale offerings through oversight of exploration, development, production, and ultimately decommissioning. Figures 1 and 2 depict the OCS off of the continental United States (Figure 1) and off of Alaska (Figure 2). This Subcommittee has played an important role in shaping the Nation's domestic energy program, particularly with regard to encouraging environmentally sound development of our domestic oil, gas, and renewable energy resources on the OCS.

The MMS is charged with managing access to and development of energy and mineral resources on the OCS in a manner that is operationally safe and environmentally sound, prevents waste, and provides a fair return for public resources. This mission is accomplished through the Offshore Energy and Minerals Management office's implementation of its two major programs: managing conventional OCS oil and gas development and facilitating new renewable energy production on the OCS. In addition, MMS administers the OCS revenue sharing programs established by Congress including the provisions under section 8(g) of the OCS Lands Act, the Gulf of Mexico Energy Security Act (GOMESA), and the 4-year State grants program, the Coastal Impact Assistance Program (CIAP) established under the Energy Policy Act of 2005 (EPAAct).

The OCS plays a vital role in domestic energy development, including the new OCS Renewable Energy Program established with the enactment of the EPAAct. Under this new OCS renewable energy program, the Secretary of the Interior has oversight and regulatory authority for activities on the OCS that produce or support production, transportation, or transmission of energy from sources other than oil and gas, including wind, wave, and ocean current. The Secretary has delegated this

authority to the MMS because of its extensive experience in offshore oil, gas and marine sand and gravel leasing and development.

My testimony today will highlight MMS's stewardship role in managing conventional resource development on the OCS and will focus on four areas of the Federal offshore program:

1. Data and trends regarding OCS oil and natural gas;
2. The OCS oil and gas leasing program;
3. The MMS Deepwater Gulf of Mexico 2008 Report and recent deepwater development; and
4. Our expanding Renewable Energy Program

Data and Trends for the OCS Oil and Natural Gas Program

In 2007, 14 percent of the nation's natural gas and 27 percent of its oil production, including oil for the Strategic Petroleum Reserve, came from the OCS. Even as we aggressively pursue renewable energy opportunities on the OCS, the OCS's role in conventional energy production is likely to remain critical as all sources of energy contribute to our Nation's energy security.

MMS currently administers about 8,124 leases covering 43.4 million acres and oversees 3,795 production facilities. In calendar year 2008 alone, 1,439 new oil and gas leases were issued from four OCS lease sale offerings, resulting in bonus bids totaling nearly \$6.9 billion.

To ensure the Federal government receives a fair market return for these offshore lease rights, the MMS employs a detailed bid evaluation process to determine bid adequacy. This process considers the potential income stream to the lessee associated with the lease and all potential royalties and rental payments to be paid to the Federal government to ensure the bonus received adequately reflects the value of the potential resources associated with the lease. As a result of our evaluation process, nearly \$10 million in high bids were rejected in four 2008 sales because they did not meet fair market value criteria.

About one-quarter of the leased acreage on the OCS is producing, accounting for about 8 billion cubic feet of natural gas per day and 1.4 million barrels of oil per day. As noted earlier, in 2007 the OCS contributed roughly 14 percent of the domestic natural gas supply and 27 percent of the domestic oil supply. According to the MMS publication, Gulf of Mexico Oil and Gas Production Forecast: 2007-2016, gas production in the Gulf of Mexico has struggled to remain at current levels. The 2008 production data, when tabulated, will most likely represent a decline from the 2007 statistics due to the impacts on Gulf of Mexico production from Hurricanes Gustav and Ike. The bulk of federal offshore production occurs on the Gulf of Mexico OCS—about 98 percent for natural gas and 95 percent for oil—illustrating the need to consider diversifying the types of energy we use. While hurricanes pose a threat in the Gulf of Mexico, Arctic conditions in Alaska also present challenges. Even so, the Northstar and Liberty projects represent promising developments in the Beaufort Sea. The Northstar project is a federal-state unit with about 18 percent of the production allocated to federal leases. In August 2008, MMS approved the Plan of Operations for the Liberty project.

The MMS OCS resource assessment and the USGS national onshore and State water assessments of oil and gas resources show significant potential remains as both proven reserves (in known fields) or undiscovered resources (yet to be discovered fields). The majority of the estimated undiscovered technically recoverable oil and natural gas are expected to underlie Federal lands—onshore and OCS—with the OCS share accounting for about 64 percent of the oil and 39 percent of the gas. The 2006 MMS National OCS Assessment estimates that the OCS holds 15.4 billion barrels of oil and 60.2 trillion cubic feet of gas in reserves. Technically recoverable OCS resources are estimated at 85.8 billion barrels of oil and 419.9 trillion cubic feet of gas, though not all of these volumes are economically recoverable at today's prices. When the congressional moratoria expired on October 1, 2008, many of these resources became available for consideration for potential leasing. These newly available OCS areas hold the potential of about 14 billion barrels of oil and 55 trillion cubic feet of gas. However, there is uncertainty in resource estimates for these areas of the OCS subjected to long-standing moratoria or presidential withdrawal. In the Atlantic and most of the west coast, the last acquisition of geophysical data and drilling of exploration wells occurred more than 25 years ago.

The MMS manages and tracks an extensive array of information about oil and gas lease activity requiring MMS review and approval. As requests for MMS approvals come in, the information is recorded in our computer system. Every plan of exploration, every development plan, every production request, and every pipeline is entered into the computer. Every individual well is also captured. Every environmental review is captured. Any approval of a lease extension, through a suspension

of operations or suspension of production, is also captured. However, MMS does not capture information at the individual company level such as when the lessee is evaluating a lease or a prospect and deciding whether to go forward.

The MMS is a leading participant and supporter of scientific research relating to the ocean environment. Environmental stewardship is emphasized in all phases of OCS activity, from the development of the 5-Year Program through platform decommissioning and removals. A fundamental goal of MMS's Environmental Program is to develop workable solutions for those activities in the OCS that could adversely affect environmental resources. This allows approved exploration and development to continue while the environment is safeguarded. In Fiscal Year 2008, 29 environmental studies were contracted at nearly \$16 million. In that same time, the MMS also completed 320 environmental assessments and 2 detailed environmental impact statements (EIS).

The MMS also funds research into operational safety, pollution prevention, and oil spill response and cleanup capabilities through its Technology Assessment and Research (TAR) Program. This research enables MMS managers to make better decisions in evaluating operational proposals and enables regulators to consider the latest technological advancements in enacting new regulations. In Fiscal Year 2008, the MMS funded 29 TAR studies at nearly \$3 million. As a result, the MMS has a robust regulatory system designed to prevent accidents and oil spills from occurring. This includes redundant well control equipment, emergency plans, and production safety systems as well as a host of other requirements. This has proven effective both in the wake of hurricanes in the Gulf of Mexico and in the Arctic conditions on the Alaska OCS. The MMS also requires oil spill contingency plans because spills are always a possibility.

Oil and gas exploration and development activities do not begin as soon as a lease is granted. Rather, in accordance with the OCS Lands Act, before any drilling begins, a company must provide a detailed exploration plan or development plan explaining how its operations will be safely conducted and how any potential environmental issues will be mitigated. Many regulatory approvals are required. Air emissions permits and water discharge permits must also be obtained as required by law. In Fiscal Year 2008, 253 exploration plans and 224 development plans were approved by MMS as being technically and environmentally sound.

For major facilities, MMS conducts an onsite inspection before allowing production to begin. Often this is a joint inspection with the U.S. Coast Guard. The MMS also has an extensive, detailed inspection program to ensure the safety of offshore oil and gas operations and compliance with environmental stipulations, and to verify production quantities. This program places MMS inspectors offshore on drilling rigs and production platforms on a daily basis to check operator compliance with extensive safety and environmental protection requirements. The MMS has a staff of inspectors and engineers that daily fly offshore to conduct both planned and unannounced safety and environmental inspections. In Fiscal Year 2008 alone, over 26,780 oil and gas compliance inspections were conducted including 682 drilling, 3,632 production, 4,358 environmental, 7,113 meter, 4,908 pipeline, and 6,087 other (e.g., U.S. Coast Guard, flaring, etc.) inspections.

The OCS Oil and Gas Leasing Program Process

The MMS manages access to the OCS for oil and gas development through the 5-Year OCS Oil and Gas Leasing Program (5-Year Program). The process to develop the 5-Year Program, as mandated by section 18 of the OCS Lands Act, includes three separate public comment periods, two separate draft proposals, development of an environmental impact statement, and the final proposal. It culminates in a decision by the Secretary of the Interior on a new 5-Year Program. Additionally, there is an "annual review" step for the years during which a 5-Year Program is in place and a new one is not yet being developed. A 5-Year Program consists of a schedule of oil and gas lease sales indicating the size, timing and location of proposed leasing activity that the Secretary determines will best meet national energy needs for the five year period following its approval. An area must be included in the current 5-Year Program in order to be offered for leasing. Even after the Secretary approves a final program, there is a lengthy public preparation process for each lease sale that includes consultation with stakeholders at several junctures and more specific environmental analysis also in accordance with the National Environmental Policy Act (NEPA).

Current 5-Year Program: 2007-2012

The current 5-Year Program covers the years 2007 through 2012 and includes 21 sales in eight OCS planning areas. While most of the sales scheduled are within OCS planning areas in the Gulf of Mexico and offshore Alaska as traditionally of-

ferred, the 5-Year Plan also includes “new” areas: Proposed Sale 214 offers a portion of the North Aleutian Basin area; Proposed Sale 220 offers an area in the mid-Atlantic offshore the Commonwealth of Virginia; Sale 208 offers the newly opened “181 South” area (Figure 4) in the Central Gulf of Mexico; and, Sale 224 held March 2008, included a newly offered portion of the Eastern GOM Planning Area. Because the Eastern Gulf of Mexico Sale 224 was mandated by GOMESA to include a half million acres in the Eastern Gulf of Mexico, it was not subject to section 18 analysis. Also pursuant to GOMESA, 37.5 percent of all revenues from new leases in that area will be shared among the four Gulf of Mexico producing states and their coastal political subdivisions beginning with the bonuses and first year rentals received on blocks in that 0.5 million acre area. Another 12.5 percent will be distributed to the Land and Water Conservation Fund to provide financial assistance to states.

Since the current 5-Year Program began on July 1, 2007, six sales have been held resulting in 2,395 new leases and \$10 billion in bonus bids. Sale 208, offering acreage in the Central Gulf of Mexico, will be held tomorrow. It will be the first sale in the program to offer the newly available acreage in the “181 South Area” as mandated under GOMESA. Revenues from new leases issued in the “181 South Area” also are subject to GOMESA’s immediate revenue sharing provisions.

As Figure 3 depicts, in recent years, there has been a rising trend in OCS oil and gas leases issued and acreage leased. OCS oil and gas lease sales held in Fiscal Year 2008 contributed significantly to the inventory of acreage leased on the OCS. In fact, Sale 206 in the Central Gulf of Mexico held in March 2008 set the record in high bids (both number received and dollar amount) in U.S. leasing history. As the moratoria were only recently lifted, the Gulf of Mexico and Alaska Regions account for the bulk of active leases; all newly leased OCS acres are in the Eastern, Central, and Western Gulf of Mexico Planning Areas and the Beaufort Sea and Chukchi Sea Planning Areas.

The MMS has begun the process of preparing an EIS to assess the potential impacts of proposed OCS oil and gas leasing, and potential subsequent exploration and development activities in the North Aleutian Basin Planning Area in the Bering Sea, off southwestern Alaska (depicted on Figure 2). Proposed Sale 214 is tentatively scheduled for 2011. MMS has evaluated the oil and gas resource potential for the North Aleutian Basin Planning area. The current knowledge of geology in the basin indicates that it is gas prone. The 2006 OCS Resource Assessment estimate for this area is a mean value of undiscovered technically recoverable natural gas resource of 8.62 trillion cubic feet and the mean value of undiscovered technically recoverable oil resource of 750 million barrels.

The MMS has also initiated the first step for a potential lease sale offshore Virginia (depicted on Figure 1). The proposed sale will be held no earlier than 2011. The MMS published a Call for Information and Interest/Nominations and Notice of Intent to Prepare an EIS (Call/NOI) for Lease Sale 220 in the Federal Register on November 13, 2008. The area covered by the Call/NOI is about 2.9 million acres offshore Virginia in the Mid-Atlantic Planning Area, and is at least 50 miles offshore.

Under the 2007-2012 5-Year Program schedule, there are 13 other proposed sales yet to be held: 4 in the Central Gulf of Mexico; 3 in the Western Gulf of Mexico; 2 in the Beaufort Sea; 2 in the Chukchi Sea; and 2 special interest sales in Cook Inlet; all are in various stages of the sale process. Again, the Central Gulf of Mexico Sale 208 will be held tomorrow.

New OCS Oil and Gas Leasing Program: 2010-2015

In the summer of 2008, the Secretary of the Interior directed MMS to begin the initial steps for developing a new 5-Year program. On August 1, 2008, MMS published a Federal Register Notice requesting information on whether to start a new program and what areas should or should not be included in a new program. As of October 1, 2008, Congress discontinued its longstanding moratoria on new leasing in the Atlantic, Pacific and a portion of the Eastern Gulf of Mexico, making most of the OCS available for consideration of leasing in a new program. (Most of the Eastern Gulf of Mexico and a portion of the central Gulf of Mexico are under moratorium until 2022, pursuant to GOMESA).

The Draft Proposed Program (DPP) issued January 16, 2009, is the second step in a multi-year process to develop a new oil and gas leasing program. The DPP seeks public comment on all aspects of a new program beginning as early as 2010 including conventional and renewable energy development and economic and environmental issues in the OCS areas.

On February 10, 2009, Secretary Salazar announced his strategy for developing an offshore energy plan that includes conventional and renewable energy resources. As part of his plan, the comment period for the DPP was extended for an additional 180 days to September 21, 2009, in order to provide additional time for input from

states, stakeholders and affected communities. Also, Secretary Salazar directed the MMS and the U.S. Geological Survey to assemble a report on offshore energy resources along with information regarding sensitive areas and resources in the OCS. This report will synthesize the vast knowledge-base on OCS energy resources and environmental factors in one concise document. The report will be delivered to the Secretary at the end of this month. Following the publication of the report, the Secretary will conduct four regional meetings, one each for the Gulf Coast, Pacific Coast, Atlantic Coast, and Alaska in an effort to gain insight and comment from all stakeholders in OCS energy.

MMS's 2008 Deepwater Gulf of Mexico Report and Deepwater Development

The MMS report *Deepwater Gulf of Mexico 2008: America's Offshore Energy Future* highlights the activities, trend analyses and technological advancements in this important portion of the Gulf of Mexico for 2007. Deep water has continued to be a very important part of the total Gulf of Mexico production, providing approximately 72 percent of the oil and 38 percent of the gas from the region. In 2007, MMS approved 15 new technologies for use in the deepwater Gulf of Mexico.

Deepwater continues to play an important role in our nation's energy portfolio with 15 deep water discoveries announced in 2008. Figure 5 denotes these discoveries and their development options. Operators of the Kodiak and the Freedom/Gunflint discoveries have indicated that these discoveries could add significant new oil production. Several of the natural gas discoveries are already under development as subsea tiebacks and additional natural gas discoveries are planned for subsea tieback.

The year 2008 was an active year for leasing activity with 679 leases covering about 3.9 million acres issued in the deep waters of the Eastern, Central, and Western Gulf of Mexico. About 74 percent of the acres leased in the Gulf of Mexico OCS in 2008 were in water depths greater than 400 meters. Bonus bids accepted for deep water leases accounted for nearly 93 percent of all bonus bids accepted in 2008, suggesting that this deep water acreage is some of the most promising acreage leased in the Gulf of Mexico.

Renewable Energy

The EPO encourages the development of renewable energy resources as part of an overall strategy to develop a diverse portfolio of domestic energy supplies for our future. The quantity of domestic renewable energy produced on Federal lands is currently small in comparison to conventional resources. However, the need to diversify our energy portfolio and transition to a clean energy economy has spurred an increased interest in renewable energy development on federal lands both onshore and offshore, and the potential for increased use of these resources is great.

The EPO granted the Department discretionary authority to grant leases, easements or rights-of-way for activities on the OCS that produce or support production, transportation, or transmission of energy from sources other than oil and gas. Simply put, the new authorities gave the Department the ability to manage the future development of promising new ocean energy sources in the OCS such as wind, wave, ocean current, and solar energy. Additionally, the Department was given the authority to grant leases, easements, or rights-of-way for other OCS activities that make alternate use of existing OCS facilities. These other uses would be limited to energy-related and authorized marine-related purposes, such as offshore research, recreation and support for offshore operations to the extent that those activities are not authorized by other applicable law.

Secretary Salazar has stated his commitment to issuing a final rulemaking to encourage orderly, safe, and environmentally responsible development of renewable energy resources and alternate use of facilities on the OCS. The publication of a final rulemaking is pending a thorough analysis by the Administration to ensure its completeness and clarity in promoting the sound development of OCS renewable energy resources.

The MMS completed a programmatic EIS in November 2007, which examines the interface between the marine and human environments and the technologies and activities that generate energy from ocean renewable energy resources. While the Department is the lead agency for this program, the MMS continues to work with its sister agencies to make certain that the unique role of each agency is considered and addressed in order to ensure that the Federal Government's myriad interests in such projects are fully considered and that the Nation's economic, environmental and land use interests are adequately protected.

The MMS has also evaluated the Cape Wind Energy Project identified by EPO for concurrent consideration along with the ongoing rulemaking process. The Final EIS, which assesses the physical, biological and social/human impacts of the pro-

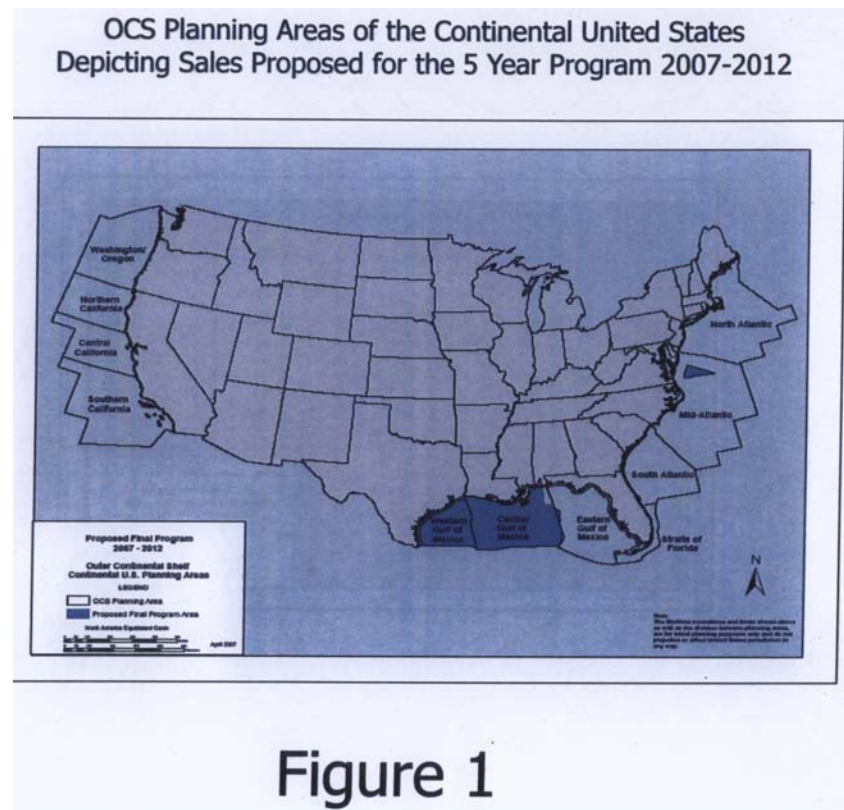
posed Cape Wind Energy Project as well as all reasonable alternatives and proposed mitigation, was announced on January 16, 2009. A Record of Decision on Cape Wind is pending.

The MMS's renewable energy program is an integral component of Secretary Salazar's commitment to a comprehensive energy plan for the OCS. Indeed, developing a comprehensive plan for offshore energy development is our focus as we compile our comprehensive report and conduct regional meetings to gather more insight into both renewable and conventional energy development.

Conclusion

With President Obama identifying clean energy as an issue critical to our Nation's economic recovery, the Department and MMS are poised to play a vital role as the manager of OCS energy resources, both conventional and renewable. As the MMS now embarks on providing an orderly, safe, and environmentally responsible program to develop renewable energy on the OCS, we continue our stewardship role in managing the Federal offshore oil and gas, and mineral resources. The magnitude and complexity of being a responsible steward requires a continued commitment to balance our Nation's energy needs with environmental protection, safe operations, and receipt of fair returns for Federal resources.

We welcome your input on our Nation's energy initiatives and look forward to working with the Committee as we move forward with our OCS energy and minerals programs.



Pace of Leasing

Fiscal Year*	Leases Issued	Acres Leased	Planning Areas Offered
2008	1,439	7,996,920	ChukSea; CGOM; EGOM; WGOM
2007	1,046	5,760,793	BeauSea; CGOM; WGOM
2006	763	4,122,703	CGOM; WGOM
2005	872	4,635,967	BeauSea; CGOM; EGOM; WGOM
2004	888	4,689,702	CGOM; WGOM
2003	923	4,848,116	BeauSea; CGOM; EGOM; WGOM
2002	804	4,192,904	CGOM; WGOM
2002-2008	6,735	36,247,105	BeauSea; ChukSea; CGOM; EGOM; WGOM

*Sales Held in Fiscal Year/Leases Issued over time

Figure 4

MMS Gulf of Mexico Region 2008 Announced Deepwater Discoveries

Prospect Name	Area and Block	Operator	Water Depth	Development Options
			(feet)	
Diamond	Lloyd Ridge 370	Murphy	9,975	Subsea or New Gas Hub
Hal	Walker Ridge 848	StatoilHydro	7,657	Lease Expired
Tortuga	Mississippi Canyon 561	Noble Energy	6,302	Potential Subsea Tieback
Freedom/Gunflint	Mississippi Canyon 948	BP/Noble Energy	6,090	Potential Significant New Oil
Dalmatian	Desoto Canyon 48	Murphy	5,876	Planned Subsea Tieback
Kodiak	Mississippi Canyon 771	BP	4,986	Potential Significant New Oil
	Green Canyon 448	LLOG	3,266	Planned Subsea Tieback
Gladden	Mississippi Canyon 800	Newfield	3,116	Subsea Gas Development
	Mississippi Canyon 503	LLOG	3,099	Planned Subsea Tieback
Geauxpher	Garden Banks 462	Mariner Energy	2,820	Subsea Gas Development
Anduin West	Mississippi Canyon 754	Newfield	2,696	Subsea Gas Development
Sargent	Garden Banks 339	Deep Gulf Energy	2,180	Subsea Gas Development
	Mississippi Canyon 72	LLOG	2,013	Planned Subsea Tieback
	Vlosca Knoll 821	Walter Oil & Gas	1,030	Subsea Gas Development
	Green Canyon 141	LLOG	1,003	Potential Subsea Tieback

Figure 5

Mr. COSTA. Thank you, and I am sure there will be questions. And that now brings us to our next witness, Ms. Mary Kendall. We thank Ms. Kendall here, who will testify on behalf of the Inspector General's Office within the Department of the Interior.

