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

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CONTENTS

SUMMARY

MOST RECENT DEVELOPMENTS

BACKGROUND AND ANALYSIS

Offshore Leasing System
    Federal Distribution of OCS Revenues

Offshore Leasing Moratoria
    California Leases

Lease Development in the Gulf of Mexico
    Barriers to Development

LEGISLATION

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

SUMMARY

Budget reconciliation provisions approved by the House Resources Committee October 26, 2005, would allow states to opt out of longstanding moratoria on oil and gas leasing on the outer continental shelf (OCS). States that agreed to allow such leasing would receive a larger share of royalty revenues.

The OCS moratoria, which prohibit leasing on most federal offshore lands, have been an important issue in the debate over energy security and the potential availability of additional domestic oil and gas resources. Congress has enacted the moratoria for each of fiscal years 1982-2006 in the annual Interior Appropriations bill. Proponents of the moratoria contend that offshore drilling would pose unacceptable environmental risks and threaten coastal tourism industries.

President George H.W. Bush, in 1990, responding to pressure from the states of Florida and California, and others concerned about protecting the ocean and coastal environments, issued a Presidential Directive ordering the Department of the Interior not to conduct offshore leasing or preleasing activity in places other than Texas, Louisiana, Alabama, and parts of Alaska — areas covered by the annual legislative moratoria — until 2000. In 1998 President Clinton extended the prohibition until 2012.

The Outer Continental Shelf Lands Act (OCSLA) of 1953, as amended, provides for oil and gas leasing of OCS lands in a manner that protects the environment and returns revenues to the federal government in the way of bonus bids, rents, and royalties. OCSLA requires the Secretary of the Interior to submit five-year leasing programs that specify the time, location, and size of the leases to be offered. The outer continental shelf is defined as submerged lands, subsoil, and seabed between the seaward extent of states’ jurisdiction and the seaward extent of federal jurisdiction.

States with offshore energy development have been seeking to receive a direct share of the federal revenues generated by those activities. Currently, the affected states receive revenue indirectly from offshore oil and gas leases in federal waters. This is in contrast to states with onshore leases on federal lands, which receive a direct share of the oil and gas leasing revenues. The state share of OCS revenues would be increased by a bill introduced by Senator Landrieu on September 22, 2005 (S. 1765).

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

Even if more of the OCS is opened to oil and gas leasing, there may be constraints to development, such as the availability of offshore drilling rigs and production platforms.
MOST RECENT DEVELOPMENTS

Budget reconciliation provisions approved by the House Resources Committee October 26 would let states to opt out of longstanding moratoria on oil and gas leasing on the outer continental shelf (OCS). Titled the Ocean State Options Act of 2005, the OCS provisions would give states allowing such leasing a larger share of royalty revenues.

A bill introduced by Senator Landrieu September 22, the Louisiana Katrina Reconstruction Act (S. 1765), would increase states’ share of certain OCS revenues.

The Department of the Interior is required to conduct a comprehensive inventory of OCS oil and natural gas resources by the Energy Policy Act of 2005 (P.L. 109-58, Section 357), signed by the President August 8. The inventory requirement would be repealed by the House Resources budget reconciliation package.

BACKGROUND AND ANALYSIS

Oil and gas leasing has been prohibited on most of the outer continental shelf (OCS) since the 1980s. Congress has enacted OCS leasing moratoria for each of fiscal years 1982-2006 in the annual Interior Appropriations bill, allowing leasing only in the Gulf of Mexico (except near Florida) and parts of Alaska. President George H.W. Bush in 1990 issued a Presidential Directive ordering the Department of the Interior not to conduct offshore leasing or preleasing activity in areas covered by the annual legislative moratoria until 2000. In 1998 President Clinton extended the offshore leasing prohibition until 2012.

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

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

Budget reconciliation provisions approved by the House Resources Committee October 26, 2005, would allow states to opt out of the OCS leasing moratoria and give states that allowed such leasing a larger share of royalty revenues. The OCS inventory in the Energy Policy Act would be repealed. The Committee estimates that the leasing provisions would raise $600-$800 million for the federal government over five years but only $300 million over 10 years because of the larger state revenue share.¹

¹Evans, Ben. “House Panel Votes to Open Refuge to Oil Leasing, Expand Offshore Drilling.” CQ (continued...)
Although no similar OCS leasing provision is included in the Senate budget reconciliation package, there has been interest in the Senate in leasing additional acreage, immediately, within Lease Sale 181 (discussed later in this report) in the Eastern Gulf of Mexico (GOM). Industry analysts believe this area contains significant natural gas deposits. The area of interest, not included in the moratoria, was removed from the original lease sale because it was considered too close to Florida’s coastline, and was placed off-limits until after the current five-year leasing plan (2002-2007). Most of the Eastern GOM and the Pacific and Atlantic coasts are included in the OCS moratoria.