**STATEMENT OF MARY L. KENDALL, ACTING INSPECTOR
GENERAL, U.S. DEPARTMENT OF THE INTERIOR**

Ms. KENDALL. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to be here to testify about the findings of the Office of the Inspector General for the Department of the Interior concerning oil and gas royalty collection programs.

The OIG has devoted many resources over the past three years to overseeing Minerals Management Service, the bureau that collects royalties from offshore oil and gas drilling.

We discovered weaknesses in the internal oversight of royalties, in the drafting of leases, the underpayment of royalties and serious ethical lapses. Most recently, we completed an evaluation of the status of nonproducing Federal oil and gas leases both on and offshore.

In addition to some very challenging data integrity and lease oversight issues, we found that BLM and MMS need to develop much clearer policy concerning the expectations of production of oil and gas on Federal lands.

We found that oil and gas companies that own Federal drilling leases have little obligation to actually produce, and the Department has no formal policy to compel companies to bring these leases into production. Both industry and Bureau officials cautioned, however, that mandating production activities may not necessarily have positive outcomes and could in fact be counterproductive by reducing industry interest in Federal leases.

Our evaluation revealed three primary factors that account for the nonproducing status of so many Federal oil and gas leases, the first being data integrity issues.

In its publicly accessible data, MMS reported that less than half of all Federal oil and gas leases in the United States are producing. Without more information, these data suggest that existing leases are underutilized but do nothing to explain why.

We looked behind the reported data with hopes of making this determination. Unfortunately, we found that both MMS and BLM employ inconsistent procedures and definitions and that BLM's records are often incomplete and inaccurate, all of which call into question both the integrity and usefulness of their data.

Due to incompatible data in the tracking systems used by the two bureaus, we found that DOI is at risk of losing millions of dollars in royalties. The existing process is heavily reliant upon companies doing the right thing.

We also found inconsistencies in how BLM and MMS define and report on the status of leases. Leases that are identified as producing by BLM may be reported as nonproducing by MMS.

Industry also cited a number of obstacles to production. Despite the best expectations, millions of dollars are spent on exploration and drilling of wells that result in no actual production.

Fluctuating prices have a direct influence on project planning. Regulatory restrictions and requirements make developing onshore Federal oil and gas leases difficult, expensive and time-consuming. A shortage of drilling rigs is a worldwide problem, as are transportation availability and a shortage of oil and gas field workers.

Additionally, litigation and public opposition to oil and gas production have a significant impact on the ability of leaseholders to conduct development activities.

Finally, there is limited statutory and regulatory support for promoting production. A number of laws and regulations direct and guide the Department on all aspects of oil and gas leasing but include only general due diligence provisions concerning production. The Department has done little to provide specific guidance to lessees on the due diligence production requirements.

Other OIG efforts that are ongoing are in the other energy areas, which include an audit of MMS's process for verifying oil volumes delivered as royalty-in-kind, including oil destined for the Strategic Petroleum Reserve.

In addition, we are reviewing the status of the recommendations advanced to MMS by the Royalty Policy Committee, the OIG and GAO. We also have several law enforcement efforts ongoing concerning the underpayment of royalties, and we have queued up evaluations of the onshore lease auction process that BLM employs, the inspection and enforcement program for onshore leases, and the wind, solar and geothermal energy programs for the near future.

Mr. Chairman, this concludes my testimony. I would respectfully request that my written testimony be accepted by the Subcommittee and made part of the record. I would like to thank you for this opportunity to testify today and would welcome any questions.

[The prepared statement of Ms. Kendall follows:]

**Statement of Mary Kendall, Inspector General (Acting),
U.S. Department of the Interior**

Mr. Chairman, members of the subcommittee, thank you for the opportunity to appear today and testify about the findings of the Office of Inspector General (OIG) for the Department of the Interior's (DOI) regarding oil and gas royalty collection programs within the DOI. As you know, DOI's revenue collection volume is one of the highest of any department in the federal government. Especially in these fiscally precarious times, the value to the taxpayers of these collection programs is very important, indeed.

The OIG has devoted many resources over the past 3 years to understanding, auditing, evaluating and investigating the role of DOI bureaus and offices that collect royalties from offshore oil and gas drilling. We discovered weaknesses in the oversight of royalties, in communications in the drafting of leases, the under-payment of royalties, and a culture in the Royalty-In-Kind program where employees felt exempt from the ethics rules that govern all other federal employees.

We recently completed an evaluation, at the request of Chairman Dicks for the Interior and Environment Subcommittee of the House Appropriations Committee, concerning the status of non-producing federal oil and gas leases. In addition to some very challenging data integrity and lease oversight issues, we found that the Bureau of Land Management (BLM) and Minerals Management Service (MMS) need to develop much clearer policy concerning the expectations of production of oil and gas on federal lands. We recommended that the Department consult with Congress in this regard.

With respect to non-producing leases, we found that oil and gas companies that own federal drilling leases have little obligation to actually produce. The Department has no formal policy to compel companies to bring these leases into production. While current statutes, regulations and policies do promote exploration, production activities are not required to commence within the primary lease term. The bureaus do not inquire about the production strategies of companies and have not attempted to enforce the performance clause included in lease agreements. Both industry and bureau officials cautioned, however, that mandating production activities

may not necessarily have positive outcomes, and could, in fact, be counter-productive by reducing industry interest in federal leases.

With few exceptions, the Department does not track oil and gas leases until a company applies for an Application for Permit to Drill (APD). This means it may be years before the Department records any data about a lease. There being no mandate to track a lease, MMS and BLM do not begin tracking until the lease holder applies for an APD and exploratory activity begins or the primary term of the lease ends.

Our evaluation revealed three primary factors that account for—or, fail to account for—the non-producing status of so many federal oil and gas leases. These factors are: data integrity issues in the MMS and BLM systems; a litany of obstacles cited by oil and gas companies; and, limited statutory and regulatory requirements on either DOI or industry to promote production.

We believe that improved and more comprehensive data would assist in instituting a monitoring program for non-producing leases and paint a much more accurate picture of the production status of DOI leases. Similarly, a better understanding of the processes and problems leading to production would lead to a more accurate perception by the public of the production status of DOI leases. Further, more explicit statutory and/or regulatory mandates would contribute to clearer expectations on the parts of both DOI and the oil and gas industry.

Data Integrity Issues

We found numerous data integrity issues during our evaluation. In its publicly accessible data, MMS reports less than half—or 41 percent—of all federal oil and gas leases in the United States are producing. Without more information, these data suggest that existing leases are underutilized, but do nothing to explain why. We looked behind the reported data with hopes of making this determination. Unfortunately, we found that both MMS and BLM employ inconsistent procedures and definitions and that BLM's records are often incomplete and inaccurate, all of which call into question both the integrity and usefulness of their data.

Due to incompatible data in the tracking systems used by BLM and MMS, both of which are responsible for overseeing these leases, we found that DOI is at risk of losing millions of dollars in royalties. In one case, a breakdown in communications between MMS and BLM could have resulted in a loss of nearly \$6 million in royalties over a 5-year period, had the company holding the leases not sent its first production report to both bureaus, not just BLM. The existing process is heavily reliant upon companies doing the right thing.

We also found inconsistencies in how MMS and BLM define and report on the status of leases. Leases that are identified as producing by BLM may be reported as non-producing by MMS. We identified over 1,400 onshore leases that were reported as producing by BLM. When we selected a random sample to determine how these leases were identified by MMS, 70 percent of the sample was reported as non-producing.

From the beginning of our planning efforts for the evaluation, we were confronted with lease data availability and reliability issues that hindered our progress. For example, BLM reported 6,198 non-producing leases (19 percent) with no expiration dates (only producing leases should have no expiration dates). In addition, there were 528 producing leases that had expiration dates. Other data errors we found include leases that had terms of 8,000 years (expiration date was January 1, 9999), leases with no effective dates, and leases with negative lease terms (leases expired before the effective date).

Industry Cites Obstacles

As we were conducting our field work, the Government Accountability Office (GAO) issued a report in October 2008 in which it identified business, geologic and regulatory factors influencing companies' decisions to develop oil and gas leases. During our review, we obtained additional information from 11 oil and gas companies that held oil and gas leases, 3 oil and gas industry organizations, Interior bureaus, subject-matter experts, and our review of leases on each of these three factors. Finally, industry cited resource availability as having an effect on the production status of leases, including technology, equipment, infrastructure and workforce.

The exploration and production of oil and gas requires significant capital investment. And, it requires careful planning while considering many variables, such as variations in commodity prices, escalating material and labor costs, drilling and transportation infrastructure, lease and capital acquisition, and regulatory concerns.

Despite the best expectations, millions of dollars are spent on exploration and drilling of wells that result in no actual production. Fluctuating prices can have a direct influence on project planning. For instance, the recent downward spiral in oil

and gas prices during the second half of 2008 directly resulted in decreased domestic exploration and production.

Some leases may be considered non-producing because of geological factors. Seismic data for oil and gas inform industry as to the size of a potential reservoir and, therefore, assist in the determination of how many lease blocks to acquire. Once exploration starts and the reservoir is better defined, the leases on the outer edges of the reservoir may not be developed and therefore remain non-producing.

Regulatory issues also are a factor. Federal leases usually have a lower royalty rate than state or private leases. But developing onshore federal oil and gas leases is much more difficult, expensive and time-consuming. In large part, this is due to regulatory restrictions and requirements. These requirements are designed to protect many of the natural, environmental, historical, and cultural resources contained on federal lands. But they can also severely limit the amount of time in which companies are allowed to access the land to conduct operations. Rig availability and cost can become significant hurdles.

The increasing challenges for discovering and accessing new oil and gas reserves have caused a sharp demand for technological advancements, which can also delay exploration and production. As a result, there is a shortage of drilling rigs worldwide, causing further delays. If oil and gas is discovered and a rig is available, industry cites other challenges such as transportation availability and a shortage of oil and gas field workers.

Finally, we found that litigation and public opposition to oil and gas production have significant impact on the ability of lease holders to conduct development activities. Industry advocacy groups emphasized this point, citing a dramatic increase in opposition that begins even prior to lease issuance and continues throughout the development process.

Limited Statutory and Regulatory Support for Promoting Production

A number of laws and regulations direct and guide the Department on all aspects of oil and gas leasing. They also contain more general “due diligence” provisions concerning production, requiring lessees to take affirmative action toward diligently developing their leases.

The Department has done little to provide specific guidance to lessees on the “due diligence” production requirements. While leases typically include a performance clause to promote or compel production, the Department has not definitively established the authority in lease terms, regulations, or past enforcement actions. For the vast majority of leases—99 percent—the Department does not monitor to ensure that due diligence is exercised. Accordingly, none of these leases is terminated for failure to produce. Rather, the Department allows these leases to expire naturally.

Other OIG Efforts

We are presently conducting an audit of MMS's process for verifying oil volumes delivered as RIK, including oil destined for the Strategic Petroleum Reserve. In addition, we are reviewing the status of the recommendations advanced to MMS by the Royalty Policy Committee in 2007. At the request of MMS, we have expanded this review to include recommendations by OIG and GAO. MMS estimates that there are approximately 200 recommendations by these three entities, some of which overlap and some that may conflict with one another. We also have several law enforcement efforts ongoing concerning the underpayment of royalties. And we have queued up evaluations of the onshore lease auction process that BLM employs, the Inspection and Enforcement Program for onshore leases, and the wind and solar energy programs for the near future.

Mr. Chairman, that concludes my testimony. I would respectfully request that my written testimony be accepted by the Subcommittee and made part of the record. I would like to thank you for the opportunity to testify today and would welcome any questions you might have.

March 17, 2009



GAO
Accountability Through Integrity
Highlights

Highlights of GAO-09-506T, a testimony before the Subcommittee on Energy and Mineral Resources, Committee on Natural Resources, House of Representatives

Why GAO Did This Study

In fiscal 2008, the Department of the Interior (Interior) collected over \$22 billion in royalties and other fees related to oil and gas. Interior's Bureau of Land Management (BLM) and Minerals Management Service (MMS) manage federal onshore and offshore oil and gas leases, respectively. Acquiring a federal lease gives the lessee the rights to explore for and develop the oil and gas resources under the lease, including drilling wells and building pipelines that may lead to oil and gas production.

This statement focuses on findings from a number of recent GAO reports on federal oil and gas management. GAO has made numerous recommendations to Interior, which the agency generally agreed with and is taking steps to address. However, two important issues remain unresolved. Specifically, GAO made one recommendation and one matter for Congressional consideration that together call for a comprehensive re-evaluation of how Interior manages federal oil and gas resources. Interior has not undertaken such a comprehensive review and until this is done, the public cannot have reasonable assurance that federal oil and gas resources are being appropriately managed for the public good.

View GAO-09-506T or key components. For more information, contact Frank Rusco at (202) 512-3841 or ruscof@gao.gov.

OIL AND GAS LEASING

Federal Oil and Gas Resource Management and Revenue Collection in Need of Comprehensive Reassessment

What GAO Found

In recent years, GAO has conducted numerous evaluations of federal oil and gas management and found many material weaknesses. Key among the findings in these reports are:

- Interior does less to encourage development of federal oil and gas leases than some state and private landowners. For example, the eight states GAO reviewed used more tools to encourage development on their oil and gas leases, using increasing rental rates as well as shorter lease terms and escalating royalty rates. Some states also do more than Interior to structure leases to reflect the likelihood of oil and gas production, which may encourage faster development.
- The annual number of federal oil and gas leases issued and the pace of development have generally increased in recent years. Several factors influence industry's decisions to acquire and develop federal oil and gas leases, including oil and gas prices; the availability and cost of equipment; the geology of the land underlying the lease; and regulatory issues, such as limitations on when drilling can occur.
- Development and production activity in a sample of leases issued from 1987 through 1996 varied considerably. Development occurred on about 26 percent of offshore and 6 percent of onshore leases issued, but production was less frequent, with about 12 percent of offshore leases and 5 percent of onshore leases ultimately achieving production. Shorter leases were generally developed more quickly than longer leases, but not as frequently.
- MMS and BLM employ different practices for deciding which federal properties to lease and when, and could do more to encourage faster development of certain federal oil and gas leases that are relatively more likely to have significant oil and gas resources.
- BLM has encountered persistent problems in hiring and retaining sufficient and adequately trained staff to keep up with workload as a result of rapid increases in oil and gas operations on federal lands.
- The federal government receives one of the lowest shares of revenue for oil and gas resources compared with other countries and Interior has not systematically re-examined how the federal government is compensated for extraction of oil and gas for over 25 years.

In recent reports, GAO has made a number of recommendations to improve the accuracy of oil and gas royalty measurement and collections and to improve the overall management of federal oil and gas resources.

Response to questions submitted for the record by Mary L. Kendall

Questions from Chairman Jim Costa

1. **Ms. Kendall, the report by the Inspector General's office points out that the 8-year offshore lease is the only case of a federal oil and gas lease that has a specific performance requirement prior to the end of the primary term of the lease, in this case the lessee is required to drill a well in the first five years of the lease. Ms. Kendall, do you believe that including performance requirements such as this on other federal oil and gas leases would be a positive way for the government to encourage diligent development, and when and where do you think it might be appropriate?**

Response: For leases located in “frontier” regions, such as deepwater leases in the Gulf of Mexico and previously undrilled onshore regions, a performance requirement would likely have little benefit. In these areas, companies tend to need the full 10-year primary term to begin production work. However, for well established producing onshore and offshore areas requiring less up-front geophysical study and fewer development costs, a performance clause may be more practical. Nevertheless, as discussed in our report, oil and gas development is usually a prolonged process and companies indicated a need for an inventory of leases to enable long-term planning.

2. **Ms. Kendall, your testimony discusses \$6 million in royalties that could have been lost due to miscommunication between MMS and BLM. Please provide more detail about this specific occurrence. Can you make any estimates on how common problems like this might be, based on how much effort it took your office to identify this particular example, or based on any other factors?**

Response: The incident described in the report involved leases owned by EnCana Oil and Gas, Inc. located in Garfield and Mesa counties in western Colorado, a major natural gas producing area. The BLM Colorado State Office and the Glenwood Springs Field Office have jurisdiction over these leases. Royalty payments started in December 2003; however, BLM did not have documentation in their files for when EnCana notified BLM of first production. In addition, MMS did not have any documentation in their files that BLM notified MMS of EnCana's first production. After we notified BLM of this problem, the Glenwood Springs Field Office notified the Colorado State Office of the status of these leases on February 5, 2009. BLM needs to be vigilant on industry activity due to the large number of wells and leases that the bureau oversees. In Colorado alone, BLM manages 8,161 wells on 1,977 leases. Nationwide, the bureau manages 127,858 wells on 22,959 leases.

Because we did not use scientific sampling techniques during our fieldwork, we cannot estimate with precision how common such incidents may occur. Nevertheless, 4 of the 60 leases (7 percent) in our sample did have the problem, so it can logically be reasoned that this was not an isolated case.

3. **Ms. Kendall, one of the major themes that was present in your written testimony, and also arose during the discussion at the hearing, was the idea that the MMS leasing program is more comprehensive and methodical than the BLM onshore leasing program. To your knowledge, are there any reasons why an MMS-style leasing program—with multiyear planning, minimum acceptable bids, and other features that are unique to MMS—would not be appropriate for the onshore leasing program?**

Response: In a separate evaluation that began in January, we are examining various aspects of the BLM lease auction process. As part of that review, we are comparing various aspects of the leasing programs managed by both BLM and MMS, and hope to determine if MMS has best practices that BLM should adopt. Concerning minimum acceptable bids, many years ago BLM developed minimum bid amounts for leases located in known geological structures. However, the bureau discontinued the practice because it could not reliably predict the value of the production that could be extracted from the leases.

4. **Ms. Kendall, both the IG and GAO make it clear that when companies get a 10-year lease, they get extensions provided they have initiated drilling activities by the end of those 10 years. Is there any reason a company can't get the lease, hold it in an inactive state for 9 years and 11 months, then start drilling a well right before the expiration date and get the 2 additional years automatically? Are there any requirements for leaseholders to do anything on their 10-year leases prior to the end of the primary term?**

Response: At the company's discretion, it may begin production activities at the tail end of the primary term and receive an extension, since there is no requirement to develop the lease during the primary term. In fact, as long as the leaseholder pays the required annual rental payments on a timely basis, it may even choose never to develop the lease. In this case, the lease would administratively expire after 10 years.

5. **Ms. Kendall, have either of you taken a look at the oil and gas activities of the Bureau of Indian Affairs? Is there any sense of whether they have similar problems as BLM when it comes to data reliability and communication with MMS?**

Response: We did not look at the oil and gas activities of the Bureau of Indian Affairs during our review, and so we do not know if the bureau has similar issues as BLM. We do plan to conduct reviews of BIA's energy leasing activities in the future.

6. **Ms. Kendall, do you believe that it would make sense—either fiscally, environmentally, or from a diligent development viewpoint—for the BLM to extend the term of leases to take into account stipulations that limit the amount of time that lessees can conduct operations on their leases?**

Response: As noted in our report, MMS and BLM are inconsistent in their administration of seasonal restrictions. Whereas MMS extends a lease for the accumulated length of time an operator is not physically allowed on the premises, BLM does not grant an extension. It may be fair for BLM to adopt the MMS practice, although, from a diligent development perspective, we could not verify that approving time extensions has resulted in increased production activity.

7. **Ms. Kendall, your report points out that BLM may impose a diligence requirement for onshore units, such as requiring a well to be drilled every six months. Do you have any data that indicates how many leases they have imposed that diligence requirement on?**

Response: We did not determine the number of leases on which the diligence requirement has actually been imposed. However, BLM manages about 1,400 units and bureau policy is to require that a well be drilled somewhere on the unit at least once every six months until production is established.

Questions from Ranking Member Doug Lamborn

1. **How many leases offered by the federal government had no diligence requirement in the lease?**

Response: We did not research the number of leases that contain the performance (diligence) clause, but for many years this has been standard language contained in both offshore and onshore federal leases. It is likely that the vast majority of federal leases include the clause.

2. **How much do you believe the additional reporting and accounting suggestions which you made for BLM and MMS might cost?**

Response: We do not have an estimate of the costs, as this would depend on the level of oversight the bureaus choose to conduct. The costs for both industry and government could be kept to a minimum if the bureaus keep the process informal and merely request that lessees provide an annual update on the development progress on federal leases.

3. **Do you believe those accounting changes will result in any additional oil production on federal lands?**

Response: Because development decisions are ultimately controlled by oil and gas companies, improved accounting on the part of the government would probably not result in additional production. Rather, the benefit of these accounting changes would be increased transparency about the status of activity on federal oil and gas leases. In fulfilling their roles as responsible land managers, the bureaus may find this information useful.

Mr. COSTA. Thank you very much. We appreciate your timeliness.

And that brings us to Mr. Frank Rusco, the director for natural resources and the environment at the U.S. Government Accountability Office, and I made reference earlier to the GAO Report. Mr. Rusco?

STATEMENT OF FRANK RUSCO, DIRECTOR, NATURAL RESOURCES AND ENVIRONMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. RUSCO. Thank you, Mr. Chairman and Members of the Subcommittee. I am pleased to be here today to discuss the Department of the Interior's management of Federal oil and gas leasing. Interior's Bureau of Land Management oversees Federal onshore oil and gas leases while Interior's Minerals Management Service oversees offshore leases and collects revenues for all Federal leases.

The past 15 years have been a volatile period in energy markets. For example, the spot price of West Texas Intermediate crude oil, a commonly used benchmark for world oil prices, was near to \$10 per barrel in the late 1990s. It rose as high as \$146 last summer and currently sits around \$46 per barrel.

Similarly, the monthly average price of natural gas at the well-head was as low as \$1.43 per thousand cubic feet in 1995. It rose to near \$11 in June 2008 before falling and last December was down to \$5.87.

Oil and gas company profits rise and fall with oil and gas prices, as do oil and gas development to some extent.

In recent years, there has been an increase in the annual number of new oil and gas leases sold by BLM onshore and MMS offshore but an even more rapid increase in the amount of development activity and drilling on these and already existing leases.

In the past five years, GAO has found many deficiencies in Interior's management practices that raise doubts about the accuracy of oil and gas production data and revenue collection. We have made numerous recommendations to improve Interior's practices, and Interior has generally agreed with and is implementing most of these recommendations.

My statement today will discuss two areas in which Interior has not fully agreed with, nor addressed, important recommendations to comprehensively reevaluate its revenue collection and lease management practices and policies.

First, the Federal government collects a smaller share of oil and gas revenue than do most other resource owners for which we have information. According to a study by one of the preeminent energy consultancies, the share of oil and gas revenue collected by the Federal government on Gulf of Mexico leases ranked 93rd lowest of 104 resource owners, including most major oil-producing countries and regions.

The Federal revenue collection system is also relatively unstable because it collects a large share of oil and gas company revenues when these companies' profits are low and a smaller share of revenue when profits are high. This system has led to ad hoc adjustments to royalty rates.

For example, in the mid-1990s, low oil and gas prices prompted companies to seek and Congress to grant royalty relief for deepwater leases sold in the Gulf of Mexico between 1996 and 2000. For two of these years, this royalty relief was not linked to thresholds for oil and gas prices. As a result, when prices of these commodities rose, the royalty relief on these leases was not removed. Litigation by one company has challenged the authority of the Secretary of the Interior to apply thresholds on any of the deepwater leases granted royalty relief.

GAO reported last year that the cost to the Federal government in terms of forgone royalty revenues as a result of this litigation could be in the range of between 21 and 53 billion dollars.

In contrast to the mid-1990s, in 2007, when oil and gas prices were high and rising, Interior twice increased royalty rates for new leases in the Gulf of Mexico. Subsequently, prices of oil and gas fell significantly.

We recommended that Interior undertake a comprehensive reevaluation of how much and how it collects revenues from oil and gas companies and that it convene an expert panel, including industry representation, to do so.

We also recommended that Interior evaluate revenue collection systems that increase the share of revenue collected when prices and profits are high and decrease the share when prices and profits are low to reduce the likelihood of future ad hoc adjustments to royalty rates.

Second, Interior could do more to encourage diligent development of Federal leases. Some states and private landowners use more tools than Interior to encourage rapid development of oil and gas. For example, some charge rental rates that escalate significantly over time unless and until companies develop the leases and begin paying royalties. While Interior does include escalating rental rates, both the initial rental rates and the escalation are small compared to some states and private landowners.

Some states and private landowners also use shorter lease terms for lands that are deemed to be more likely to produce significant volumes of oil and gas and longer lease terms for more speculative properties. In contrast, Interior does not make distinctions in its lease terms for how productive the agency believes a lease will be.

We recommended that Interior undertake a comprehensive reevaluation of its lease management practices to determine if it could apply some of these tools, particularly on leases that are most likely to produce economic volumes of gas and oil.

To conclude, Interior has not undertaken a comprehensive look at its oil and gas revenue collection and lease management policies for over 25 years despite a great deal of change in the oil and gas industry.

We believe that without such a reevaluation, the public will not have a reasonable assurance that it is receiving an appropriate share over time of oil and gas revenues produced on Federal leases and that the management of these leases is done efficiently and in the public interest.

Thank you. This concludes my statement. I would be happy to answer any questions the Subcommittee may have.

[The prepared statement of Mr. Rusco follows:]

**Statement of Frank Rusco, Director, Natural Resources and Environment,
U.S. Government Accountability Office**

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to participate in this hearing to discuss the Department of the Interior's management of federal oil and gas leases. In Fiscal Year 2008, the Department of the Interior (Interior) collected over \$22 billion in royalties for oil and gas produced on federal lands and waters, purchase bids for new oil and gas leases, annual rents on existing leases, making revenues from federal oil and gas one of the largest nontax sources of federal government funds. Within Interior, the Bureau of Land Management (BLM) manages onshore federal oil and gas leases and the Minerals Management Service (MMS) manages offshore leases, while MMS is responsible for collecting royalties for all leases. In recent years, GAO and others, including Interior's Inspector General have conducted numerous evaluations of federal oil and gas management and revenue collection processes and practices and have found many material weaknesses. These weaknesses place an unknown but significant proportion of royalties and other oil and gas revenues at risk and raise questions about whether the federal government is collecting an appropriate amount of revenue for the rights to explore for, develop, and produce oil and gas on federal lands and waters. Specifically, our recent work has found the following:

- Interior does less to encourage development of federal oil and gas leases than some state and private landowners. Interior officials cited one lease provision that may encourage development—escalating rental rates. For example, the rental rates for 10-year onshore federal leases increase from \$1.50 per acre per year for the first 5 years to \$2 per acre per year for the next 5 years. Compared to Interior, the eight states we reviewed undertook more efforts to encourage development on their oil and gas leases, using increasing rental rates as well as shorter lease terms and escalating royalty rates. Some states also do more than Interior to structure leases to reflect the likelihood of oil and gas production, which may encourage faster development. Specifically, while Interior uses varying lengths for offshore leases, with deeper waters receiving longer lease terms, this provision is not explicitly related to the expected productivity of the lease. On the other hand, five of the states that we reviewed—Alaska, Louisiana, Montana, New Mexico, and Texas—vary lease lengths or royalty rates to reflect the likelihood that the lease will produce. We also found that private landowners have used various leasing methods to encourage faster development, including lease terms as short as 6 months.
- The annual number of federal oil and gas leases issued and the pace of development have generally increased in recent years. Over the past 20 years, the total number of oil and gas leases Interior issued has varied each year but generally increased in recent years, as has the amount of development activity, and industry officials told us that a range of factors influence their decisions to acquire and develop leases. The number of offshore leases issued annually from 1987 through 2006 had two large peaks—in 1988 and 1997—and has generally been increasing since 1999. Onshore leases peaked in 1988 and then declined until about 1992, remaining at these lower levels until about 2003 when they increased, coinciding with rising oil and historically higher natural gas prices. Drilling and production activity on federal leases was higher from 1997 through 2006 than from 1987 through 1996, but the increase was more dramatic for onshore leases. Industry officials told us that several factors influence their decisions to acquire and develop federal oil and gas leases, including oil and gas prices; the availability and cost of equipment; the geology of the land underlying the lease; and regulatory issues, such as limitations on when drilling can occur.
- Development and production activity in a sample of leases issued from 1987 through 1996 varied considerably. We reviewed data on about 55,000 offshore and onshore federal leases issued from 1987 through 1996—those that have exceeded their primary 10-year lease terms. We then tracked development activity on that sample of leases through 2007 to determine what, if any, development activity occurred, and at what point in time. We identified three key findings regarding development. First, development occurred at some point during the period 1987-2007 on about 26 percent of offshore and 6 percent of onshore leases in the sample. Production was less frequent, with about 12 percent of offshore leases and 5 percent of onshore leases ultimately achieving production. Second, shorter leases were generally developed more quickly than longer leases, but not as frequently during the term of the lease. Finally, for those leases that eventually produced oil or gas, a substantial amount of the initial

drilling activity—about 25 percent onshore—took place after the scheduled expiration of the lease, following a lease extension.

- MMS and BLM employ different practices for deciding which federal properties to lease and when, determining the initial length of the lease, and determining the price at which the leases are sold. In addition, some states and private resource owners use more tools than the federal government, including incentives for early development or penalties for later development, to encourage rapid development, particularly of leases that are deemed to be likely to contain significant oil and gas resources. In this regard, we found that Interior could do more to encourage faster development of certain federal oil and gas leases that are relatively more likely to have significant oil and gas resources.¹
- BLM has encountered persistent problems in hiring and retaining sufficient and adequately trained staff to keep up with an increasing workload as a result of rapid increases in oil and gas operations on federal lands. For example, between 1999 and 2004, when applications for permits to drill more than tripled, BLM was unable to keep up with the commensurate increase in its workload, in part, as result of an ineffective workforce planning process, the lack of key data on workload activities, and a lack of resources. As a result of this staffing shortfall, BLM was unable to meet its requirements to mitigate environmental impacts of oil and gas development.² More recently, we reported that BLM's inability to attract and retain sufficient trained staff have kept the agency from meeting requirements to inspect drilling and production of oil and gas on federal lands. This puts federal revenues at risk because when inspections are made, violations have been found, including errors in the volumes of oil and gas reported by operators to MMS.³
- The federal government receives one of the lowest shares of revenue for oil and gas resources compared with other countries. For this and other reasons, the United States is an attractive country for investment in oil and gas development. Specifically, in 2007, the revenue share that the federal government collects on oil and gas produced in the Gulf of Mexico ranked 93rd lowest of 104 revenue collection regimes around the world that were studied. However, despite significant changes in the oil and gas industry over the past several decades, Interior has not systematically re-examined how the federal government is compensated for extraction of oil and gas for over 25 years. In contrast, some other countries have recently increased their shares of revenues as oil and gas prices rose and, as a result, will collect between an estimated \$118 billion and \$400 billion, depending on future oil and gas prices.⁴
- In 1995, a time when oil and natural gas prices were significantly lower than they are today, Congress passed the Outer Continental Shelf Deep Water Royalty Relief Act (DWRRA), which authorized MMS to provide “royalty relief” on oil and gas produced in the deep waters of the Gulf of Mexico from certain leases issued from 1996 through 2000. This “royalty relief” waived or reduced the amount of royalties that companies would otherwise be obligated to pay on the initial volumes of production from leases, which are referred to as “royalty suspension volumes.” We recently reported that litigation over this royalty relief for deep water leases sold between 1996 and 2000 could cost the public in the range of \$21 billion to \$53 billion in forgone revenue over the next 25 years, depending on how much oil and gas is eventually produced on these leases and the prices at which the oil and gas is sold.⁵
- Interior's verification of federal oil and gas production is insufficient. Specifically, we found that Interior is not meeting statutory or agency targets for inspections of certain onshore and offshore leases and metering equipment for measuring oil and gas production, raising questions about the accuracy of company-reported oil and gas production figures. In addition, we found that MMS's

¹GAO, Oil and Gas Leasing: Interior Could Do More to Encourage Diligent Development, GAO-09-74 (Washington, D.C.: Oct. 3, 2008).

²GAO, Oil and Gas Development: Increased Permitting Activity Has Lessened BLM's Ability to Meet Its Environmental Protection Responsibilities, GAO-05-418 (Washington, D.C.: June 17, 2005).

³GAO, Mineral Revenues: Data Management Problems and Reliance on Self-Reported Data for Compliance Efforts Put MMS Royalty Collections at Risk, GAO-08-893R (Washington, D.C.: Sept. 12, 2008).

⁴GAO, Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment, GAO-08-691 (Washington, D.C.: Sept. 3, 2008).

⁵GAO, Oil and Gas Royalties: Litigation over Royalty Relief Could Cost the Federal Government Billions of Dollars, GAO-08-792R (Washington, D.C.: June 5, 2008). The Department of the Interior has since lost the case on appeal. *Kerr-McGee Oil & Gas Corp. v. Dept. of Interior*, 554 F. 3d 1082 (5th Cir. 2009).

management of cash royalty collection lacks key controls, such as the ability to effectively monitor and validate oil and gas company adjustments to self-reported royalty data including those made after audits have been completed, which could have implications for the amount of revenue collected. Further, we found that MMS's royalty compliance efforts rely too heavily on self-reported data and that the more consistent use of available third-party data as a check on self-reported data could provide greater assurance that royalties are accurately assessed and paid.⁶ We have an ongoing engagement further examining production verification issues expected to be completed later this year.

- More could be done to verify production levels for Interior's royalty-in-kind (RIK) program, in which companies provide the federal government with oil or gas in lieu of cash royalty payments. Specifically, we found that under the RIK program, MMS's oversight of natural gas volumes is less robust than its oversight of oil volumes—a finding that raises questions about the accuracy of company-reported volumes of natural gas from which MMS must determine whether it is receiving its appropriate share of production. In addition, we found that MMS's annual reports to Congress do not fully describe the performance of the RIK program and, in some instances, may overstate the benefits of the program.⁷ We also have an ongoing engagement examining the RIK program expected to be released later this year.

In response to recommendations made by GAO and others, Interior has put into place a wide-ranging plan to significantly modify its current practices. We acknowledge Interior's efforts to change and improve many of its current practices as an important first step to address material weaknesses in the existing system. However, we are concerned that Interior may lack the resources and skills to simultaneously address significant changes in its practices while effectively meeting its routine responsibilities. If steps are not taken to effectively manage these challenges, the agency may face a decline in staff morale, continued employee turnover at its senior levels, and ongoing challenges hiring qualified new staff, further putting federal revenues at risk.

More importantly, we believe that Interior needs to fundamentally reexamine the way in which federal oil and gas resources are managed. Specifically, we recommended that Interior develop a strategy to encourage faster development of oil and gas leases on federal lands for those leases deemed to be more likely to produce oil and gas.⁸ In developing this strategy, Interior could benefit from evaluating alternative leasing practices used by some states and private land owners, as well as other countries, to determine what changes to federal leasing practices and the law is needed to speed up development of some specific leases that are likely to be highly productive. While Interior generally agreed with our recommendation and is looking at some of these issues in a study, we do not believe Interior's study is sufficiently comprehensive to meet the needs we identified. As a result, we believe this puts at risk the agency's mission to effectively manage federal oil and gas resources in the public interest.

In addition, we believe that a comprehensive reassessment of how much revenue the federal government collects from oil and gas produced on federal lands and waters, and in what manner, is long overdue, and we recommended to Interior that it undertake such a reassessment in our draft report, *Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment*.⁹ However, in commenting on this recommendation, Interior stated that such a reassessment would be premature in light of a study the agency had under way that was looking at some aspects of these issues. Because we believe Interior's ongoing study is too limited in scope and scale, in the final report we proposed that Congress consider directing the Secretary of the Interior to convene an independent panel to perform a comprehensive review of the federal system for collecting oil and gas revenue. In the event that the Secretary of the Interior convenes a panel, the panel and Interior should utilize available information about the share of oil and gas revenues that other resource owners, including states and other countries, collect and the ways in which they structure these collections to create more stable

⁶GAO, *Mineral Revenues: Data Management Problems and Reliance on Self-Reported Data for Compliance Efforts Put MMS Royalty Collections at Risk*, GAO-08-893R (Washington, D.C.: Sept. 12, 2008).

⁷GAO, *Oil and Gas Royalties: MMS's Oversight of Its Royalty-in-Kind Program Can Be Improved through Additional Use of Production Verification Data and Enhanced Reporting of Financial Benefits and Costs*, GAO-08-942R (Washington, D.C.: Sept. 26, 2008).

⁸GAO, *Oil and Gas Leasing: Interior Could Do More to Encourage Diligent Development*, GAO-09-74 (Washington, D.C.: Oct. 3, 2008).

⁹GAO, *Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment*, GAO-08-691 (Washington, D.C.: September 3, 2008).

investment environments in their oil and gas industries. Until this comprehensive reassessment is undertaken and completed, the federal government will not have reasonable assurance that it is collecting an appropriate share of revenue from oil and gas produced on federal lands and waters.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other Members of the Subcommittee might have.

Response to questions submitted for the record by Dr. Rusco

Majority Question Responses

1. **Mr. Rusco, the report by the Inspector General's office points out that the 8-year offshore lease is the only case of a federal oil and gas lease that has a specific performance requirement prior to the end of the primary term of the lease, in this case the lessee is required to drill a well in the first five years of the lease. Mr. Rusco, do you believe that including performance requirements such as this on other federal oil and gas leases would be a positive way for the government to encourage diligent development, and when and where do you think it might be appropriate?**

Response: Our review of the Department of the Interior's (Interior) leasing practices found that it was not structuring lease terms to encourage development as some states do. In particular, some states and private land owners use more tools to encourage quicker development of leases that are deemed to be more likely to be productive, while allowing more time to develop more speculative properties. To the extent that Interior could link performance requirements to the likelihood of finding economic volumes of oil and gas, this would be consistent with our recommendation to explore whether the tools used by states and private landowners could be useful for managing federal oil and gas leases.

2. **Mr. Rusco, from your extensive studies of how things can go awry with our leasing program, whether it is data collection or revenue collection, what should we keep in mind if we start to look at opening new areas of the Outer Continental Shelf? Are there things that we should do beforehand to ensure the same problems do not keep happening?**

Response: New areas in the outer continental shelf hold promise for significant new oil and gas discoveries compared to most areas onshore that have been more thoroughly explored and developed. As Interior considers whether or where to allow increased exploration and development in offshore areas that have been previously off limits, it is essential that Interior undertake the comprehensive reviews of how much it can collect and in what way it collects revenues and manages such leases before it begins opening these new areas. Only in this way can we be more certain that the federal government is correctly balancing the need to promote energy security, a competitive energy sector, environmental protection, and ensuring that the American public is receiving an appropriate share of revenues from new oil and gas production and that the leases are managed efficiently in the public interest.

3. **Mr. Rusco, during the hearing you indicated that the GAO had previously taken a look at the impact of litigation on federal oil and gas leases, but that you did not have the conclusions from that study with you at the time. What were the conclusions that GAO found regarding the impact of litigation on leasing, exploration, and development? Did GAO determine what percentage of potential lease tracts, either onshore or offshore, were protested prior to sale, and if so, what are the figures? Did GAO determine what percentage of issued leases were the subject of subsequent litigation, and if so, what are those figures?**

Response: In our report, Oil and Gas Development: Challenges to Agency Decisions and Opportunities for BLM to Standardize Data Collection, GAO-05-124, November 30, 2004; we found that areas on the Outer Continental Shelf open to offshore oil and gas development experienced few public challenges. According to data provided by MMS officials, between fiscal years 1999 and 2003, the agency was challenged on only one of its 1,631 decisions approving offshore oil and gas development and production, and only one of its 1,997 decisions approving offshore oil and gas exploration.

For the period we examined, MMS reported no lawsuits challenging its 5-year offshore management plan or the land parcels included in its 13 lease sales. The 13 lease sales offered 42,994 tracts covering 230,493,810 acres for lease sale. Of the tracts offered for sale, 3,541 tracts covering almost 18,659,610 acres were leased.

MMS also reported that there were no challenges to the 2,850 drilling permits it issued.

- 4. Mr. Rusco, one of the major themes that was present in your written testimony, and also arose during the discussion at the hearing, was the idea that the MMS leasing program is more comprehensive and methodical than the BLM onshore leasing program. To your knowledge, are there any reasons why an MMS-style leasing program—with multiyear planning, minimum acceptable bids, and other features that are unique to MMS—would not be appropriate for the onshore leasing program?**

Response: To support its work overseeing the leasing of offshore areas, MMS has developed both the geologic and economic modeling skills necessary to develop multi-year plans and determine minimum acceptable bids. BLM, however, may not currently possess the requisite geologic information or the staffing and skills required to implement such a program for the onshore areas it oversees. Therefore, while an MMS style leasing program may be a desirable goal for onshore leases, it would face some challenges in implementation.

- 5. Mr. Rusco, one of the statistics in your diligent development report shows that the amount of time it takes to produce oil and gas from a lease closely tracks the length of the primary term of the lease—5 year leases take just under 5 years to produce and 8 year leases take just under 8 years to produce. Has GAO been able to determine if the longer lease terms accurately reflect the inherent time necessary to produce oil and gas at different depths on the OCS, or if the longer lease terms provide an incentive for companies to create a timeline that would result in production occurring towards the end of the primary lease term?**

Response: While our review did not specifically attempt to gauge the amount of time it takes to develop leases at various depths in the Gulf of Mexico, companies have told us that deep water developments require both more time and money than developments located closer in to shore where there is often more existing pipeline and other infrastructure.

- 6. Mr. Rusco, both the IG and GAO make it clear that when companies get a 10-year lease, they get extensions provided they have initiated drilling activities by the end of those 10 years. Is there any reason a company can't get the lease, hold it in an inactive state for 9 years and 11 months, then start drilling a well right before the expiration date and get the 2 additional years automatically? Are there any requirements for leaseholders to do anything on their 10-year leases prior to the end of the primary term?**

Response: At present, a company holding a lease onshore may keep that lease for 9 years and 11 months, begin drilling prior to the end of the lease expiration date, and subsequently keep the lease for up to an additional two years. The only requirement is that companies pursue “reasonable diligence”, though Interior has not yet provided a clear definition of that term.

- 7. Mr. Rusco, you mentioned in the hearing that the analysis GAO undertook of government take did not include bonus bids because while they are observable, there are a lot of payments in other countries that are not observable. Could you elaborate on this, and provide examples of what you mean by unobservable payments?**

We do not know the extent to which foreign companies operating in countries other than the United States are pressured or encouraged to pay money or spend resources in other ways in order to be able to do business in other countries. For example, we reported in 2004 that, “[i]ndexes, surveys, and studies indicate that corruption in sub-Saharan Africa is pervasive, but assessing it is inherently difficult. Indexes published by the World Bank Institute and Transparency International have limitations; for example, both focus on perceptions of corruption, and both recognize their measures to be imprecise. Regional surveys indicate that many businesses are affected by corruption, although perceptions of corruption levels vary among countries.”¹

¹ GAO, U.S. Anticorruption Programs in Sub-Saharan Africa Will Require Time and Commitment, GAO-04-506 (Washington, D.C., April 26, 2004).

8. Mr. Rusco, have you taken a look at the oil and gas activities of the Bureau of Indian Affairs? Is there any sense of whether they have similar problems as BLM when it comes to data reliability and communication with MMS?

Response: The BLM is also responsible for leasing oil and gas lands for Indians, though we have not included Indian leases in our work. This is principally due to Cobell lawsuit and the resulting shut down of several of Interior's information technology systems, which has made Indian data much more difficult for MMS to access.

9. Mr. Rusco, do you believe that it would make sense—either fiscally, environmentally, or from a diligent development viewpoint—for the BLM to extend the term of leases to take into account stipulations that limit the amount of time that lessees can conduct operations on their leases?

Response: To date, we have not studied this in sufficient detail to give a simple definitive answer. However, we would point out that while federal leases may be subject to more strict stipulations, some states and private land owners provide significantly shorter primary lease terms—as little as 3 years—and also provide incentives or requirements for more rapid development, particularly of promising leases.

10. Mr. Rusco, how many total leases are encompassed by the 1,393 active onshore units, and how many are encompassed by the 215 active offshore units?

Response: We do not have the number of leases encompassed by either the offshore or onshore units because those numbers did not result from our analysis and are not readily available in published form from MMS or BLM. In addition, I would note that some leases may be part of more than one unit, depending on the specific circumstances, which makes the evaluation of the number of leases encompassed by existing units complicated.

Minority Question Response

1. In your report on Diligent Development you state that, “development occurred on about 26 percent of offshore and 6 percent of onshore leases issued during the sample period. Production was less frequent, with about 12 percent of offshore leases and 5 percent of onshore leases ultimately achieving production.” How many of these leases paid a bonus bid up front to the federal government? How many of these leases made rental payments to the federal government during their term? Do you believe that companies will hold leases and pay rental fees and bonus on leases which they know will not produce oil and gas?

Response: For offshore leases, MMS estimates the fair market value of each lease it sells, which becomes the minimum acceptable bid. If MMS determines that it did not receive the minimum acceptable bid, then MMS may withdraw the lease and offer it again at a future sale, at which point MMS may receive an acceptable bonus bid. Onshore, if the lease is not secured through a competitive bonus bid, a company may obtain it non-competitively without offering a bonus bid. We do not have summary data from BLM to assess what proportion of leases actually paid a bonus bid.

Federal law requires that all non-producing leases held by companies pay annual rent to the government. Therefore, all of the leases identified in our report should have paid rent.

It is unlikely that a company would bid on a lease and subsequently pay rent for the duration of the lease knowing that the lease will never produce viable quantities of oil and gas. However, some leases may be economically viable to produce only if prices are above a certain level. Individual companies must take into consideration the amount of potentially recoverable resource, the costs of accessing them, and their own expectations for future oil or gas prices.

2. In your report you state that “Interior does less to encourage development of federal leases than some state and private landowners.” Is failing to process permits in a timely manner one of the ways interior fails to encourage development on federal leases? There are companies with leases in the Alaska OCS that have been waiting nearly 3 years for a federal permit, would that constitute a hindrance to diligent development by the federal government?

Response: The length of time it takes BLM to process a drilling permit certainly impacts the rate at which a company can develop a lease. Our review did not examine timeframes related to processing drilling permits for Alaska's outer continental shelf. However, we found that BLM has shifted staffing and resources to processing

these permits from other important agency functions. We found that this has had the effect of reducing the agency's ability to keep up with other parts of its mission, including overseeing environmental mitigation on federal onshore leases. Given this shifting of priorities and resources, it is likely that the speed at which BLM has been able to process drilling permits was increased, but we cannot say by how much.