**Offshore Leasing System**

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

The offshore leasing program is administered by the Minerals Management Service (MMS), an agency within the Department of the Interior. The MMS is scheduled to conduct 20 OCS oil and natural gas lease sales during the current five-year program from 2002-2007. Half of those sales will be in the Western or Central Gulf of Mexico (GOM), two in the Eastern GOM and the remainder around Alaska. Alaska’s lease sales will be held in the Beaufort Sea, Norton Basin, Cook Inlet (not referenced on map below), and the Chukchi Sea/Chukchi Basin (see figure 2). To date, nine of the twelve GOM lease sales and four of the seven Alaska lease sales have taken place. MMS defines the OCS as submerged lands, subsoil, and seabed between the seaward extent of states’ jurisdiction and the seaward extent of federal jurisdiction.

Lease sales are conducted through a competitive, sealed bonus bidding process, and leases are awarded to the highest bidder. Successful bidders make an up-front cash payment, called a bonus bid, to secure a lease. A minimum bonus bid is determined for each tract offered. Over the past 13 years annual bonus revenues have ranged from $85 million in 1992 to $1.4 billion in 1997. Bidding on deepwater tracts in the mid-1990’s led to the surge in bonus revenue.\(^2\) Bonus bids totaled $523.4 million in FY2004. In addition to the cash bonus bid, a royalty rate of 12.5% or 16.66% is imposed on the value of production depending on

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\(^1\) (...continued)

*Today.* October 26, 2005.

\(^2\) Department of the Interior, FY2002 Budget Justifications, p. 63.
location factors, or the royalty is received “in-kind.” The rate could be higher than 16.66% depending on the lease sale. Annual rents are $3-$5 per acre, with lease sizes generally ranging from 2,500-5,760 acres. Initial lease terms of 5-10 years are standard and leases continue as long as commercial quantities are being produced. Bonding requirements are $50,000 per lease and as much as $3 million for an entire area. The Secretary of the Interior may reduce or eliminate the royalty established by the lease in order to promote increased recovery.

Federal Distribution of OCS Revenues

Federal revenues from offshore leases were estimated at $5.3 billion in FY2004 by the MMS. Over the previous 10 years (1994-2003) revenues from federal OCS leases had reached as high as $7.5 billion in 2001. Revenues were as low as $3.2 billion in 1999. Higher prices for oil and gas are the most significant factors in the revenue swings. Of the $5.3 billion revenue in FY2004, $4.6 billion was from royalties.

These revenues are split among various government accounts. Revenues from the offshore leases are statutorily allocated among the coastal states, Land and Water Conservation Fund, the National Historic Preservation Fund, and the U.S. Treasury. For distribution of all revenue from federal leases, see figure 1. The states’ share from offshore leases was $75.8 million out of $1,248.7 million in total state receipts. States receive 27% of

3 A royalty-in-kind payment would be in the form of barrels of oil or cubic feet of natural gas.
OCS receipts closest to state offshore lands under section 8(g) of the OCSLA amendments of 1985. A dispute over what was meant by a “fair and equitable” division of those receipts was not settled until 1985 with the enactment of P.L. 99-272.5

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

Coastal Impact Assistance

States with offshore energy development in federal waters have been seeking to return a significant portion of the federal revenues generated to these states. They particularly want more assistance for coastal areas that may be most affected by onshore and near-shore activities that support offshore energy development. Proponents of these proposals look to the rates at which funds are given to jurisdictions where energy development occurs within those jurisdictions on federal lands, and seek revenues that will help coastal states respond to adverse onshore effects of offshore energy development. Coastal destruction has received more attention in Louisiana, where many square miles of wetlands are being lost to the ocean each year. And one of the causes of this loss is thought to be wide-spread energy related development. Currently, the affected states receive revenue indirectly from offshore oil and gas leases in federal waters. This is in contrast to states with onshore leases on federal lands, as noted above.

There are two fundamental purposes for revenue sharing programs, according to the Coastal Impact Assistance Working Group (an MMS advisory group): 1) to fund projects that will mitigate the environmental and economic impact of OCS energy development, including the need for infrastructure and public services, and 2) to help sustain development of nonrenewable energy sources.