- 3. In your report, you state "while Interior uses varying primary terms for offshore leases, depending on water depth, with leases in deeper waters receiving longer primary lease terms, this is not explicitly related to the expected productivity of these leases." Could the reason Interior offers longer terms in the deepwater have to do with the technical challenge expected from drilling and developing leases 9,000 feet below the water and 25,000 feet below the sea floor? You frequently compared lease terms between state and federal leases, how many state leases were deepwater leases? How many state leases that you examined required infrastructure costing more than \$5 billion?**

Response: Developing leases in deepwater is time consuming, complicated, and costly, which are reasons why Interior offers leases in the deep waters of the Gulf of Mexico with a 10 year lease term. Because the federal government has jurisdiction over the outer continental shelf, there are no deepwater state leases. Rather, most offshore state leases in the Gulf of Mexico are closer-in, shallower, and in areas with more existing infrastructure. And because of these factors one would expect development costs to be less than for development of federal leases located in deeper, and further out locations in the Gulf of Mexico. What we have recommended is that both MMS and BLM explicitly consider all the available tools for managing federal leases, paying particular attention to leases that are deemed to be more likely to be productive, and to evaluate whether or not it is possible to utilize some of these tools to encourage more rapid development of some oil and gas leases.

Mr. COSTA. Thank you. It is interesting to note in the report on what type of incentivizing we can look at and the differences between private and state leases in terms of how you did your comparative analysis.

Last year—Members of the Subcommittee, you probably know this—it was the largest year for revenue from payments received from our program—\$18 billion. It was the second-largest source of revenue to the budget to the Federal Treasury outside of American tax dollars.

Our last witness—no, second-to-last witness, excuse me, is Mr. Tom Fry, president of the National Ocean Industries Association. Mr. Fry, please begin.

**STATEMENT OF TOM FRY, PRESIDENT,
NATIONAL OCEAN INDUSTRIES ASSOCIATION**

Mr. FRY. Thank you very much, Mr. Chairman, Mr. Ranking Member, and Members of the Committee. It is a pleasure to be with you today.

I represent the National Ocean Industries Association, a group of companies who work in the offshore energy business. It is not only oil and gas but people in the renewable energy business who work in the offshore.

My testimony is testimony that has been approved not only by NOIA but also a number of other trade associations that are also involved in representing folks in the offshore oil and gas industry.

As we look to our energy future, we feel very strongly that there are a number of things that have to be done. We are going to have to find ways to conserve. We are going to have to find ways to use renewable energy: wind, solar and others. We are going to have to use coal. We are going to have to use oil and gas. All of these

things are going to be necessary if we are going to meet our energy needs.

I am concerned that we may be lulled into some complacency because of low prices today. Let me suggest to you that the oil and gas industry is a very cyclical business—prices go up, prices go down; production goes up, production goes down—and there is certainly the possibility that we will see high prices in the future.

I have to point out here that we are in a world now that we have not been in for a long time. We do not have moratoria anymore. The congressional or Presidential moratoria have gone away. However, leasing takes place under the auspices of the OCS Lands Act, administered by MMS, and they have to have a five-year plan. That five-year plan lists all the leases that will occur. If it is not in the five-year plan, a lease cannot take place. About 13 percent of all of the OCS land is in the current five-year plan, meaning that only 13 percent would have been available for leasing even without the moratoria.

So we are still in a situation where we have lots of acres that have not been looked at or explored, and this is true even though over 20 percent of our domestic production comes from the offshore.

Is there more oil and gas out there? Most likely. We have found five times more oil and gas in the Gulf of Mexico than was thought to be there when the first estimates were made by the government.

There is also a jobs component to this. It has been estimated that if we were to open up additional areas of the OCS, we might create 76,000 jobs. These are high-paying jobs. They average today about \$93,000 a year. That compares with the average for the country of about \$44,000 a year. It has 70 percent lower incidences of injury and illness than industry in general.

As the Chairman pointed out, last year we were treated to a whole number of catchy phrases that I think had the tendency to polarize us at a time when we need to be talking seriously about how we develop and how we supply energy to this country. This needs to be a serious discussion. It does not need to be wrapped around phrases.

The Chairman has been to Independence Hub where they are now producing one billion cubic feet of natural gas a day. He has been to a drill ship where he has seen the technology that industry is able to bring to bear where a ship can sit in 10,000 feet of water with no anchors and stay still and drill in 10,000 feet of water and maybe as much as 30,000 feet of the crust of the Earth.

The technological advances are staggering in terms of what industry has been able to do. Sometimes we compare it to NASA of 15 to 20 years ago. This is high technology.

I think we also need to point out the enviable safety record of the oil and gas industry. The National Academy of Sciences study showed that of all the oil that is in the sea, less than one percent comes from offshore exploration activity. Interestingly enough, two-thirds of the oil that is in the sea comes from natural seeps; it just comes out of the ground naturally.

So science and technology will lead us to the ability to find new opportunities for oil and gas development if the country has the will and the wherewithal to allow for the safe and proper development.

With that, I will yield my nine seconds, Mr. Chairman.
[The prepared statement of Mr. Fry follows:]

Statement of Tom Fry, President, National Ocean Industries Association

Mr. Chairman and members of the Committee, thank you for inviting me to speak before you today about leasing and development of oil and natural gas resources on the nation's Outer Continental Shelf (OCS). My name is Tom Fry, and I am the President of the National Ocean Industries Association, which represents nearly 300 companies working to explore for and produce energy resources from the OCS in an environmentally sensitive manner.

I am here today also representing the Independent Petroleum Association of America, the U.S. Oil & Gas Association, the American Exploration and Petroleum Council, the International Association of Drilling Contractors, the American Petroleum Institute, the Natural Gas Supply Association, and the Petroleum Equipment Suppliers Association. Together, we represent thousands of companies, both majors and independents, engaged in all sectors of the U.S. oil and natural gas industry, including exploration, production, refining, distribution, marketing, equipment manufacture and supply, and other diverse offshore support services.

Through the development and application of technology, as well as adherence to a scientifically rigorous regulatory process, the companies of the offshore industry continue to improve their ability to bring new supplies of oil and natural gas online. For over fifty years, these companies have learned how to operate in deeper and deeper waters and locate resources that were once not accessible. At the same time, the technological advances pioneered by these companies have allowed for less impact on the environment and a wise stewardship of the resources beneath the ocean.

The need to safely harness these domestic energy sources is amplified by recent trends which show still-increasing American dependence on foreign sources of oil amidst a global economic downturn which has stifled energy prices from their record highs of last year. But when global economic conditions improve in the future, demand for energy will increase and we must begin preparing for this reality today.

Certainly, conservation and efficiency gains are the most immediate means to lowering energy use and helping to moderate prices in the short term. Simultaneously, renewable and alternative energy sources are growing every day and aggressive investment in these sectors must continue. As witnesses from the U.S. Energy Information Administration and the International Energy Agency recently testified before this committee, we must also face the fact that traditional fossil energy will continue to play the predominant role in meeting our energy needs for decades to come.

This reality dictates that responsible domestic production of these resources be encouraged, not hindered; and that risk and innovation aimed at improving our understanding of how better to find and produce oil and natural gas be rewarded, not punished.

Simply stated, given renewable energy sources' limited contribution to the current energy portfolio, and the massive investments and long time horizons needed to grow them to any meaningful level, the world will require more oil and natural gas to meet future energy demand. The oil and gas industry can increasingly produce these resources here in America safely and cleanly, including from the OCS.

New Areas Hold Unknown Potential

The United States' OCS is conservatively estimated by the Minerals Management Service (MMS) to hold undiscovered technically recoverable resources of over 419 trillion cubic feet of natural gas and 86 billion barrels of oil.

That's estimated to be enough natural gas to heat 100 million homes for 60 years, and enough oil to drive 85 million cars for 35 years or to replace current Persian Gulf imports for almost 60 years.

In fact, there may be even more than that. In the parts of the Gulf of Mexico (Gulf) where industry has been allowed to buy leases and explore, they have found about five times as much oil and three times as much natural gas as was once thought to be there. In 1987, MMS estimated that the Gulf of Mexico held about 10 billion barrels of oil and 100 trillion cubic feet of natural gas; yet, earlier this decade the Gulf was estimated to have 45 billion barrels of oil and 230 trillion cubic feet of gas yet to be discovered, in addition to the 6 billion barrels of oil and 75 trillion cubic feet of gas already produced since the 1987 estimates. The more industry explores, the more they find.

I know the Chairman has personally seen OCS oil and gas facilities such as Independence Hub and Thunder Horse on a past offshore trip with MMS officials, and recommend that all committee Members see it for themselves. Twenty years ago,

the part of the Gulf visited by the Chairman was not well understood and exploration had not started, thus explaining the significantly underestimated resources.

Technology and the actual act of drilling led to some of the incredible finds of the OCS. Independence Hub has the capability of producing a billion cubic feet of gas per day. Thunder Horse has the capacity of producing 250,000 barrels of oil per day. The five fold estimate increase may not be the case in all places, but it does appear to be clear that the more industry looks, the more they find. Imagine the potential of those places where exploration has been off-limits for over 25 years. We need that information and we can have it with no cost to the taxpayer.

Another way to quantify the energy potential held within new OCS areas is to examine the size of those offshore areas producing our energy now. The OCS currently is producing 27% of the entire U.S. oil production. However, that 27% of domestic oil production comes from only one half of one percent of the 1.7 billion acres of OCS lands.

When you consider how much oil is coming from a comparatively small amount of land, it becomes increasingly clear just how much potential resource may exist in areas in which we haven't looked.

As decision makers, Congress doesn't have all of this information. The information we do have is often over thirty years old and reliant on outdated technology. We know there are plenty of areas where oil and gas exploration may not be compatible with the landscape. We also know there will be parts of the ocean where resources will not be present or will not be economic. With talk of opening up areas or closing some down, shouldn't we increase our knowledge base so we can have an informed discussion about the consequences?

Safely Providing Energy and Jobs

Producing energy from previous moratoria areas in the OCS also holds the potential for hundreds of thousands of jobs and hundreds of millions of dollars in revenue. According to a recent study, oil and natural gas resources in former or current OCS moratoria areas could generate \$1.3 TRILLION in additional federal, state, and local government revenue, and over 76,000 jobs. Importantly, we already know that these will be family-supporting jobs, as oil and gas exploration and production wages averaged \$93,575 per year, according to 2007 Bureau of Labor Statistics data—over twice the average annual pay of \$44,458 across all U.S. industries.

These are significant resources that can be developed safely and that we ignore to our consumers' disadvantage. Yet until last year, more than 85 percent of the nation's OCS around the lower 48 states was off limits to oil and gas exploration because of presidential withdrawals and congressional moratoria, even though 1.4 million barrels of oil is produced from the OCS every day with less than .001 percent spilling into the ocean from drilling and extraction, according to MMS.

Similarly, as Chairman Costa often notes, a 2002 National Academy of Sciences (NAS) report entitled "Oil in the Seas III" found that less than 1% of oil in North American waters is from drilling and extraction, while 63% comes from natural seepage and the remainder from non-point sources. Clearly, the offshore oil and gas industry enjoys an enviable environmental record, and we appreciate committee members and witnesses alike recognizing this fact in hearings earlier this year.

Moving Beyond Slogans

Also mentioned in earlier hearings was the Chairman's desire to move beyond the "Use It or Lose It" and "Drill, Baby, Drill" slogans of last year. I agree it is important to have a serious discussion about the pace and development of offshore leases and appreciate these hearings presenting such a forum. Perhaps citing a real world example may help in this regard.

In the mid 1990's deep water was considered anything over 1,000 feet and not terribly far offshore, operating on what is known as "the shelf". But at that same time some companies bought leases in thousands of feet of water over a hundred miles from shore. They essentially placed a bet on themselves and advancing technology that might allow them to deal with water depths of almost two miles and drilling and producing depths of six miles or more. In addition, much of this area beneath the ocean floor is patterned with thick layers of salt, in some cases thousands of feet, that at the time prevented accurate seismic readings.

While some of these leases ended up having producible resources, many did not. Even many of the leases that had economically recoverable quantities were too technically difficult to produce for many companies. This resulted in leases that were turned back into the government because either the lease term had run its course or the tract was not deemed prospective enough.

Then in March of last year, the federal government conducted the largest lease sale in OCS history. Why? While not the only factor, a large part can be attributed

to the availability of some of these same deep water tracts that had been turned back in. Seismic technology has greatly improved to get a better understanding of resources below the salt. Platforms and drill ships now can work and handle the water depths and pressures associated with 10,000 feet of water and total depths over 30,000 feet.

That sale is the very essence of “use it or lose it.” The companies that made it work are producing. The ones that could not turned in their leases after having previously paid bonuses and rentals, while those same blocks were leased back out for a combined sale of over \$3.6 billion dollars to the taxpayer.

Looking at utilization rates of offshore drilling rigs can also help to illustrate the pace with which offshore leases are being developed. Toward the end of last year, nearly 90 percent of the roughly 700 offshore drilling rigs in the global fleet were being utilized. In the U.S. Gulf, about 90 rigs were working, including a record of close to 15 drillships in deep water and ultra-deep water. Daily rental rates for the newest generation of drillships reached as high as \$650,000 a day.

While the global economic downturn is expected to lead to some reductions in the exploration and production budgets of some companies, the drilling market in the deep Gulf should remain fairly positive, according to many drilling contractors. At the start of 2009, about 120 rigs were on order in shipyards. Subsea equipment suppliers predict an active year for components such as subsea completions and shut off valves.

A Process Shaped by Science and Stakeholders

Another commonly discussed issue in previous committee hearings is the desire that science-based decision making guide our national energy and environmental policy. This standard certainly is worthy of following, and indeed the current process of allowing for offshore exploration and production of natural gas and oil is rich with public input, deliberate in its manner, and is certainly exposed to the utmost scientific scrutiny and examination.

In order for oil and gas to ultimately be produced from the offshore, the process must essentially go through four separate phases: development of a Five Year OCS Leasing Program, planning for a specific lease sale within that Program, preparation of an Exploration Plan, and finally the preparation of a Production Plan. During the course of these various phases, no less than half a dozen separate environmental reviews are conducted.

Additionally, under the Coastal Zone Management Act (CZMA), all these activities must be consistent with a given coastal state’s science-based Coastal Zone Management Plan. Enacted in 1972, the CZMA created a national, science-driven program intended to comprehensively manage and balance competing uses of, and impacts to, coastal resources. The CZMA’s consistency provisions require the federal government to certify that its activities are consistent with the scientific policies of a state’s federally approved coastal management plan.

In fact, when working their way through the regulatory processes inherent with offshore production, oil and gas companies must abide by a long series of statutes which ensure science-based decision making, including: CZMA, the National Environmental Policy Act, the Endangered Species Act, the Marine Mammal Protection Act, the National Marine Sanctuaries Act, the Outer Continental Shelf Lands Act, the Clean Air Act, the Clean Water Act, and many others.

Stringent regulatory oversight helps maintain environmental performance, as offshore operators work under at least 17 major permits and must follow numerous sets of federal regulations from across several different federal agencies—including MMS, the Environmental Protection Agency, the U.S. Coast Guard, the National Oceanic and Atmospheric Administration, the National Marine Fisheries Service, and the U.S. Fish and Wildlife Service—each of which impart their own scientific rigor into their various rulemaking and permit granting processes.

For decades, the offshore oil and gas industry has relied upon science-based decisions to guide their operations; and will continue to do so as new innovations allow them to explore more areas.

A Source of Constant Technological Innovation

Today’s offshore technology allows us to produce more energy by reaching places that would never before have been possible. New world records are always being set.

Industry recently set one of these records by drilling a well in water depths exceeding 10,000 feet. That’s the equivalent of successfully navigating nearly two miles down from the surface of the ocean before even beginning to drill, sometimes another 30,000 feet into the earth below the sea floor. The technology required to drill, complete and produce this type of well must overcome an environment of high pressure (in excess of 20,000 pounds per square inch) and high temperature (exceed-

ing 350°F). Deep wells such as this are expensive, costing as much as \$100 million apiece.

After coming from the ground, the oil or natural gas then travels through a pipeline where the temperature is just above freezing and the formation of ice crystals threatens to block the flow unless constantly supervised and adjusted. At depths far beyond where humans can travel, sometimes as much as 5,000 feet or more below the ocean surface, Remotely-Operated Vehicles (ROVs) are used to perform maintenance and repairs.

All this is possible with fewer facilities and less impact—even visual—than ever before. For example, multiple subsea wells can be connected by tiebacks to a single platform over great distances. Such an installation is capable of reaching wells on the ocean floor dozens of miles away in all directions while connecting to an ocean surface platform one mile above.

Directional drilling also allows for extraction of resources which are miles away from the point where the actual well is drilled.

This cutting edge technology doesn't come cheap, however. The total cost of this type of project, including wells drilled and the subsea connection system, can exceed \$5 billion.

An Exemplary Record of Environmental Protection and Stewardship

The outstanding environmental record of U.S. companies operating offshore around the world is well recognized as “technologies are allowing the offshore industry to venture into deeper waters than ever before, while protecting marine life and subsea habitats”¹—even in the most challenging areas such as the Arctic and North Sea and in otherwise catastrophic weather.

Off the part of our coast in which exploration and production has historically been allowed, the safety of our operations was recently demonstrated in the most severe hurricane situations. Though many of the exploration and production facilities in the Gulf of Mexico were severely damaged or destroyed, the high-tech safety and environmental protection equipment and processes worked.

Careful scientific environmental study and operational planning always precede OCS activity. For example, our offshore geophysical companies, which conduct seismic work that allows us to “see” geologic structures beneath the seabed, have worked with the National Marine Fisheries Service and MMS to implement many procedures and practices designed to avoid harm to marine mammals, including:

- Monitoring for the presence of animals of concern
- Shutdown or no start-up when they are too close
- Slow, gradual ramp-up of operations just in case

During exploration, jack-up or semi-submersible rigs and drill ships have multiple systems and physical barriers to ensure that no spill occurs. Most important, along with multiple, redundant remote control systems, are “blowout preventers” which in deepwater are installed on the well at the seabed and are capable of immediate closure in event of any emergency.

Also, a “downhole safety valve” in the well itself below the seabed provides an added protection barrier in the event of some catastrophic event.

As a result of these safeguards, the offshore oil and gas industry has a laudable environmental record, as noted in the previously mentioned “Oil in the Seas III” NAS study, which finds that although the amount of oil produced and transported on the sea continues to rise, improved production technology and safety training of personnel have significantly reduced both blowouts and daily operational spills.

The industry remains under intense scrutiny by its two primary regulators—the MMS and the U.S. Coast Guard—as well as a host of other governmental agencies with oversight responsibilities such as the Environmental Protection Agency and the National Oceanic and Atmospheric Administration. However, it is the MMS that regulates all exploration, development, and production activities on about 8,000 active leases to ensure that these activities are conducted safely and in an environmentally sound manner. The MMS reviews and approves industry exploration and development plans before allowing any operations to commence, monitors all lease operations to ensure that industry is in compliance with relevant requirements, and conducts scheduled and unscheduled inspections. In 2008, MMS conducted over 25,000 inspections of OCS facilities.

To summarize, the latest technology and sound management practices not only allow for the continued production of domestic energy resources, but they have also made the U.S. offshore industry the envy of the world. Its environmental record is superb:

¹ Clinton Administration DOE report: Environmental Benefits of Advanced Oil and Gas Exploration and Production Technology, 1999.

- Since 1985, more than 8 billion barrels of oil were produced in federal offshore waters with less than 0.001 percent spilled—a 99.999 percent record for clean operations.
- There has not been an incident involving a significant oil spill from a U.S. exploration and production platform in nearly 30 years (since 1980).
- Government statistics show that the injury and illness rate for offshore workers is about 70 percent lower than for all of private industry.
- Today’s modern technology includes such environmental protections as automatic subsea well shut-in devices, including sub-seabed safety valves.

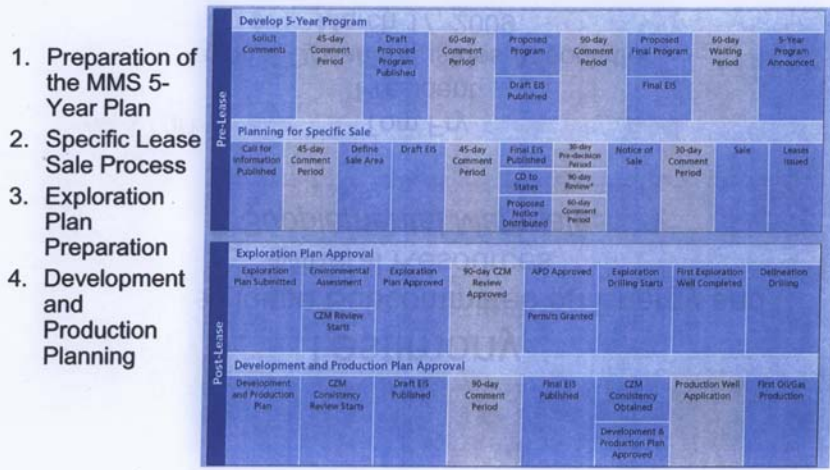
As mentioned earlier, the industry’s performance during the 2005 hurricanes, which moved through a core area of offshore operations, is instructive. While it is true that 115 platforms were destroyed, the storm threatened over 3,000 facilities, the vast majority of which survived. Despite sustained winds reaching 170 miles per hour and towering waves and the resulting destruction of numerous platforms and rigs, there was no significant spill from production wells and no injury or loss of life among the 25,000—30,000 workers who are offshore at any given time.

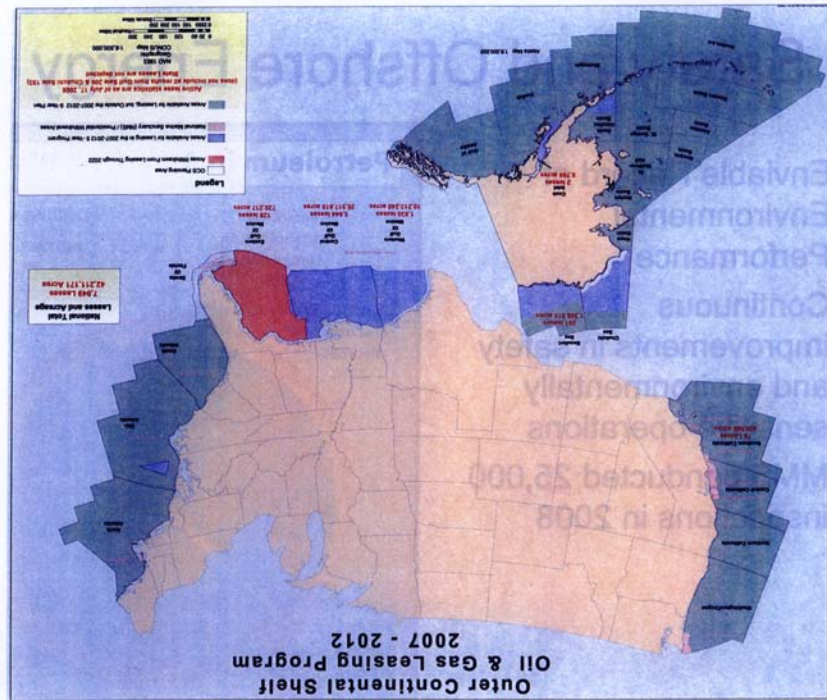
Because today’s weather forecasting capabilities provide ample lead-time as storms approach, operators are able to follow routine shutdown and evacuation procedures. In the case of the Katrina, Rita, Gustav, and Ike hurricanes, 100% of oil production was shut-in ahead of the storms.

Conclusion

The offshore oil and natural gas industry will continue to make advances in the development of new technologies, and to abide by the science-based regulatory processes which guide their operations. This innovation and adherence to scientific rigor will allow the industry to keep bringing reliable supplies of energy to market while also ensuring the safe and efficient management of the nation’s energy resources. Thank you for allowing me to be here with you today.

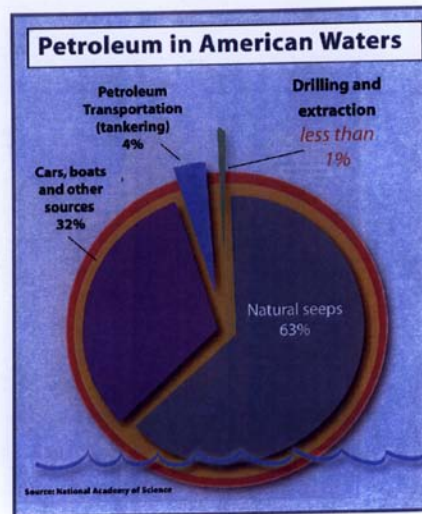
OCS Activity is governed by a thorough, multi-phase, public regulatory process:





Safety and Offshore Energy

- Enviably Record of Environmental Performance
- Continuous improvements in safety and environmentally sensitive operations
- MMS conducted 25,000 inspections in 2008



Response to questions submitted for the record by Tom Fry

Answers to Questions from Chairman Jim Costa, from the State of California

1. Current statute dictates that any offshore oil and gas lease on which no production activity is taking place at the conclusion of the primary lease term must be returned to the Department of the Interior so that it may be re-leased in a subsequent sale. This is true for all leases, regardless of their length. As such, leaseholders currently operate under strict performance requirements which provide ample incentive to diligently develop leases or else return those leases to the government and lose all economic investment in the form of bonus bids, rental payments, and other data acquisition and lease development costs. Companies bear this economic risk from the outset of every lease acquisition, realizing they may not find sufficient quantities of economically recoverable resources and may have to relinquish the lease, often voluntarily before the expiration of the primary lease term. We have witnessed this very scenario most recently when several leases offshore Alaska in the Beaufort Sea were voluntarily returned to the government before their expiration upon regulatory, legal, and technological challenges proving too great to overcome. Amidst such circumstances, industry feels that sufficient performance requirements exist with regard to offshore oil and gas lease development.

2. Requiring that leaseholders provide additional information to MMS with regard to the status of non-producing leases, even while providing that the information would only be published or disseminated by MMS in the aggregate and individual lease information would be treated as proprietary and confidential, may seem attractive in theory; however, its implementation in practice raises serious questions and concerns. Among these are the specific data that would be accumulated to provide this information; the methodology in defining various phases of "non-production"; industry's role in developing such definitions; and the ultimate purpose in obtaining, and use of, such information. Answers to these and other questions would be helpful in determining industry's feelings on the larger issue.

3. The notion of structuring offshore oil and gas lease terms according to resource "prospectivity" assumes that one is able to accurately predict, in a very detailed fashion, the amount of potential resources contained within a given lease. This is simply not possible; and furthermore, this notion seems to rely on the same faulty logic used to develop the so-called "use it or lose it" theory which Chairman Costa has criticized at numerous Committee hearings this year. Geologically speaking, there is no such thing as a "common" OCS lease. Natural gas and oil resources do not occur on all leases and are not always economically recoverable. Companies invest millions of dollars in hopes that a given area may hold significant resources without any way to verify their assumptions, short of investing additional resources on an exploratory well which also does not guarantee a positive economic outcome. While some states may use "prospectivity"—at least in part—to guide terms for onshore leases, operating in the deep waters of the OCS presents numerous technological and physical challenges on a scale which renders any comparison between the two operating environments moot. Namely, predicting resource potential a few hundred or thousand feet below the onshore surface is not comparable to predicting resource potential beneath, by way of example, 10,000 feet of water and another 20,000 feet below the ocean floor. For these reasons, it would be unwise to structure offshore oil and gas lease terms according to some definition of "prospectivity" which is inevitably theoretical in nature and not based on the realities of offshore lease development.

With regard to the notion of structuring offshore lease terms based on proximity to existing infrastructure, one must again take into account the dramatic differences between operating in the deep waters of the OCS and on a traditional onshore lease. When considering the inherent challenges of producing in the offshore under current lease terms, one must view any further lease conditions with caution and prudence. Furthermore, no matter the presence or absence of existing infrastructure, leaseholders must still navigate the same pre-production approval processes, and this significant component of the lease development timeline will remain unchanged.

4. While being very careful not to paint all offshore lease development timelines with the same broad brush, it can be said that upon successfully bidding on a given offshore lease, companies may sometimes seek a vested interest in a nearby lease via partnership or purchase. As noted in the Inspector General's report, this practice is "common to mitigate the risk associated with lease development." This is not to say, however, that other development activities are not concurrently moving forward, such as the acquisition and interpretation of seismic and other geological data, or the gathering of specific environmental, archaeological, and biological information needed to obtain MMS approval to drill.

5. When it comes to managing multiple uses of the OCS, NOIA firmly believes that existing processes governing oil and gas exploration and production have proven to be sufficient. Indeed, they ought to serve as the model for developing any additional offshore multiple-use planning. Further, we believe that any effort to complete a one-time, comprehensive assessment of all ocean resources might be misused to delay (and perhaps prevent) the expansion of offshore energy development.

One of the principal assumptions behind the call for a comprehensive system of ocean zoning or marine spatial planning is that there is no coordination in the current management of the oceans. This could not be further from the truth.

In designing the current regulatory system that governs the offshore development of energy resources, the writers of the Outer Continental Shelf Lands Act (OCSLA) anticipated that there would be a need for multiple uses to successfully coexist. For that reason, development of the 5-Year Leasing Plan, and every single exploration and development plan that stems from it, includes multiple public comment periods and an interagency sign-off. This allows for local communities to make their voices heard, for commercial and recreational fishermen to weigh in, and for the military to inform the decisions about the suitability of certain areas for energy development.

In addition, the Coastal Zone Management Act (CZMA) requires coordination of offshore energy development with the coastal states that abut that development. Further, the National Environmental Policy Act (NEPA) mandates that new development must be compliant with other prevailing environmental regulations and be subject to scientific analysis.

In its 2004 final report, the U.S. Commission on Ocean Policy stated that "...the scope and comprehensiveness of the OCS oil and gas program can be a model for the management of a wide variety of offshore activities." (Page 356) If the current offshore energy regime should serve as a guide for any additional offshore multiple use planning efforts, the principal aspect that must be accommodated is flexibility and regular review as the cornerstone. The Interior Department did not conduct a one-time review of offshore resources; it conducts a new one every five years. In fact, that five-year review may be started anew at any point if the current leasing program is deemed to fall short of evolving national energy priorities.

The reason for such regular reassessment is that our understanding of the resources in and below our oceans is constantly expanding. At the same time, our technological capacity to safely and economically harness those resources is perpetually improving. Today, wells are routinely drilled in water depths exceeding 5,000 feet, which would have been impossible just a decade ago. Likewise, a 1984 resource assessment conducted by the Minerals Management Service estimated there to be approximately 6 billion barrels of oil remaining beneath the Gulf of Mexico; today, even after 25 years of continuous, safe development, we now believe there to be an additional 45 billion untapped barrels of oil. Technology advances, often exponentially.

With that in mind, it would be short-sighted at best to believe that we could adequately assess both the resources and our ability to safely harness them with only the information available at this moment in time. The same is true of fish stocks, recreational uses of the offshore, the nascent ocean renewable energy technologies, commercial shipping, subsea telecommunications, etc. Any attempt at planning for multiple uses of the complex ocean environment must, by its nature, be ongoing and adaptive. NOIA's concern is that "comprehensive" is really code for one-time, static planning that will cut the offshore energy industry out of future areas where they might safely and economically develop the energy resources the nation requires.

6. Areas being included in a Final Five Year OCS Oil and Gas Leasing Program, with assurance that those areas would not be subject to a de-facto moratorium in the form of unnecessary regulatory delay or open-ended legal challenges, is sufficient incentive for industry to conduct pre-lease activities such as seismic surveys. As we have seen in the Western and Central Gulf of Mexico planning areas, when favorable conditions exist industry has, and will continue to, aggressively conduct seismic surveys. Similarly, MMS has already received significant interest from industry in conducting seismic surveys off the Atlantic coast in preparation for a possible lease sale offshore Virginia. When new areas are included in a Five Year Program with reasonable certainty as to their potential development, industry has proven their willingness to conduct seismic surveys at no cost to the taxpayer.

7. NOIA does not maintain the detailed data sought by this question. As inferred in the question, MMS is the more appropriate source for such information.

8. Yes, the industry has taken steps to reduce the impact of seismic surveys on whales and other marine life, and efforts are ongoing to continue to do so. For more than a quarter-century, the energy industry has sponsored and conducted research in the field of anthropogenic (human-generated) sound and its potential effects on marine mammals. The industry has significantly expanded its research effort with

plans for a multi year global research program commenced in 2006 with a budget projected in excess of \$20 million. The energy industry is undertaking this effort because it recognizes that while much has been learned about marine mammals and anthropogenic sound, some gaps remain in our knowledge base. The industry will continue to be committed to developing a sound scientific understanding of our operations on marine mammals. In addition, the industry strongly supports the need for additional scientific investigation by government, academic and other stakeholders on marine sound and associated effects on marine mammals, at both the individual and population level.

9. When discussing zero discharge operations, one must consider the many varying types of drilling operations currently used in the offshore. Different types of drillships, collection systems, and other operation facilities make it difficult to provide a single, uniform characterization as to the feasibility of requiring zero discharge operations in the U.S. Furthermore, companies within our membership may have differing opinions on this subject, precluding us from offering an industry-wide position.

10. Generally speaking, rig availability is one factor, among many, impacting lease development. Other such factors include permitting bottlenecks, legal challenges, and limited access to leasable acreage.

However, the existing fleet of offshore drilling rigs has successfully met current demand, and the industry is capable of meeting future demand. Over 100 new rigs are under construction globally, many of them for the deepwater, and many in Asian shipyards. However, significant domestic rig production is occurring in several Gulf state shipyards as well, including in Texas and Mississippi. Production platforms are also built domestically in the Gulf region, including in Texas and Louisiana. It is also noteworthy that components for rigs and platforms are manufactured in approximately 34 U.S. states.

The Committee may be interested in contacting the International Association of Drilling Contractors for more detailed information regarding the precise number of rigs built in recent years and expected to be built in future years.

11. The offshore oil and gas industry is required to comply with numerous federal statutes when conducting their operations, including both the Clean Air Act (CAA) and the Clean Water Act (CWA). NOIA is not aware of any exemptions to offshore operators with regard to the CWA or CAA.

12. It is not readily apparent what the Inspector General means by “prioritize projects” in the lease timeline chart on page 6 of their report. In terms of the chart’s accuracy, it is obviously extremely difficult to characterize a “typical” offshore lease. However, charts such as this are useful in demonstrating that the offshore lease development process is filled with necessary pre-production activities, all of which accumulate significant costs to the leaseholder with no guarantee that economical resource quantities will ever be found.

13. Industry faces many challenges in attempting to develop its offshore leases; and certainly workforce and infrastructure issues are among these. However, factors which play a far greater role in hampering offshore lease development include permitting bottlenecks, unreasonable legal challenges, and limited access to leasable acreage.

Answers to Questions from the Ranking Member Doug Lamborn, from the State of Colorado

1. In order for oil and gas to ultimately be produced from the offshore, the process must essentially go through four separate phases: development of a Five Year OCS Leasing Program, planning for a specific lease sale within that Program, preparation of an Exploration Plan, and finally the preparation of a Production Plan. During the course of these various phases, numerous separate environmental reviews are conducted, in addition to several public comment periods, state reviews, and other assessment periods.

The five-year leasing program is subject to analysis under the National Environmental Policy Act of 1969 (NEPA), which requires comprehensive analyses of the environmental and socioeconomic impacts of potential activities. The Minerals Management Service (MMS) will use the highest level of review and documentation under NEPA, and the resultant the Environmental Impact Statement (EIS), to evaluate the five-year leasing program. It will identify any adverse environmental effects that cannot be avoided or mitigated, alternatives to the proposed action, the relationship between short-term resources and long-term productivity, and irreversible and irretrievable commitments of resources. This process also incorporates opportunities at several steps in the process for public and stakeholder review and comment.

When planning for each specific lease sale within a given Five Year Program, MMS must conduct separate EIS reviews, as well as conduct state consistency reviews under the Coastal Zone Management Act (CZMA). The EIS for an individual lease sale focuses on the potential environmental effects on biological, physical, and socioeconomic environmental resources from oil and gas exploration, development, and production activities on the OCS. MMS may also gather supplemental environmental information apart from the EIS review, as was the case in a recent MMS-hosted workshop in Williamsburg, VA on the environmental research needs in support of potential Virginia offshore oil and gas activities. The focus of the workshop was on the existing scientific knowledge base along the Virginia coast and the information gaps that need to be addressed should a lease sale for oil and gas activities be held offshore Virginia.

If the decision is made to conduct a given lease sale and leases are acquired, a company would then need to submit an exploration plan (EP) to MMS proposing to drill wells on specific sites. Upon acquiring a lease, any lessee who wants to drill an exploration well must submit an extensive EP application containing an array of environmental, monitoring, and mitigation information that must demonstrate to MMS that the proposed EP activities "...do[es] not cause undue or serious harm or damage to the human, marine, or coastal environment." (See 30 CFR 250.202, 250.212-228.) The MMS would review the EP to determine any potential impacts on the environment and ensure engineering safety. Affected States would also review the EP and determine its consistency with the State's coastal zone program. After all reviews, MMS would approve the EP, if acceptable. Other Federal agencies also review and issue permits for aspects of the activities. For example, the Environmental Protection Agency issues the water discharge permits.

Before any development or production activities can begin, a development plan must be submitted to MMS for review and approval. Again, the proposed development plan must contain a full array of environmental, monitoring, and mitigation information that must demonstrate to MMS that the proposed activities do not harm the environment. Specific environmental, archaeological, and biological information must be submitted in support of the plans. The plans and supporting information are evaluated for seafloor or drilling hazards; air and water quality impacts; hydrocarbon resource conservation; appropriate mitigation of potential impacts; and compliance with NEPA, MMS operating regulations, and other requirements. Other Federal agencies and the designated coastal zone management agencies in Atlantic Coast states may take part in the review process.

As previously mentioned, the CZMA also plays a prominent role in offshore energy development. Enacted in 1972, the CZMA created a national program intended to comprehensively manage and balance competing uses of, and impacts to, coastal resources. The CZMA's consistency provisions require the federal government to certify that its activities are consistent "to the maximum extent practicable" with the policies of a state's federally approved coastal management program. A federal agency is forbidden from granting a license or permit unless the state has determined that the activities are consistent with its plan, or unless the Secretary of Commerce elects to override the state's objections. Even with a secretarial override, the appeals process can take a significant amount of time. Commerce appeals have taken up to four years, and rulings have never been made in some cases.

In addition to NEPA and CZMA, offshore oil and gas operators must abide by many other statutes, including the Clean Air Act, the Clean Water Act and the Marine Mammal Protection Act. Under the Clean Water Act, oil and gas operators must be granted a permit from the Environmental Protection Agency for possible discharges before drilling may be authorized by the MMS. EPA Region 6 issues a general National Pollutant Discharge Elimination System (NPDES) permit for discharges associated with offshore exploration facilities in the Gulf of Mexico. Over the years, there have been problems getting the permits issued in a timely manner and ensuring that there are not unnecessary restrictions placed on the permits.

The Marine Mammal Protection Act (MMPA) was enacted in 1972 to protect and conserve marine mammal populations. The original Act established a moratorium on the taking or importing of marine mammals and marine mammal products except for certain activities which are regulated and permitted. The MMPA defines "take" as "to harass, hunt, capture, or kill or attempt to harass, hunt, capture, or kill any marine mammal." Under the Act, the Secretary of the Interior has jurisdiction over sea otters, polar bears, manatees, dugongs, and walrus, while the Secretary of Commerce has jurisdiction over all other marine mammals.

The MMPA was last amended in 1994 and a number of new provisions were added to the Act. Since the enactment of the 1994 amendments, lawsuits have hindered the agency's permitting process for scientific research, and the regulated com-

munities have questioned the agencies' implementation of certain provisions in the Act.

For decades, the offshore oil and gas industry has relied upon this deliberate, statutorily guided and public-driven process to reach science-based decisions which shape their operations; and will continue to do so as new innovations allow them to explore more areas.

2. Geologically speaking, there is no such thing as a "common" OCS lease. Economically recoverable quantities of natural gas and oil do not occur on all leases. Companies invest millions of dollars in hopes that a given area may hold significant resources without any way to verify their assumptions, short of investing additional resources on an exploratory well which also does not guarantee a positive economic outcome.

Said a bit more technically, an OCS lease is a regulatory designation that defines the boundaries where a leaseholder can explore for oil and natural gas; it has nothing to do with the underlying geology, which controls whether a particular lease contains oil or natural gas. Oil and gas explorers do not drill leases per se, they develop and drill exploration prospects within leases. Exploration prospects are based on geological conditions. And while a given petroleum basin may have some geological similarities, such as reservoir type, the specific geological conditions of a particular prospect make each prospect/lease different.

3. Strong disincentives to avoid non-producing leases already exist as offshore leases are not open-ended in duration and rent is paid annually on leases to the federal Treasury (leases are for 5, 8, or 10 year terms depending on water depth). If exploratory wells do not indicate economically recoverable resources and companies do not produce a given lease, they must relinquish the lease back to the federal government at the conclusion of the primary lease term. Often, companies voluntarily relinquish leases before the conclusion of the primary lease term, as recently witnessed in the Alaska OCS where several leases in the Beaufort Sea were voluntarily returned to the government upon regulatory, legal, and technological challenges proving too great to overcome. Amidst such circumstances, industry feels that sufficient performance requirements exist with regard to offshore oil and gas lease development.

Answers to Questions from Representative Dan Boren, from the State of Oklahoma

1. Oil and gas companies are not "sitting" on sizable acres worth of offshore leases, intentionally allowing them to remain "inactive." In fact, there is no such thing as an "inactive" lease. All leases are under near constant review, whether environmental assessments are being conducted, permits are being secured, seismic data is being acquired or processed, the lease is undergoing appraisal, or other pre-production processes are taking place.

The notion of an "inactive" lease doesn't make business sense because companies must ensure an adequate return on shareholders' pre-production investments. After investing millions of dollars in lease acquisition that includes an initial bonus payment and annual rental payments during the pre-production period, "sitting" on leases would mean companies are shirking their responsibilities to shareholders that all assets and capital expenditures are being utilized toward ultimate development and production to ensure an adequate return on that investment.

Furthermore, the notion of "inactive" leases assumes that there are natural gas and/or oil resources on every lease and that all non-producing leases represent untapped resource potential. This is clearly not the case, as exploring for oil and gas is not akin to planting crops on farmland. Natural gas and oil resources do not occur on all leases in economically recoverable quantities. Companies invest millions of dollars in hopes that a given area may hold significant resources without any way to verify their assumptions, short of investing additional resources on an exploratory well which also does not guarantee a positive economic outcome.

Strong disincentives to avoid non-producing leases already exist as offshore leases are not open-ended in duration and rent is paid annually on leases to the federal Treasury (leases are for 5, 8, or 10 year terms depending on water depth). If exploratory wells do not indicate economically recoverable resources and companies do not produce a given lease, they must relinquish the lease back to the federal government at the conclusion of the primary lease term.

There is simply no evidence of any lack of diligence by the companies in pursuing the development of their lease holdings in the Gulf of Mexico. On the contrary, the development effort in the Gulf has been spectacular. Since 1995, more than 750 new exploration wells have been drilled, yielding over 100 announced discoveries, much of which used technologies only dreamed of as little as two decades ago. As a result of these efforts, 7 of the top 20 U.S. oil fields are in the deep water of the federal

OCS. Since 1995, natural gas and oil produced from the deep water have expanded by 620 and 535 percent, respectively (2006 data).

2. Please see the response to question # 1 for a discussion on the so-called “use it or lose it” doctrine. Clear incentives already exist to actively develop offshore leases, and these results are demonstrated in the sizable contributions of the offshore toward our domestic oil and natural gas production. In 2007, the OCS accounted for 27% of domestic oil production and 14% of domestic natural gas production.

As the global economy recovers and energy demand continues to rise, we will need even more oil and gas. As noted in my testimony, witnesses from the U.S. Energy Information Administration and the International Energy Agency recently testified before this committee that we must face the fact that traditional fossil energy will continue to play the predominant role in meeting our energy needs for decades to come.

The oil and gas industry can increasingly produce these resources here in America safely and cleanly, including from the OCS, if only given the chance. Yet, industry’s access to OCS areas continues to be hindered. According to MMS, roughly only 2% of total OCS acreage (continental U.S. and Alaska) is currently leased; and roughly only 6% of OCS acreage within the continental U.S. is currently leased. Also, less than 15% of OCS acreage is even included for possible leasing in the current Five Year OCS Oil and Gas Leasing Program. In order to continue meeting rising demand for oil and gas, industry must be given increased access to new OCS areas that can be developed in an environmentally sensitive manner utilizing modern technological advancements.

Mr. COSTA. Thank you.

Our last witness, and we will then begin the questioning, is Mr. James Farnsworth. He is the President of Cobalt International Energy. Mr. Farnsworth?

**STATEMENT OF JAMES W. FARNSWORTH, PRESIDENT,
COBALT INTERNATIONAL ENERGY, L.P.**

Mr. FARNSWORTH. Thank you, Mr. Chairman. I would like to spend just a few minutes talking about my experiences with the OCS.

I have degrees in geology and geophysics, 28 years in the industry, and I work for Cobalt International Energy, a relatively new startup company. And prior to Cobalt, I worked for BP where I was responsible for their global exploration program. I became very familiar with the world’s great hydrocarbon basins and also the fiscal terms of the different countries around the world.

Within the U.S., my career has really centered on the OCS where I have been responsible for over 30 lease sales in the Gulf of Mexico, the East Coast and Alaska.

Cobalt International Energy, which was formed in November 2005, is a privately held company based in Houston, Texas, and founded by four seasoned executives, of which I am one. Our intent was to build a company with a unique business model and through access to great talent, the latest technology and sufficient capital, compete and succeed in some of the world’s most technically challenging prospective areas and against some of the world’s largest companies as well, all this with about 50 or 60 people.

The Gulf of Mexico is a key basin in our business model, and a well-established and stable OCS leasing process was essential to our success. From my experience, the deepwater Gulf of Mexico is one of the most technically challenging hydrocarbon basins in the world. It is highly complex, and to be successful requires scientific expertise and the disciplined application of the very latest tech-

nology. Above all, it requires a long-term, multi-decade commitment, and a lot of experience also helps.

Since its inception in late 2005, Cobalt has hired approximately 50 employees, including world-class geoscientists, engineers and commercial experts. These people have both in-depth experience in the Gulf of Mexico and substantial experience in other basins around the world.

Within the first year, Cobalt spent over \$200 million on state-of-the-art seismic data and technology which was used to understand the geology of the Gulf of Mexico and then high-grade specific areas which might have the potential for large oil and gas accumulations.

This then allowed our experts to evaluate thousands of leases in deepwater Gulf of Mexico prior to bidding on only a small fraction. Over the past two years, Cobalt spent over \$635 million acquiring the rights on 142 leases and four separate, highly competitive, record-breaking OCS lease sales. We were amongst the top two or three bidders in terms of money spent and competitive bids won. This gives us nothing more than the right to explore on those leases. There is no guarantee of us finding oil and gas. This scientific, highly technical and costly endeavor is no place for guessing or dart boards.

Earlier this year, three years after our inception, we and our partners completed drilling Cobalt's first two wells in over 5,000 feet of water. The first well cost over \$100 million; the second, well over \$200 million. The average industry success rate on these types of prospects is less than one in three.

Let me say this another way: We and our partners were prepared to invest over \$300 million in these two wells alone with absolutely no guarantee of success. This is the nature of our business. We were very fortunate that those first two wells actually did discover big new oil fields.

Cobalt and Partners will now begin additional seismic analysis and drill more wells in these discoveries in order to understand their size and commercial potential. This will likely take at least another two years to execute, and it is absolutely essential before committing to multi-billion-dollar developments.

In addition, we will continue to test the rest of our inventory in the Gulf of Mexico and elsewhere in the world. In fact, we have committed to a brand-new deepwater floating rig, which will cost us approximately half a million dollars a day to operate and will work in up to 8,000 feet of water. The construction of this rig is expected to be completed and arrive in late 2010. That is five years after the founding of Cobalt and four years after acquisition of our first leases.

In late 2005, when Cobalt was founded, the oil price was approximately \$45 a barrel and, as you know, climbed up to over \$140 a barrel. It is now back down to \$40 a barrel. Our costs also went through the roof with rig rates, services and costs of steel more than doubling. These unfortunately have not yet come down.

What also has increased has been the cost of leases. When we first started the company with leasing, the maximum cost was about a million dollars or so; now, recently, over \$100 million per lease.

But fluctuations in costs and price are something we are used to. What we are not used to and what we were not expecting were increased royalty rates and increases in lease rental costs. Those have gone up by nearly 50 percent in each case. We have always thought the complexity of the Gulf of Mexico and the technical challenges were offset by a stable environment, and now, after four years, we are finding that the physical environment is shifting on us.

As you can appreciate, this process does not take overnight. It takes many, many years, but we are up for the challenge, and we are here to be successful, and what we are looking from the government is for a stable environment, a stable fiscal environment where we know the terms and know the timetable and we can participate in it.

What you can expect from us from the industry is a very self-funded model, and we will compete. We will compete against the biggest companies in the world and other national oil companies, but having that stable environment is extremely important to us.

Thank you for your time this morning. I deeply appreciate it.

[The prepared statement of Mr. Farnsworth follows:]

**Statement of James Farnsworth, President and Chief Exploration Officer,
Cobalt International Energy, L.P.**

Mr. Chairman and Committee Representatives:

Thank you for the opportunity to be with you this morning to discuss the leasing and development of oil and natural gas resources on the U.S. Outer Continental Shelf.

My name is Jim Farnsworth. I'm President and Chief Exploration Officer of Cobalt International Energy, L.P. My degrees are in Geology and Geophysics and I have 28 years of experience in the Energy field. Prior to Cobalt, I worked for BP where I was responsible for their world-wide Exploration business. During that time, I became familiar with the geologic complexity of many of the world's petroleum provinces, and also their fiscal and tax regimes. Within the U.S. my career has centered on the OCS, participating in over 30 Lease Sales and the drilling of many wells in The Gulf of Mexico, Alaska and Atlantic East Coast.

In my brief remarks this morning I would like to cover three things: First, I would like to give you an overview of Cobalt, a relatively new start-up. I'll do this only to provide some context and insights into the offshore leasing and exploration process; second, give some insight into the significant challenges and risks we face (financial, geological, technical, and commercial) in exploring for and then developing hydrocarbons in the deepwater Gulf of Mexico; and finally the importance of creating a comprehensive energy strategy for the OCS.

Cobalt International Energy, which was formed in November 2005, is a privately held company, headquartered in Houston, Texas and founded by four seasoned internationally experienced industry executives, of which I'm one. Our intent was to build a company with a unique business model and through access to great talent, the latest technology and sufficient capital, compete and succeed in some of the most technically challenging and prospective areas in the world, and against some of the world's largest companies. All with about 50-60 people.

The Gulf of Mexico is a key basin in this business model and a well established and stable OCS leasing process was essential for our success. From my experience, the deepwater Gulf of Mexico is one of the most technically challenging hydrocarbon basins in the world. It is highly complex and to be successful requires scientific expertise and the disciplined application of the very latest technology. Above all it requires a long-term, multi-decade commitment. Many years of experience also helps.

Since its inception in late 2005 Cobalt has hired approximately 50 employees, including world-class geoscientists, engineers and commercial experts. These people have both in-depth experience in the Gulf of Mexico and substantial experience in other basins and oil and gas projects around the world. Within the first year, Cobalt spent over \$200 million on state of the art seismic data and technology, which we've used to understand the geology of the Gulf of Mexico and high-grade specific areas which might have the potential for large oil and gas accumulations.

This allowed our experts to evaluate thousands of leases in the deepwater Gulf of Mexico prior to bidding on only a small fraction. Over the past two years, Cobalt has spent over \$635 million acquiring the rights on over 140 leases at four separate, highly competitive, record breaking OCS Lease Sales. We were amongst the top 2-3 bidders in terms of money spent and competitive bids won. This gives us nothing more than the right to explore on those leases. There is no guarantee of finding any oil or gas. This scientific, highly technical and costly endeavor is no place for guessing or dart boards.

Earlier this year, three years after our inception, we and our partners completed drilling Cobalt's first two wells in over 5000 feet of water. The first well cost over \$100 million, the second, well over \$200 million. The average industry success rate for these type of prospects is less than one success in three attempts. Let me say this another way, we and our partners were prepared to invest over \$300 million on these two wells alone with absolutely no guarantee of success. This is the nature of our business. We were very fortunate in that both wells resulted in significant new oil discoveries.

Cobalt and Partners will now begin additional seismic analysis and drill more wells on these discoveries in order to understand their size and commercial potential. This will likely take at least another two years to execute and is absolutely essential before committing to multi-billion dollar developments of the new discoveries. In addition we will continue to test our inventory of other exploration opportunities both in the Gulf of Mexico and elsewhere in the world. In fact a new 5th generation floating deepwater rig is being built now for Cobalt's use. The rig will be capable of operating in 8000 feet of water and drill wells 6 miles deep at a cost of over \$500,000 a day. The construction of the rig is expected to be completed and arrive for Cobalt's use in the Gulf of Mexico in late 2010, five years after the founding of Cobalt and four years after acquisition of our first leases.

In late 2005 when Cobalt was founded, the oil price was approximately \$45/bbl, pretty close to today's price. As you know, oil prices climbed briefly to over \$140/bbl and back down again to the \$30-\$40/bbl level. Our costs also went through the roof, with rig rates, services, and costs of steel more than doubling. These unfortunately have not yet followed the oil prices down. The cost of offshore leases also increased substantially with high bids escalating from a few million dollars to in some cases over \$100 million dollars. Tomorrow there will be another Gulf of Mexico lease sale and it will be interesting to see the level of interest by industry.

Fluctuations in prices and costs are something we in the industry have come to expect and have learned to manage. What has taken us by surprise however, is the change in fiscal terms in the United States. For us, the high cost and technical complexity of the Gulf of Mexico was off-set by a stable tax and royalty system. Since 2005 when Cobalt was founded and we began investing over \$1 billion dollars, Federal royalty rates in the offshore have increased by 50%, and lease rental costs have increased by 47%. This increase has occurred despite the fact that oil prices have reverted back to 2005 levels. Additional taxes and fees are now being considered to add even more burden to companies that are trying to find new oil and gas fields here in the U.S.

As you can appreciate, the process I have just described does not take place overnight. On average, starting from seismic acquisition through discovery, appraisal and development, to first production, can take 7-10 years in the deepwater Gulf of Mexico. Thus it's important that the lease duration fully reflects and supports the ability for the industry to successfully implement the exploration discovery to production process. It is Cobalt's view that the current leasing process is working.

Our actions confirm that Cobalt and the industry are keenly interested in domestic offshore oil and gas exploration and development opportunities. Currently only a very small proportion of the OCS is available for leasing. We strongly support additional area-wide opening of the OCS, including the Atlantic East Coast. This approach in the Gulf of Mexico has been remarkably successful for the United States.

The Federal Government's scientific assessment suggests that there are 86 billion barrels of oil and 420 trillion cubic feet of natural gas that is undiscovered and technically recoverable on the federal OCS. What the study doesn't provide of course is the precise location of these prospective resources. That would require enormous work and investment, just as it has in the deepwater Gulf of Mexico and other basins in the world.

While we really don't know the true potential, with close to 30 years in this industry, I would assert the assessment will probably prove to be conservative. The Energy Information Administration has observed that "the estimate of ultimate recovery increases over time for most reservoirs, for the vast majority of fields, all regions, all countries, and the world." This is not because the initial assessments were flawed. Rather it is because as we explore and develop oil and natural gas resources,

our knowledge of the subsurface improves, which leads to better geologic models, new technologies and new exploration ideas.

This point is emphasized as we look back at the hydrocarbon exploration and development history of the Gulf of Mexico. Initially, the focus was the shelf in relatively shallow water. We then moved to the deeper water, but with the objective of tapping geological reservoirs that were still relatively shallow. We have now progressed to exploring in the deepwater, looking for hydrocarbon reservoirs some 30,000 to 35,000 feet deep, below huge salt canopies that distort our ability to accurately target the objectives.

The U.S. offshore oil and gas industry has and continues to be a significant economic driver creating both direct and indirect benefits. These range from the development of skilled jobs here at home, the continual supply of goods and services needed by the industry, taxes and royalties paid, to capital expenditures on the order of billions of dollars.

The U.S. oil and gas offshore industry has a tremendous track record in the application of science to exploration, development and production of hydrocarbons. Through the continuous development and implementation of new technology (most of it developed in the U.S.) coupled with the rigorous environmental and safety standards of the federal government, our industry is well positioned to prove the potential resource base in those areas now restricted in the OCS. If successful, I'm convinced this would result in new sources of domestic supply.

It is Cobalt's view that through a consultative process with industry, the key areas of the OCS where the potential is greatest could be refined. This must be driven by geological and geophysical analysis. Some of these resources will be far from shore, others will be closer in. But scientific understanding should guide this process, so that the nation's resources are developed most efficiently for the benefit of its people.

It will take a partnership to create new domestic supply.

The oil and gas industry will look to the government to do its part; creating a comprehensive and diversified energy strategy. Further investment and new supply can be encouraged by an energy policy which combines new access opportunities, efficiency, conservation and stable and competitive fiscal and royalty terms.

The oil and gas industry will do our part. In our risky, capital intensive business, the government can look to our "self funded" industry to continue to invest in new technology to safely, environmentally and efficiently explore, develop, and produce additional energy in new and existing domestic offshore basins.

On behalf of Cobalt International Energy, L.P., I would like to thank you for the opportunity to participate in this very important hearing.

Response to questions submitted for the record by James W. Farnsworth

Questions from Chairman Jim Costa, from the State of California

- 1. Mr. Farnsworth, the report by the Inspector General's office points out that the 8-year offshore lease is the only case of a federal oil and gas lease that has a specific performance requirement prior to the end of the primary term of the lease, in this case the lessee is required to drill a well in the first five years of the lease. Mr. Farnsworth, what is the industry's opinion on the performance requirement in the 8-year leases? Did the industry object to the establishment of the 8-year leases with the current performance requirement? Would the industry object to including similar performance requirements in other leases, particularly if those requirements were coupled with an overall longer primary lease term?**

The performance requirement of the 8 year lease is the drilling of a well within the first 5 years.

While I cannot speak for industry, in my opinion, the 8 (5+3) year lease initially was established as an effective compromise between the 5 years for shallow water and 10 years for deep water when shallow, lower cost prospects were being targeted for exploration by industry. Those shallow prospects have now largely been drilled. What remains to be explored are much deeper (30,000 plus ft.) and much more complex sub-salt deep Miocene and Lower Tertiary prospects. Because of the higher cost and complexity of these prospects, the current form 8 year leases have become much less effective in attracting industry interest and multiple competitive high bids and thus exploration activity.

The performance requirement to drill within 5 years requires an operator to: 1) put together a multi-block partnership, 2) complete the time consuming acquisition

and processing of depth seismic data, 3) procure an acceptable heavy duty deep-water rig and 4) drill a well in the first 5 years. Extending this performance requirement condition to the rest of deep water would have an immediate negative impact on the industry's interest in these leases, the value companies would place on leases in the deepwater Gulf of Mexico and thus bid levels would decrease, and finally the number of exploration wells would fall.

- 2. Mr. Farnsworth, at our March 24th hearing, three witnesses, including a witness invited by the minority, expressed their desire to see a "zero-discharge" policy applied to U.S. offshore operations. One witness testified that this was now a requirement imposed by the Norwegian government for operations offshore of their country. What sort of additional effort would be required by the U.S. industry in order to implement zero-discharge operations? Would the industry be able to comply with such a requirement if it was made a condition of being able to operate in a frontier OCS area?**

It is important to understand that the Norwegian zero discharge policy is not a true total prohibition on any and all overboard discharges; but a policy aimed at reducing the amounts of oil and environmentally hazardous chemicals discharged during the course of normal exploration & production activities on the Norwegian continental shelf. The term "zero discharge" was introduced in a white paper¹ on environmental policy for sustainable development around 2003 and has since been refined into a more precise definition.

Based upon our examination of the legislative record and literature the U.S. EPA, in general, already sets zero discharge limits and prohibits the discharge of oil, oil-based drilling fluids, and certain chemicals (such as produced sand, water and drilling wastes) demonstrated to be toxic to the marine environment. Offshore operations in frontier areas typically tend to deploy newer, state-of-the-art technologies that incorporate the latest environmental protection safeguards and as a result do not generally have undo difficulty in meeting current requirements.

Questions from the Ranking Member Doug Lamborn, from the State of Colorado

- 1. You have been working in the deepwater of the OCS for a number of years now, can you explain to this committee the difference in the technology since say 1990? What was the major cause for the advances in the technology?**

Over the past 20 years, there have been several important technological advances in the offshore. I'll mention only 3. The enormous improvement in seismic imaging (the ability to "see" into the earth) is closely tied to the advances in computing power and computational algorithms. Many of the most powerful computers on earth are used in industry exclusively for seismic imaging of the earth. Just as in medical imaging technology, the imaging of the earth has made it possible to "see" into the earth with greater clarity, depth and detail. The result has been the identification of new areas and targets for hydrocarbon exploration that had never been tested or conceived of before. Closely associated with these advances have been huge advances in deepwater drilling technology. Not simply to greater water depths, but much deeper depths in the earth. Twenty years ago, drilling in 3000-4000 ft. water depths was considered extreme and the industry only dreamt of drilling beyond 5000 ft. of water. Wells are now being drilled in 10,000 ft of water. Suggestions of drilling wells to depths of 30,000-35,000 ft. were considered laughable. Now this is almost becoming routine. Lastly is the design and deployment of deepwater production platforms that "float" in the ocean at great depths, are located hundreds of miles from shore and safely produce oil and gas. These complex and often enormous facilities use the latest metallurgy, satellite positioning, and state of the art marine, safety and environmental engineering.

- 2. Cobalt operates not just in U.S. waters correct? What is the business climate like in some of the other countries that you have worked in? Do any of those countries limit access to the OCS the way America does? Given a choice, would you rather work in the U.S. or overseas?**

The business climate varies tremendously outside the United States and hence it's difficult to generalize. In deciding where to explore, most companies consider several factors including 1) the hydrocarbon resource potential and technical risk (could there be a lot of recoverable oil and gas?), 2) the commercial terms (what are the

¹ Starting White Paper No. 25 (2002-2003) The Environmental Policy of the Government and the State of the Environment in Norway.

costs and how is the value of what is discovered and produced split between government and industry?) and 3) the commercial or political risks (is the country stable and will they stand behind their agreements and contracts?). We evaluate all opportunities, including those within the U.S., using these criteria. Most companies choose to work both in the U.S. and elsewhere to balance their technical and commercial risks. The U.S. is the most heavily drilled country in the world and hence the discovery sizes tend to be smaller than in other countries. This is off-set by a more stable political climate and until recently, a more consistent royalty and tax regime. I would prefer to work in the U.S., but in the end the industry will invest where the opportunities exist to profitably find and produce oil and gas. There is a global competition by countries to attract quality companies to find and produce their oil and gas, and a global competition by companies for the “best” opportunities in the world.

3. On March 18th MMS held a lease sale in New Orleans where the 181 south area will be offered for lease for the first time in more than 20 years. I was wondering if you were hired to do work in this area what kind of timeline would you foresee for development from lease to production?

Given the remote location, the extreme water depths and my view of the technical risks, I would foresee a time-scale of 7-10 years. This assumes no delays due to environmental permits, availability of seismic vessels, or deepwater rigs.

4. Geologically speaking, is there such a thing as a “common” OCS lease?

Each lease, or from a geological perspective, each exploration prospect is unique. Even though there are trends of similar geological characteristics within most petroleum basins, these trends represent only high level similarities, such as sandstone reservoirs or carbonate reservoirs.

Geological variations, ranging from sea floor conditions, which dictate facility design, to variations in reservoir characteristics, which dictate well design, make each lease/prospect different.

An OCS lease is a regulatory construct, a series of lines on a map that define the areal boundaries of where a leaseholder is able to explore. As such, it has nothing to do with the underlying geology, which controls whether a particular lease contains oil or natural gas.

When an exploration company bids on a lease, it has typically made an initial assessment of the underlying geology and determined based on that assessment that the probability of finding oil and gas there is high enough to warrant submitting a bid. It is pursuing an exploration concept. There is no guarantee that the concept will work, and that they will find oil and natural gas on a particular lease. Finding petroleum requires drilling at least one exploration well in the area. That is the only way to determine whether for certain leases contain oil and natural gas.

If the exploration concept works, and the exploration well discovers commercial quantities of hydrocarbons, the process of field development begins. A designation by MMS of an oil or natural gas field, and the approval to produce the petroleum contained therein, is a regulatory boundary with geological significance.

But if the company does not find oil and natural gas during their exploration program, that doesn’t necessarily mean that the lease is barren. It means that the exploration concept didn’t work. The data obtained during the exploration phase may enable the company to refine its exploration idea, or to try a different idea with a future exploration well. Or they relinquish the lease, and subsequent exploration companies try a different exploration concept.

There is a misperception that all oil and natural gas leases contain petroleum, and that if companies would just “drill the leases” we would find the oil and natural gas contained therein. The exploration process is actually based on the scientific method: developing a hypothesis and then testing that hypothesis. It is reliant on scientific and technical advances. Each region of the OCS and in fact each lease block has geologic variability that determines whether it contains oil and natural gas.

Questions from Representative Dan Boren, from the State of Oklahoma

1. You already have 68 million acres you are sitting on. Please tell us why we would give you more access to acreage.

The industry does not “sit” on its leases, nor were we “given” acreage. In fact, Cobalt paid the Federal government over \$630 million to acquire leases over the past two years. The last thing we or our investors wish to do is sit or delay activity on leases and the investments we’ve made. Cobalt and the entire industry make money by efficiently exploring, developing and producing from leases. We spend an enor-

mous amount of time and money after we've acquired the leases, evaluating their potential through the use of seismic and geologic technology prior to drilling. The analysis of the data helps to better define the areas that are most likely to contain oil or gas. Despite our investment, most of our leases will in the end not contain oil and gas. Oil and gas fields are quite rare and difficult to find. Sometimes after drilling we find that our ideas were wrong and that we have to look elsewhere, either on existing leases or on un-leased areas. Regardless of whether or not we find oil and gas, to retain the leases Cobalt will also pay to the U.S. Government approximately \$5.6 million each year in lease rentals. Not progressing work on these leases is like continuing to pay rent on an empty house or commercial building. It adds absolutely no value.

2. Many of my colleagues assert that the oil and gas industry already has access to a vast amount of acreage of the OCS, but you have developed only a fraction of it and thus no new leasing is necessary until those leases have been utilized, the so called "use it or lose it" doctrine. So why does your industry need more leases when you haven't developed the ones you already have?

The MMS estimates that only about 15% of the OCS is currently available for leasing. Of this only a tiny fraction will actually contain oil and gas. Areas are leased because one of the dozens of exploration companies thinks it "may" contain oil and gas. Many turn out to be wrong. No one knows until much more technical evaluation and possibly drilling is completed. The most compelling reason to offer more leases is simply because it offers the country the best opportunity to find substantial new oil and gas resources. Science, geology and technology should lead in identifying where leasing and drilling should be done. I'm convinced the industry can safely and efficiently find and produce significant new resources if leasing is expanded. Every barrel of oil we can find in the U.S. means one less barrel that will need to be shipped across the oceans in tankers and imported into the U.S.

Mr. COSTA. Thank you, Mr. Farnsworth.

We are now at the part that I think most of the Subcommittee Members look forward to, and that is an opportunity to question our witnesses and make comments.

Let me begin. Mr. Rusco and Ms. Kendall, in your testimony and reading the GAO Report, I was struck by the differences between the Minerals Management Service's process for leasing and the Bureau of Land Management and the more methodical seemingly at least from the layperson's perspective, that being mine, the more comprehensive and methodical system on offshore as opposed to onshore.

Would you care, both of you, to comment as to whether or not you think we ought to maybe put them all under one agency or whether or not we should employ the same sort of process that MMS uses with BLM?

Ms. KENDALL. I think that there certainly are some economies of scale that could be had, whether it is putting them all under one or having the bureaus work together in several areas. I agree with you that the MMS leasing process is much more methodical, much more well thought out.

Mr. COSTA. More comprehensive?

Ms. KENDALL. And more comprehensive, yes, sir. I believe that with the recent—

Mr. COSTA. I mean, why couldn't they be done by one? We might even save some money.

Ms. KENDALL. I do not know that there is a reason.

Mr. COSTA. OK. Because it is my understanding, I spoke actually with Secretary Salazar, and he is looking at this, after the State of the Union, and for Members of the Subcommittee's information,

this was actually created organically as I understand but not by statute, and so this bears more looking.

Mr. Rusco, could you care to comment?

Mr. RUSCO. Yes. I agree with what Ms. Kendall said in general. There seem to be differences in the way that MMS and BLM manage leases that have more to do with historical accident or bureau culture than sort of a comprehensive plan to manage the resources, and that is why what we have called for is for Interior to undertake a comprehensive review of how it is going to manage these resources, and if that leads to different practices onshore than offshore, some of those are likely warranted. But we would just like to have some assurance that if there are going to be differences in the way these leases are managed, that it is a reasoned decision and one that has been given enough due diligence.

Mr. COSTA. And so both of you basically have indicated that in terms of a more predictable and transparent process that we could do a lot more in standardization, using computer modeling as well.

Ms. KENDALL. I think certainly in our most recent review, we found a number of areas where they use inconsistent terms, they measure things differently, one bureau from the other. So getting together so at least you have consistent measurement, consistent management and consistent oversight would certainly go a long way.

Mr. COSTA. Thank you. We want to explore that further, but before my time is up, Mr. Oynes, you indicated on the lease provisions that you cited last year the striking difference between different leases that were bid on in Alaska and other parts that were made available. Could you cite off the top of your head the extreme differences on what the successful bids were?

Mr. OYNES. I do not remember the successful bids, but we did have a very successful sale in the Chukchi Sea in Alaska last year. It was a record-setting sale.

Mr. COSTA. As much as over a billion dollars or more?

Mr. OYNES. It was over \$2 billion.

Mr. COSTA. That is what I thought.

Mr. OYNES. Yes.

Mr. COSTA. And, of course, some leases were down in the hundreds of millions of dollars and less, right?

Mr. OYNES. Right. That is correct.

Mr. COSTA. And what does that tell you? I mean, what would that tell me as the layperson? Some leases are more valuable than others?

Mr. OYNES. Well, some have more prospectivity as to whether the hydrocarbons are there and whether there are more significant accumulations. Until you do drill, though, it is not known.

Mr. COSTA. Right. No, I understand that. Because my time is limited, I would like to get to Mr. Farnsworth on that point, and it gets back to what I think is nonsensical about "Drill, Baby, Drill" or "Use It or Lose It." I could be humorous here, but I will not.

My time is up, but, please, both of you, take a crack at this. We want to incentivize this balanced portfolio that you have heard me speak of, but yet the New York Times article that came out—that I hope most of you saw—talks about how as oil and gas prices plunge, the frenzy of drilling ends. There are various citations in

there by some of your cohorts that indicate that one company, Devon, has gone from a 35-rig count down to eight. It talks about the ratcheting back down.

And, I mean, I guess you could make more leases available, as we did with this most recent lease that my colleague from Colorado cited, but nonetheless, which begs the question, back last fall, a lot of it is determined by market prices. So how do we incentivize you if we want to get a better balance and less dependency on foreign sources of oil and gas, in particular if in fact the prices have plummeted and there is less incentive for you folks to take availability because of market forces of that resource that is there? Do you understand the question?

Mr. FARNSWORTH. I think I do. Let me give it a shot.

You referenced the companies dropping rigs, Devon in particular. I am pretty sure that most of those rigs they were talking about were actually onshore where they are drilling gas. In the deep water offshore, because of the long duration of the time from exploration to development and production, we have not seen any decrease in deepwater rigs because of the long-term commitment to that region.

So I think the incentives in the deep water and the OCS are well in place. Despite the collapse of oil prices, we have not seen companies pick up and move their rigs elsewhere because the Gulf of Mexico is a robust basin and the terms are sufficient to attract capital there.

Mr. COSTA. So your point is it is more in marginal leases.

Mr. FRY, you want to make a comment?

Mr. FRY. Yes, Mr. Chairman. I agree with Mr. Farnsworth. The thing about the Gulf of Mexico we have to remember, though, is it is a mature basin. It has been there for many, many years, like some of the leases that you have in your district that have been there for over 100 years producing.

Mr. COSTA. Yes.

Mr. FRY. There are new areas that are being looked at, but it is because of technology. The technology has taken us into the deeper water, into more harsh environments. So there were incentives that got people into those areas, but there is going to come a point where no matter how much we continue to work the Gulf of Mexico we are not going to be able to replace what is currently coming out of there.

So part of the incentive would be to look at some other areas. We do not say you ought to drill everywhere, but I think you have to look at some other places, some other places where prospects are.

Mr. COSTA. I want to get back to that, but my time has expired. The gentleman from Colorado, the Ranking Member, Mr. Lamborn.

Mr. LAMBORN. Thank you, Mr. Chairman.

Mr. Oynes, there was some discussion that we need a comprehensive inventory of the OCS before we act on leasing in new areas, but in Section 357 of the Energy Policy Act of 2005, Congress directed the Secretary of the Interior to provide a report titled Comprehensive Inventory of OCS Oil and Natural Gas Resources. This document was completed in February 2006 and is a collection of assessments completed over the years by the MMS and the U.S. Geological Survey. No new government-sponsored geologi-

cal or geophysical data acquisition was undertaken in this inventory.

What would be the cost if government created a comprehensive inventory of the OCS using geological and geophysical data? How long would it take, and in your opinion, does MMS have the resources to create this type of inventory?

Mr. OYNES. Thank you for the question. I think I would be better serving the Committee if I could provide a more detailed answer to that question.

Certainly it would depend a lot on what is the extent of the area that you are trying to do this assessment over. As an example, if you are trying to do it over the entire OCS, you are talking probably several hundred millions of dollars to acquire new seismic data in that kind of range of area. It would also depend on how extensive, how close, the line shooting is for the seismic. Again, it would just depend on a lot of variables. So I guess I would prefer to provide that kind of more finite estimate to the Committee later.

Mr. LAMBORN. Well, I can understand that. Take a crack if you would at the timeframe that would be involved because time is critical when we are talking about energy.

Mr. OYNES. I think, first of all, if you are trying to do the entire OCS, you would potentially run into a question of lack of seismic vessels that would impede the timing; that is, you would have to do this over a pretty good number of years in order to acquire that kind of data for an extensive area like that. Again, it would depend on the scope of what you would initiate.

Mr. LAMBORN. So a pretty good number of years.

Mr. OYNES. Probably three to five at minimum, probably three to five at minimum, again, if you are talking the entire area.

Mr. LAMBORN. OK. OK. Thank you.

Now, Mr. Fry, you just heard the answer from Mr. Oynes. A common refrain we seem to be hearing from both sides of the debate is that we need more information in terms of what potential resources are out there. Is a government-funded inventory with the timeframe and the cost that you just heard him take a stab at the most cost-effective and efficient way to determine the best-possible areas for further exploration in the OCS?

Mr. FRY. I do not believe that having government do it is the most efficient way. The situation with the lease sale that is taking place tomorrow, 208, once that area was opened for leasing by the Congress and people knew there was going to be a lease sale, the companies went in and spent the money to get that geophysical work done. The same thing would happen in other areas if those areas were open for potential leasing. You could have industry pay for the whole thing and it would not cost taxpayers a penny.

Mr. LAMBORN. OK. Thank you.

Mr. Oynes, back to you. In January, the MMS submitted a notice of intent to begin an environmental impact statement for seismic activity in the Atlantic. The notice specifies that, if started in early 2009, then the EIS would be completed in late 2010, which would open the door for private companies to submit applications for seismic inventories in the Atlantic. Can you give the Committee an update on this EIS? Also, will funding be available, and in your estimation, if we begin the EIS soon, could it be completed by 2010?

Mr. OYNES. Thank you for the question. The update is that MMS just finished closing or will be closing here in the next couple of days the comment period on that notice of intent. We had a 60-day comment period. So we are waiting first of all for that.

Second, as we indicated in the notice, the Federal Register notice, MMS does not currently have the funding to do that EIS, so we are considering whether there are other options for other sources of potential funding for that for preparation of that environmental impact statement. It would probably be again very, very late 2010 before such a document could be done, but if the decisions were made somewhat shortly, I believe we could have it done by that time.

Mr. LAMBORN. I will reserve any further questions for another round. Thank you.

Mr. COSTA. Thank you. Next is the gentleman from New Jersey, Mr. Holt.

Mr. HOLT. Thank you. Thank you, Mr. Chairman.

Mr. Oynes, let me first turn to a question on a different subject. It was announced today that there is an agreement in principle between Interior and FERC to work on permitting renewable energy in offshore waters. The conflicting or mismatched jurisdictions there have certainly put a lot of uncertainty into that development, and so I am interested to know what this actually means. How soon do you expect there will be working groups? When will we see these mismatched jurisdictions resolved?

Mr. OYNES. I think you will see that resolved relatively shortly. I would like to be able to talk with the Secretary as to what kind of discussions he has already had with FERC before I would get more specific than that. I know that he and the acting chairman have had some discussions, and certainly I am anticipating that the two staffs of FERC and the MMS and the Department of the Interior will be put together very, very soon to conclude an agreement on this.

Mr. HOLT. OK. Well, I will watch, more than watch, with interest.

Mr. Fry, the question of the day and the question I keep getting from folks back home has to do with what are regarded as unused leases or oil companies sitting on leases for eight years and finally getting around to doing something or prospectors, oil companies, spending their lease time buying other leases, neighboring leases, working out agreements and so forth.

The GAO Report indicates that only about a quarter of the leases in the OCS ever get drilled, and I am trying to understand why that is. The question I get from back home is, "Why are we talking about more leases?" There are millions and millions of acres out there that never see a drill bit. Is it technology barriers? I mean, you have the lease, and you are just not quite sure how to drill it? Mr. Farnsworth's high-tech folks have not shown up yet? Or is it a shortage of rigs? There just are not enough to purchase or hire, or are you waiting for a higher price? What is going on there?

Mr. FRY. Thank you, Congressman. There are a number of factors that come into play here. As Mr. Farnsworth talked about, you may have a lease that is not producing, but it does not mean it is

idle. You have things going on. You may be working on the seismic. You may be working on getting permits.

Mr. HOLT. That is three-quarters of them, is that right?

Mr. FRY. That is right. Certainly over half of what is out there that is not producing is—

Mr. HOLT. For the Committee's purpose, you might explain "working on seismic." You know, you are getting into technical jargon here, and people need to understand what you are talking about.

Mr. FRY. I am sorry. "Seismic" is the geophysical work where the companies will go out and try to take a picture of what is under the crust of the Earth, and then there is lots of work that has to be done to determine how to interpret that data. Oftentimes, it is below salt, which is hard to see through. So there have been lots of advancements in terms of trying to determine what is there.

So a company will do some of that before they engage in a lease sale, and then after the lease sale, they may go buy more seismic data in order to interpret that.

There are permits that are required, 17 different permits, from the time you get a lease until you actually have production.

Mr. HOLT. Let me try to find out in the limited time I have then does this activity start right away, the seismic activity, the prospecting, using the site, preparing the site, or are they, as it certainly appears to many of us outside the industry, just sitting on it?

Mr. FRY. Let me say it one other way.

Mr. HOLT. My time is just about up.

Mr. FRY. I am sorry. I thought you were asking me.

Mr. COSTA. I will grant the gentleman the extra time because I think his question should be answered.

Mr. HOLT. OK. All right. Thank you.

Mr. COSTA. On both sides.

Mr. HOLT. So, Mr. Fry, please continue.

Mr. COSTA. Yes. Finish your answer.

Mr. HOLT. If the gentleman would yield me a little more time, I would like to hear Mr. Fry's answer.

Mr. COSTA. Yes, I will.

Mr. HOLT. But I do want to get to Ms. Kendall.

Mr. COSTA. Yes. Mr. Fry?

Mr. HOLT. Mr. Fry, please.

Mr. FRY. Yes. I am rethinking my answer. I had it there for a second. Why don't we get Ms. Kendall's answer, and I will come back to mine if that is all right.

Mr. HOLT. Ms. Kendall?

Ms. KENDALL. Much of what we relied on in our report and our analysis was information provided to us by industry. I can't tell you today, Mr. Congressman, when they start, whether it is right away or not, but I do know that we were advised that oftentimes industry will buy other leases and they will spend time working on seismic and geological information to determine how much area really they need to have to have sort of the optimal amount of space over a reservoir and then figure out where to drill optimally to get the most out of the reservoir.

One of the things that we discovered as a part of this, I think “unitizing” is the term where a number of leases will come together and be considered a unit. It may just have one lease that is being drilled on, but it is pulling out the resources from the other leases, which depending on whether it is BLM or MMS reporting these leases out as producing or nonproducing, BLM reports all leases that stand over a reservoir as producing whereas MMS will only report the single lease as a producing lease while the others that are over the reservoir are not.

Mr. GOHMERT. Mr. Chairman, I ask unanimous consent to have Mr. Fry finish the answer that he was in the process and was actually saying the words in talking about the delay that over half of the leases, and that is when you had said, “Why don’t you explain seismic.”

Mr. COSTA. Are you stumping for him today?

[Laughter.]

Mr. GOHMERT. I was getting ready to write down what he said. I am curious as to what half of the leases were.

Mr. COSTA. Yes. Sometimes I think we are a little bit—I mean, as long as we have the collegiality and the amicability taking place, because oftentimes you cut people in the middle of their answer. We live in a world with too many sound bites I think.

Mr. GOHMERT. I thought it was a good question to explain “seismic,” but I was curious what he was going to say about “over half of the leases.”

Mr. COSTA. Yes, because, I mean, for those Members who have not been out there, it is really as I understand it technology that was used to determine earthquake studies for faults that lie throughout the country to better determine them.

What they do is they take a radar shot that goes down to the capability of 30 to 40,000 feet, and they are able to in a three-dimensional fashion determine the structure of the Earth 30, 40,000 feet, and then from the fractures, they are able to make assessments based upon what they think the carbon footprint may be 30 to 40,000 feet with the seismic technology, which is when he says the term “seismic,” unless you have actually seen it and watched it in front of you, you do not know what is “seismic.” I only know it because I went down there.

Mr. HOLT. No, I mean, I certainly know that, and certainly many of my classmates, my physics classmates have gone into the field, so I understand. So I would like to hear more about that. Thank you.

Mr. COSTA. Mr. Fry, please.

Mr. FRY. Yes. I apologize. To kind of get on with where I was trying to go with that, my understanding from the MMS data is that of those leases that are not producing out there that over half of them or right at half of them are less than five years old, so you are talking about a process.

Usually when somebody asks us how long will it take you from the time you get a lease until you can actually produce it in the deepwater Gulf of Mexico, the answer to that question is on the short end seven years, and it may well be longer than that if you have to put in a large gathering facility to gather that.

Mr. COSTA. And it varies from deep water to shallower water.

Mr. FRY. That is correct. If you drill a well onshore, you drill the well, and if you have hydrocarbons, you start producing it if you have a pipeline. That is not the case here. You have to drill a number of exploratory wells, not trying to produce them, just trying to delineate the field, and then ultimately you will come in with a production plan that again has to be approved by the MMS before you start producing.

The one last point I would like to make on this, there is no incentive for a company not to develop their leases. They are paying money first off every year. The amount of money goes up each year. It is something the government sets. It is called a "rental."

Companies, if they have taken a lease and find out that because of what they have learned around that lease that it is not going to be producible, they will turn those back, and there are a number that get turned back to the government before the lease expires.

Mr. HOLT. All right. Thank you, Mr. Chairman, and I just hope the Committee will explore what appears to me to be a disconnect if not a contradiction between the first three witnesses and Mr. Fry on that particular point.

Mr. COSTA. Certainly. We are going to have a second round. You will get a chance.

I do not think you can do it today, but I am a big believer in comparative analysis. It would seem to be helpful to the Subcommittee and the full Committee's work, Mr. Oynes, if you could help provide the information. The others who were testifying can provide input to give us a snapshot between the development of producing wells, and I do not know what threshold you would determine on a field that is a good field that is in production. How long did that take between deep water, shallow water versus other efforts that ended up not producing? The timelines and the permit process could all kind of be laid out so we could look at it.

Mr. Chaffetz? Did I pronounce that properly?

Mr. CHAFFETZ. You are getting closer, Chaffetz, long "A."

Mr. COSTA. Chaffetz.

Mr. CHAFFETZ. Chaffetz.

Mr. COSTA. Chaffetz.

Mr. CHAFFETZ. You can call me "rookie" or "freshman." That would be fine.

[Laughter.]

Mr. COSTA. The new Member from Utah. You have been patient.

Mr. CHAFFETZ. Hey, you. I answer to that as well.

Mr. COSTA. I answer to many things.

Mr. CHAFFETZ. No. Thank you, Mr. Chairman.

Mr. COSTA. You have been patient. Go ahead.

Mr. CHAFFETZ. I appreciate it, and thanks to all of you for being here and preparing your testimonies. I have just a couple of moments, so I need to move swiftly.

Ms. Kendall, my first question is really directed toward you. In order to develop these leases and these relationships, it takes two parties, right? It takes the United States of America and it takes a contracting company or a private company that will develop a contract, and that is a two-way relationship.

Now, in those contracts, in those types of agreements, if the company unilaterally just decided that they were going to pay us less

or just decided that they did not want to pay as much as they had originally contracted to, we would take great issue with that, wouldn't we?

Ms. KENDALL. I believe so, yes.

Mr. CHAFFETZ. And so, if we were to unilaterally as a contracting party, the other side, if we were to just unilaterally go and change the terms of that contract, would that be fair?

Ms. KENDALL. I do not believe so.

Mr. CHAFFETZ. OK. So the idea that we would just unilaterally after developing and signing a contract with a company, if we would actually go and impose a new fee that they did not have before, do you think that would be fair to those companies? Would that be right and legal?

Ms. KENDALL. Without context, without an actual case in point, I do not know whether "legal" or "not legal" would be something that I could opine on. I think if you have a contractual relationship and an agreement, you are bound by those terms.

Mr. CHAFFETZ. I guess my concern is just as if the company decided unilaterally not to pay us as much money as they had contracted to, if we as the United States of America imposed a new fee, the President here had introduced in his budget \$1.1 billion over 10 years for "charging a new fee on nonproducing leases in the Gulf of Mexico," that that would constitute a change in the contract and the relationships that we already have.

Ms. KENDALL. I do not feel qualified to opine on that quite frankly, but I think you would need to look at the terms of the lease document themselves and see whether there is an opportunity in that lease document—I am truly not familiar—some of these lease documents are inches.

Mr. CHAFFETZ. OK. Yes. Just the concept I think is what I am concerned about.

Mr. Rusco, if I can ask you a couple quick questions.

Of the leases that you looked at in the study here, how many of these leases paid a bonus bid up front to the Federal government, what percentage of those contracts?

Mr. RUSCO. Actually I do not know the answer to that. That was not in the data that we looked at. I would have to look into that, but I am not sure that we could easily answer that.

Mr. CHAFFETZ. Do you have any idea how many of these leases made rental payments to the Federal government during their term?

Mr. RUSCO. Almost certainly all or most of them did, yes.

Mr. CHAFFETZ. Ms. Kendall, do you have any idea how many of these leases paid a bonus bid up front?

Ms. KENDALL. I am not familiar with that information.

Mr. CHAFFETZ. Or how many pay a rental fee along the way, a rental payment I guess to the Federal government?

Ms. KENDALL. No. I am afraid I cannot answer that.

Mr. CHAFFETZ. Going back to Mr. Rusco, in your report, you state that "Interior does less to encourage development of Federal leases than some states and private landowners." Is failing to process permits in a timely manner one of the ways Interior fails to encourage development on Federal leases? Does that slow down the process?

Mr. RUSCO. In a previous report—I cannot remember the date of the report, but maybe four or five years ago—we looked into BLM’s inability to match workforce planning with the increase in leasing and drilling applications. Essentially what happened was the drilling applications shot way up. BLM was not prepared to put more staff on that, so they put essentially all their staff on that and were not taking care of some of their other responsibilities, including environmental inspections.

Mr. CHAFFETZ. There are companies, my understanding is, in the Alaska OCS that have been waiting nearly three years for a Federal permit. Would that constitute a hindrance of diligent development by the Federal government?

Mr. RUSCO. I do not know how to evaluate “diligent development” from the perspective of what the government requirements are. I mean, diligent development would include meeting all the requirements set by statute and regulation, but if you are asking is the process a lengthy process to get applications to drill, sometimes very lengthy, yes.

Mr. CHAFFETZ. And lawsuits, would that slow down the process?

Mr. RUSCO. We have not studied the incidence of lawsuits recently, but if there were a lawsuit, it could.

Mr. CHAFFETZ. OK. And in your report, you frequently compared the lease terms between state and Federal leases. How many state leases were deepwater leases?

Mr. RUSCO. For the state and private, almost all of them were onshore.

Mr. CHAFFETZ. OK. So there were no state leases that were offshore, correct?

Mr. RUSCO. There may be a few, but most of them are onshore.

Mr. CHAFFETZ. OK. Thank you, Mr. Chairman.

Mr. COSTA. Thank you. Now the gentleman from Texas, who has got his green tie on. Good to see you, Mr. Gohmert.

Mr. GOHMERT. I like your green tie too, Mr. Chairman.

Mr. COSTA. Flattery will get you everywhere.

Mr. GOHMERT. Well, there we go. Well, I can help my friend from Utah with the issue of what is legal because we have seen that happen here.

Normally theft, for example, is described as taking someone’s property without their permission, yet we have the ability to pass a law that we will send you to jail if you do not pay your taxes and therefore take your property without your permission, and that theft is legal unless you are the Secretary of the Treasury, and then it is not an issue.

But anyway, we have the power to legalize things that may be immoral or unfair, and that is why we should have an obligation to look at what is fair.

I did not know, Mr. Fry, where you were going with “over half of the leases,” but it is interesting. You said that over half of those leases that are not being produced are less than five years old and that, on average, it takes around seven years to get to production. And then Mr. Holt had mentioned there was some difference or dichotomy here.

So I would just like to ask our first three witnesses, do you have any different information than what Mr. Fry said about the aver-

age that well over half of those leases being less than five years old?

Mr. RUSCO. Well, we looked at two things in our report looking at development of leases, and one is we picked a sample of leases, a 10-year sample of leases from 1987 through 1996. We picked that sample so we could look through the whole life of the lease because a lease typically was 10 years, and for the second half of that sample, it was five years onshore prior to that.

And what we found in looking at that sample and following it all the way up to the point at which we reported was that there was a big difference between the degree to which onshore versus offshore leases were developed. Specifically, development activity, significant development activity, including drilling, occurred on only about six percent of the onshore leases and about 26 percent of the offshore leases, and actual production occurred on about five percent of the onshore leases and six percent of the offshore leases.

And, unfortunately, we were unable to follow each piece of property through its life cycle because it is possible that a lease onshore or offshore is issued, is not developed during the term of its lease, is given back to the government, eventually reissued and then eventually drilled, but we had a 10-year window, and we looked as long as we could look.

So I think you would have to look at the whole life cycle, especially onshore. This is important because a great deal of the land onshore has kind of been picked over, and many of the leases that exist today were past leases that did not produce and then they have been resold.

Mr. GOHMERT. And they find new structures. I mean, we have seen that in Western Louisiana and East Texas, a new formation that they did not realize would produce the natural gas that it does.

But you said something interesting. You said that we have not studied it, but if there were a lawsuit, perhaps it could delay. You have not looked at the effect of lawsuits on these leases? Because we heard information here at one point—I forget what the area was—that virtually every lease that was let by the government was litigated. You have not looked at that at all?

Mr. RUSCO. In the past, we have looked at that, and I hesitate to comment on that, that was not my work, but I do not believe that every lease is litigated. But I do not want to comment further without looking.

Mr. GOHMERT. OK. Well, let me ask, and this is more of the MMS, but it is my understanding that no exploration wells had been drilled on the leases for the OCS north of Alaska and one company supposedly had been trying to do it for three years. Do you know whether they stopped the work?

Mr. OYNES. On that question, there has been litigation on several of the more recent lease sales. Just to slightly modify your statement, though, Congressman, there were prior lease sales in the Arctic area that there have been wells drilled. So there is a current controversy, there is current litigation, but there have been some wells drilled. In fact, there are two projects that are proceeding to production.

Mr. GOHMERT. Do you know what the controversy in litigation is?

Mr. OYNES. Well, it is on several different levels. There is trying to block the exploration plans that the companies have filed for. There is also a challenge on the Chukchi sale that I mentioned with the Chairman earlier. There is a challenge to that lease sale, and that still is pending litigation. So that puts some degree of a cloud even on those leases that were issued from that sale.

Mr. GOHMERT. OK. Thank you, Mr. Chairman.

Mr. COSTA. I thank the gentleman from Texas.

We are going to do one more round here.

Ms. Kendall, in your examination of the efforts, do you think the eight-year lease is a good model for us to apply in other instances, and does it fly in the face of "Use It or Lose It"?

Ms. KENDALL. I am sorry, Mr. Chairman. Your question was the eight-year lease?

Mr. COSTA. Yes. Is that a good model for other areas in terms of application of these lease provisions?

Ms. KENDALL. I do not personally have enough information to give you an opinion on that. I am sorry, Mr. Chairman.

Mr. COSTA. All right. All right. Mr. Rusco, do you have any thoughts on that?

Mr. RUSCO. I think that a standard lease of any length may not be the answer for all properties because the properties differ a great deal. Some properties you know exactly what you are looking for and you know essentially where it is. You can look at some on-shore gas basins and the companies know where the gas is.

Mr. COSTA. But I am talking about where companies are required to drill in the first five years of the lease.

Mr. RUSCO. I do think that there is merit in looking into that, and I think that it is a complicated factor. There are a lot of complicating factors, but I do think that one of the most important things that would influence that decision is how prospective the property is. If it is very prospective, I think that having a shorter lease term may make some sense. If it is a very speculative property, then I think probably less.

Mr. COSTA. It also depends I guess if it is deep water versus shallow water in the case of the offshore.

Mr. Oynes, is it possible that Minerals Management Service could do a better job in providing the information on the leases? The Inspector General's report suggested that it would take a considerable amount of effort to track the status of the nonproducing leases, but is that true?

Mr. OYNES. I think in terms of what I think I understand the report to have said in the areas that they were focusing on, it would take a considerable effort. For one thing, MMS does not have any current requirements, and we might even need new statutory authority, to require the companies to submit some kind of status report of where they are.

As an example, if they are processing and analyzing seismic data, until they come to MMS with a proposed exploratory project for an exploratory permit, we will not know that. We would be assuming that they are getting ready to file an exploration plan, but we have no mandatory—

Mr. COSTA. Could you collect more data on the unleased properties?

Mr. OYNES. Again, within the statutory framework that we have, we probably could collect some.

Mr. COSTA. Ms. Kendall, you talked about smarter production, and I was curious, what do you mean by "smarter production"?

Ms. KENDALL. I am not sure what I meant by "smarter production," Mr. Chairman.

Mr. COSTA. Well, I mean, I thought we pulled it out of the comments there. Faster production?

Ms. KENDALL. Oh, it is certainly in our report, and we were relying on academic resources that we interviewed. I want to say the Colorado School of Mines was one of our primary sources. Their assessment, which really sort of follows Mr. Rusco's discussion, is faster is not necessarily—

Mr. COSTA. Smarter?

Ms. KENDALL.—better or smarter, yes.

Mr. COSTA. OK. All right. OK. I want to close here again with Mr. Fry and Mr. Farnsworth.

Having read the two reports, GAO and the other, what would your comment be quickly, because I want to go to another question on the reports?

Mr. FRY. Well, I think you have really covered the question that I have about the GAO Report. In that report, it talks about royalty rates being so low in the U.S., but my understanding is it does not take into account the bonus bids that are paid or the rentals that are paid.

Mr. COSTA. OK. That is the deficiency you think in the GAO.

Mr. FRY. Yes. I think if you put those back in, we would be on a par with the rest of the world.

Mr. COSTA. Mr. Farnsworth?

Mr. FARNSWORTH. The only thing I would add to that is that the size of the leases in the Gulf of Mexico and the United States are about one-two-hundredth to one-four-hundredth the size of a lease elsewhere in the world.

Mr. COSTA. Do you agree with Mr. Fry's comment then?

Mr. FARNSWORTH. I do, yes.

Mr. COSTA. OK. Mr. Rusco, what do you think?

Mr. RUSCO. It is difficult to compare, but companies and governments do it—

Mr. COSTA. In other parts of the world.

Mr. RUSCO.—in other parts of the world, and the study that we cite did include rental rates. It did not include bonus bids, and the reason it did not is because there are bonus bids and other kinds of payments that are unobservable. Ours are observable, but lots of places all over the world they are not, so there is a difficulty there.

Mr. COSTA. As to who is paying who.

Mr. RUSCO. That is part of the problem. But it is a fact that the United States is a very popular place to invest in oil and gas. When in the last five or six years the number of drilling rigs in operation in the world doubled, much more than half of the increase was in the United States alone. So that kind of indicates that we are a popular place.

Mr. COSTA. Well, I think a lot of it has to do with stability I would surmise.

Mr. RUSCO. Yes. We are a politically stable place.

Mr. COSTA. Right.

Mr. RUSCO. I mean, there is a lot that goes into it.

Mr. COSTA. And then you have Louie and me, but we are the bedrock of stability here.

Mr. RUSCO. We are stable politically, but one of the things that we pointed out is that our fiscal terms are not terribly stable, and that we think is something that Interior should look at.

Mr. COSTA. All right. My time has expired. The gentleman from Colorado.

Mr. LAMBORN. Mr. Chairman, I am glad we are in such good hands.

[Laughter.]

Mr. LAMBORN. OK. Mr. Fry or Mr. Farnsworth, you mentioned the technological advancements that have been made to be able to find more oil and gas and in a safer manner. Can you give us a quick example maybe of that, and what was the cause for the advances that have been made in this area of technology?

Mr. FARNSWORTH. The two big advances have been, as we discussed, the seismic where we have a much better image of what the Earth is doing below us. Having said that, it is still extremely difficult. Oil and gas fields are very rare, and so only a few of the leases will end up having major oil and gas fields.

The other thing is in drilling. The drilling technology has advanced tremendously over the last 10 years. We could not do what we are doing now 10 years ago. It would have been impossible.

Mr. LAMBORN. OK. Thank you.

Moving right along, Mr. Oynes, Secretary Salazar announced last week that permits for renewable projects will be getting priority, and I think we can all agree that expediting the permit process for energy development on public lands is important and I believe for whatever the type of energy we are looking for. But my question is, do we have to slow down oil and gas permits in order to process renewable permits if they are going to be getting priority?

Mr. OYNES. I do not believe so. I think we have resources to continue to move oil and gas forward.

Mr. LAMBORN. OK. OK. Thank you.

And my last question builds on what was asked a moment ago by the Chairman comparing the reports that the GAO does—this would be for Mr. Rusco—with other countries, and I know you have already touched on that, but are these other countries limiting access to their offshore drilling the way that the U.S. is? I mean, don't we have more burdens on the private companies with what they have, the permitting and the regulations, the litigation, than the other countries impose upon the people drilling there?

Mr. RUSCO. Well, it is a very mixed bag. I mean, many of the countries do not allow private investment at all or have extreme restrictions on ownership of resources and do not have stable property rights, so there is that factor.

In terms of our environmental requirements compared to other countries, I do not know. We have not studied that. There are certainly countries that have far less environmental requirements than we do, but there are many countries in Europe, for example, and Canada that must be very similar to us in that regard.

Mr. LAMBORN. Would any of those countries have the same litigation environment that the U.S. has?

Mr. RUSCO. I do not know. We have not studied that.

Mr. LAMBORN. OK. Thank you, Mr. Chairman.

Mr. COSTA. All right. The gentleman from Texas, Mr. Gohmert.

Mr. GOHMERT. Thank you, Mr. Chairman. I have a question, Ms. Kendall, just very briefly. This Committee is aware of the investigation into wrongdoing at the NLCS program. Do you know what the status of that is?

Ms. KENDALL. At which program, sir?

Mr. GOHMERT. The National Landscape Conservation System this Committee has dealt with or the full Committee. Are you familiar with the investigation by your office into that?

Ms. KENDALL. I am familiar with the investigation. I am not familiar with its status right now.

Mr. GOHMERT. OK. Well, another issue too. You know, the leases which recently the checks were sent back for the shale in Utah, Colorado and Wyoming, we had heard in here in this room that actually that was a seven-year-long process of companies doing their investigation, leading up to award of the leases, the auctioning of the leases. Do you know for sure how long that was in progress leading up to the award of the leases before the end of last year?

Ms. KENDALL. I am not aware of that, sir.

Mr. GOHMERT. Mr. Oynes, do you know?

Mr. OYNES. No, I don't, no.

Mr. GOHMERT. OK. Are you aware of any time the Federal government has ever just awarded leases without a lead-up process to that?

Ms. KENDALL. I do not know of any. I do not know one way or the other.

Mr. OYNES. I am more familiar with the offshore portion rather than the onshore, and the offshore portion, it would be statutorily mandated. We have a long lead-in process.

Mr. GOHMERT. Right, right. OK. I would submit that is what we do everywhere. There is a long lead-in process. So to say that something like that was done at the midnight hour is not terribly accurate without getting into motivation.

Are any of you, any of the five of you, aware of any nation in the world that has put its coasts off limit to energy development? Anybody?

[No response.]

Mr. GOHMERT. As we used to say in picking juries, I take it by your silence that nobody knows of anything. But, Mr. Fry, do you have a comment?

Mr. FRY. The answer is of course other than here.

Mr. GOHMERT. Other than here, yes.

Mr. FRY. There are certainly incidences where people have taken certain areas off limits in certain countries. There have been discussions about that in Canada from time to time, but Canada does have a process in order to try to open these areas.

Mr. GOHMERT. We do not drill the Great Lakes, do we?

Mr. FRY. We do not. Canada does.

Mr. GOHMERT. Well, that is what I mean, and as I understand, they are nice enough to sell us the energy that they suck out of

the Great Lakes. They sell it back to us after they have sucked it out from our part, and that is what you want from a good neighbor.

Well, I appreciate the written testimony that has been submitted. I appreciate the information you have. If anybody has any other thoughts, we would really welcome them. The Chairman always says if you want to add, you have five days to do so, but a lot of people overlook that, but it is a chance.

Mr. COSTA. Ten days.

Mr. GOHMERT. Ten days. That gives us additional information that you may think of when you do not have to look at people like us up here. All right. Thank you very much, sir.

Mr. COSTA. Yes. I recognize the Ranking Member.

Mr. LAMBORN. Mr. Chairman, in addition to the two articles I mentioned earlier, I would ask unanimous consent to submit for the record also a staff report on leasing and a CRS report on acreage for the record.

Mr. COSTA. Without objection.

You know, Mr. Gohmert, I am just a farm boy from California, from Fresno, but you must have been fascinating to hang out with in the courtroom. I suspect that was not only insightful but probably just good humor and fun. We make sure that we do not take ourselves too seriously when we apply the law in the courtroom.

Mr. GOHMERT. I had to be very careful about my little quips because they can be the basis for appeals.

Mr. COSTA. Yes, I would think so.

I want to thank the members of this panel for your testimony and for your responses to our questions, and I have some others that I would like to get a better sense of in terms of incentivizing the expiration of those leased properties and those that may come up for leases in an attempt to reduce our dependency on foreign sources of oil and gas and how that helps bridge the transition in light of these depressed market prices, which is good news for our economy right now actually, but at the same time, if in fact if that is a disincentive, how we move forward in this comprehensive energy portfolio that we are trying to develop and transcend to. So I will submit that in the form of questions and you can provide your best answers.

Thank you very much. This Subcommittee hearing is now adjourned.

[Whereupon, at 11:45 a.m., the Subcommittee was adjourned.]

[Additional material submitted for the record follows:]

[Congressional Research Service Memorandum from Marc Humphries to House Committee on Natural Resources, "Federal Lands Offered for Lease Since 1969 by Administration," follows:]



MEMORANDUM

January 14, 2009

To: House Committee on Natural Resources

From: Marc Humphries

Subject: Federal Lands Offered for Lease Since 1969 by Administration

This memorandum is in response to your request for information on the amount of federal lands offered for lease by various Administrations (President Richard Nixon through President George W. Bush). The table below provides offshore and onshore data by Administration. The Bureau of Land Management (BLM) does not have data for onshore acreage offered for lease prior to 1988, according to BLM Mineral Leasing Specialist Gregory Shoop.

I hope this information meets your needs. If you have any further questions, please give me a call at extension 7-7264.

Table 1. Federal Land Offered for Lease by Administration
1969-2008

Administration	Offshore Acreage	Onshore Acreage	Total Acreage
Nixon/Ford (1969-1976)	18,645,676	n/a (see note below)	n/a
Carter (1977-1980)	10,959,513	n/a	n/a
Reagan (1981-1988)	652,490,269	n/a	n/a
Bush (1989-1992)	259,554,410	36,651,813	296,206,223
Clinton (1993-2000)	420,277,357	46,427,365	466,704,722
Bush (2001-2008)	403,953,986	31,488,455	435,442,441

Source: Minerals Management Service(offshore data), Bureau of Land Management (onshore data)

Note: n/a – not available

[A New York Times article entitled "As Oil and Gas Prices Plunge, a Frenzy of Drilling Ends" by Clifford Krauss submitted for the record follows:]

The New York Times

March 15, 2009

As Oil and Gas Prices Plunge, a Frenzy of Drilling Ends

By CLIFFORD KRAUSS

FORT WORTH—The great American drilling boom is over.

The number of oil and gas rigs deployed to tap new energy supplies across the country has plunged to less than 1,200 from 2,400 last summer, and energy executives say the drop is accelerating further.

Lower prices are bringing to an end an ambitious effort to squeeze more oil from aging fields and to tap new sources of natural gas. For the last four years, companies here drilled below airports, golf courses, churches and playgrounds in a frantic search for energy. They scoured the Rocky Mountains, the Great Plains, the Gulf of Mexico and Appalachia.

But the economic downturn has cut into demand. Global oil prices and American natural gas prices have plummeted two-thirds since last summer. Not even an unseasonably cold winter drove down unusually high inventories of natural gas.

The drop has been good news for American consumers, with gasoline now selling for \$1.92 a gallon, on average, down from a high of \$4.11 in July. But the result for companies is that it is becoming unprofitable to drill.

The reversal of fortune could have important implications for the future health of the nation's energy companies, for consumer wallets and for national aspirations to rely less on foreign energy sources.

The drilling cutback has been particularly stark for natural gas. Gas exploration had soared in recent years after technology advances enabled the exploitation of gas trapped in huge shale beds found around Fort Worth, western Pennsylvania, upstate New York and elsewhere.

But that boom has created such abundant supplies that companies are not only drilling less but also deciding not to pump from wells already drilled.

Thousands of oil and gas workers who migrated around the country to work in new fields for fat salaries have been laid off.

"The big bonanza is over," said Jay Ewing, the completion and construction manager for Devon Energy in the Bamett Shale field here, where so far this year his company has brought its rig count from 35 to 8. "Everyone is really shocked how fast everything has turned."

Energy experts and company executives warn that oil and gas companies now cutting back on investments will be unable to respond quickly to a future economic recovery. John Richels, Devon's president, said that if the slump lasted two years, it could then take 18 to 24 months for companies to reassemble rig crews.

That means a glut could rapidly turn to scarcity, sending energy prices soaring again. Already, experts are predicting that lower domestic gas production by the end of the year will require increased imports of liquefied natural gas from places like Qatar.

Through most of this year, gas supplies are not likely to decline sharply because so many shale wells came on line recently. But those wells should start to decline in productivity by next year, potentially leading to tight gas supplies if industrial and residential use picks up significantly in the second half of 2010.

"Inevitably, the market doesn't react; it overreacts and shoots itself in the foot," said Adam J. Robinson, director of commodities at Armored Wolf, a California hedge fund.

Domestic oil production is expected to increase this year over last, for the first time since 1991, according to projections by the Energy Department. That swing is attributable in part to increased production in the Gulf of Mexico from two giant new platforms that were years in the making. But some potential onshore production is likely to go untapped, as companies cut back on new drilling and abandon expensive efforts to flush extra oil from aging fields.

Many energy executives had thought the drilling renaissance, coming after years of declines, represented a new era, particularly for gas production. Domestic natural gas output rose by almost 8 percent last year from 2007, the biggest annual jump in more than a generation.

That jump reversed the widely held notion that domestic gas fields were in irreversible decline. It enabled the Texas billionaire T. Boone Pickens to promote a plan to use natural gas instead of gasoline in the nation's cars.

But such ambitions are sputtering, as falling prices force companies to cut their drilling expenditures. Oil now costs \$46.25 a barrel, down from a peak of more than \$145 in July, and natural gas costs just less than \$4 per thousand cubic feet, down from a peak of more than \$13.

One reason companies need to make cuts is that the cost of drilling and servicing operations, while falling, is still roughly double the 2005 level, while the prices oil and gas companies earn from their production are suddenly below the 2005 level. Meanwhile, the cost of borrowing money for exploration and production has soared recently in the credit crisis.

“When everybody sobers up after the first quarter and sees what their real cash flow is going to be,” said G. Steven Farris, chairman and chief executive of the energy company Apache, “people are going to be very discouraged about how much capital they have to spend and that will depress the rig count even further.” So far economists say the energy patch is still doing better economically than the rest of the country. The surge of drilling and leasing poured enough money into communities with oil and gas resources that they did not begin to feel the pain of the recession until the end of last year.

However, a slowdown appears to be coming in local tax revenue and businesses like restaurants that cater to oil workers. Residents here who receive monthly royalty checks for gas pumped through long horizontal wells tapping gas deposits deep below their homes say their payments are getting smaller or disappearing altogether.

Perhaps most nervous are the rig workers themselves. With the rig count in the Barnett Shale field down to less than 100 from a high of 227 in October—and expected to go as low as 60 before the year is over—thousands of gas field workers have already lost their jobs here.

One who is worried is Chris Stamper, 32, a derrick hand from Union, Miss. A former furniture factory worker, he doubled his salary, to \$80,000 a year, when he came to the Barnett Shale field two years ago to learn to work on a rig. Fifteen of 20 workers on Mr. Stamper’s crew have already been laid off, replaced by more senior workers from other crews that were disassembled in recent weeks. He keeps thinking about the \$216,000 house he bought for his family back in Union.

“I have to pay for it,” he said. “That’s what I worry about.”

[Washington Times article entitled “EXCLUSIVE: China stocks up on bargain oil” by Chris O’Brien submitted for the record follows:]

Washington Times Thursday, March 12, 2009

EXCLUSIVE: China stocks up on bargain oil

Chris O’Brien

EXCLUSIVE:

BEIJING I—China is forging ahead with an overseas spending splurge, snapping up resources especially oil at bargain prices and strengthening its long-term prospects for growth before Western economies can bounce back.

A series of high-profile energy deals and mining bids in the past month marked an end to the nervousness that appeared to impinge on Communist Party leaders at the outset of the global financial crisis. Attention has turned from hoarding foreign exchange reserves worth close to \$2 trillion to locking up future supplies. Oil has emerged at the top of China’s shopping list.

In February, China secured oil supply deals totaling \$41 billion with Russia, Brazil and Venezuela.

Among the most lucrative: an agreement reached with Russia, in which China will lend \$25 billion to Russian oil giant Rosneft and oil pipeline company Transneft. In return, according to Russian news reports, China will receive 300,000 barrels of crude a day for the next 20 years at a rate of about \$20 a barrel less than half the current price of \$45.

While touring Latin America, Vice President Xi Jinping signed a deal to lend \$10 billion to Brazil’s state-owned oil company Petrobras. China will receive up to 160,000 barrels a day, again over a 20-year period.

A subsequent announcement from China’s National Energy Administration further clarified Beijing’s intentions. China is considering setting up a fund for China’s three state-owned energy giants PetroChina, Sinopec and the China National Offshore Oil Corp. (CNOOC) to purchase oil and gas companies overseas. The firms will benefit from low-interest loans and direct capital injections, the announcement said.

The oil deals complement efforts to buy into the Australian mining industry. China’s biggest aluminum producer, Chinalco, has submitted a bid of \$19.5 billion to

buy an 18 percent stake in beleaguered mining company Rio Tinto. Chinese firm Minmetals has offered \$1.7 billion for Oz Minerals.

China also is seeking diversification of its foreign exchange reserves, now heavily in dollars. The head of China's energy bureau, Zhang Guobao, said earlier this week that China should accumulate more gold and uranium as well as other strategic commodities.

The spending spree extends to fast cars. Last month, a delegation of 90 Chinese companies, headed by Commerce Minister Chen Deming, toured Europe. Purchases included 37,000 BMWs from Germany and 13,000 Jaguars from Britain.

The purchases were a shrewd diplomatic move, pleasing European manufacturers, making a small dent in China's huge trade surpluses and undercutting the U.S. "buy American" drive, a policy that Chinese officials have been quick to criticize.

Song Hang, a researcher at the Chinese Academy of Social Sciences, summed up the strategy in the China Daily newspaper on the eve of the European tour, saying, "Chen can take a positive message to the world: China, as a major trading power, has no interest in adopting protectionism."

Parliamentary sessions in Beijing have spurred lively debates about how best to deploy China's mountain of cash. Commentaries in state media have called for the country to push forward with overseas acquisitions.

China "should take advantage of the current weak commodity prices in global markets by boosting certain strategic resource imports and converting some capital reserves into resources reserves," said an editorial in Outlook magazine, owned by the official news agency, Xinhua.

Much less coverage has been devoted to possible political stumbling blocks if China wields its purchasing power too assertively.

China faces opposition from those who feel Chinese companies, propped up by state cash, have an unfair advantage.

Rumbles can be heard in Australian parliamentary circles in light of the recent mining bids. Critics in Australia fear China is being granted too firm a grip on the country's resource markets, enabling Beijing to influence the prices of commodities.

Similar concerns derailed a bid by CNOOC to buy Californian oil firm Unocal for \$18.5 billion in 2005. The Chinese company withdrew the bid after Congress vehemently opposed the proposed deal. Unocal was sold to Chevron, which had submitted a lower bid.

Global intelligence firm Stratfor warns of a backlash as other economies stabilize. "China's rush to buy up resources, allies and markets faces charges of imperialism on an epic scale, bottom-feeding and taking advantage of the downtrodden," Stratfor said in a report.

U.S. companies have received minimal interest from China. The Unocal affair sticks in the government's memory, nestled just behind recent investments in Morgan Stanley and the Blackstone Group in which China lost billions of dollars.

A major factor, said Nicholas Lardy, a senior fellow at the Peterson Institute for International Economics in Washington, is that China's acquisitions have been focused on resources that tend to be found outside the U.S.

But if China starts looking at U.S. firms, such as the struggling car industry, it might avoid another Unocal moment. Western economies are in such a weak position that they may not be so selective.

"If there were some opportunities in the U.S., there might be less congressional opposition than with Unocal," Mr. Lardy said. "The focus is on the domestic recovery and there is a greater recognition in the Congress that as long as we save little, we depend on capital inflows."

[NOTE: The documents listed below have been retained in the Committee's official files.]

1. "Drilling for Truth and Coming Up Empty," compiled by Minority Staff of the Committee on Natural Resources, submitted for the record by The Honorable Doug Lamborn.
2. "The Oil Shock and Recession of 2008: Part 1." Blog Posts by James Hamilton, Econbrowser, submitted for the record by The Honorable Doug Lamborn.
3. Government Accountability Office Report to Congressional Requesters. October 2008, "OIL AND GAS LEASING, Interior Could Do More to Encourage Diligent Development. GAO-09-74, submitted for the record by The Honorable Jim Costa. See <http://www.gao.gov/new.items/d0974.pdf>.