Two federal revenue sharing programs addressed coastal impacts from OCS energy development: 1) the now-expired Coastal Energy Impact Program (CEIP) established as an

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4 The 8(g) revenue stream is the result of a 1978 OCSLA amendment that provides for a “fair and equitable” sharing of revenues from 8(g) common pool lands. These lands are defined in the amendments as submerged acreage lying outside the 3-nautical mile state-federal demarcation line, typically extending to a total of 6 nautical miles offshore but which include a pool of oil common to both federal and state jurisdiction. The states’ share of the revenue (27%) was established by the OCSLA amendments of 1985 (P.L. 99-272) and is paid directly to the states. Payments to the states previously had been placed in escrow, then were paid out between 1986 and 2001.


6 State jurisdiction is typically limited to 3 nautical miles seaward of the baseline from which the breadth of the territorial sea is measured. However, the state jurisdiction off the Gulf Coast of Florida and Texas extends 9 nautical miles and for Louisiana, 3 imperial nautical miles. Federal jurisdiction extends, typically, 200 nautical miles seaward of the baseline from which the breadth of the territorial sea is measured.

amendment to the Coastal Zone Management Act, and 2) the Section “8(g)” zone program, established under OCSLA. A third program, the Land and Water Conservation Fund, has also provided state funding from the OCS revenue stream, but the distribution of those revenues has no connection with OCS activities. Even the CEIP program was not considered a “true” revenue sharing program because its funding levels were not based on the amount of leasing activity in the OCS.

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

**Offshore Leasing Moratoria**

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

President George H.W. Bush, in 1990, responding to pressure from the states of Florida and California, and others concerned about protecting the ocean and coastal environments, issued a Presidential Directive ordering the Department of the Interior (DOI) not to conduct offshore leasing or preleasing activity in places other than Texas, Louisiana, Alabama, and parts of Alaska until 2000 — the same areas covered by the annual moratoria. In 1998 President Clinton extended the presidential offshore leasing prohibition until 2012.

Despite the current Bush Administration’s interest in increasing the nation’s energy supply, Interior Secretary Norton announced in December 2001 that it would be up to the states to request a study of the potential oil and gas resources and leasing moratorium off their shores. In addition, Secretary Norton would leave it up to the states to reconsider the leasing moratorium off their coasts. Thus, at that time, there was no overarching executive branch role in trying to lift the moratoria. Reaction to this stance had been somewhat mixed because, as some saw it, she left the door open to leasing in areas now under the moratoria even though the Bush Administration officially supports the moratoria.

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

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

There are several blocks that were removed by the Administration from Eastern GOM Sale 181 that could become available for re-lease after 2007, as part of the Administration’s new five-year leasing program. The House Resources reconciliation package would require lease sales for those blocks to be held in January and June of 2007. Industry groups contend that Eastern GOM sales are too limited, given what they say is an enormous resource potential, while environmental groups and some state officials argue that the risks of development to the environment and local economies are too great.

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

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

The House Resources Committee’s budget reconciliation package would impose a statutory leasing prohibition through June 30, 2012 on the OCS areas currently under moratoria and revoke the 1998 Clinton leasing prohibition that covers the same period. States could opt out of the leasing ban and receive 40% of OCS revenues. After June 30, 2012, states could petition for five-year moratorium extensions for OCS areas within 125 miles of their coastlines.

Also included in the Resources Committee’s reconciliation package is a requirement that MMS offer “natural gas only” leases. Under current law, all OCS lease sales include both oil and gas, and a lessee is required to develop the gas or the oil once discovered. Natural-gas-only leases have been met with much skepticism by many experts in geology, who note that most of these offshore fields are likely to contain both oil and gas. Proponents
would like the states to be able to produce natural gas off their coasts with less concern about potential damage from an oil spill.

Senator Pete Domenici, Chairman of the Senate Energy and Natural Resources Committee, has expressed an interest in opening up offshore areas now under the moratoria in a push to ease the “natural gas crisis” but has not introduced any legislation. The Senate panel’s reconciliation package does not include OCS provisions.

California Leases

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

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

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

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8 Inside Energy Extra, October 6, 2005.
10 Estimating future revenues with limited drilling is difficult at best because it is not possible determine the extent (if any) or quality of hydrocarbons. According to the MMS the leased area contains an estimated 1 billion barrels of oil and 500 billion cubic feet of unproved reserves.
Recently, several oil and gas lessees involved in the dispute submitted a new round of suspension applications to prevent lease termination and loss of development rights. In response, the MMS has prepared six environmental assessments and found no significant impact for processing the applications. However, under the Coastal Zone Management Act, a consistency review by MMS and the state’s response to that review must occur before a decision is made to grant or deny the requests. The State Coastal Commission ruled unanimously on August 11, 2005, that the lease suspensions should not be renewed. Following that decision, on August 12, a U.S. District Court ordered the MMS to conduct additional NEPA studies of the 36 leases under suspension. MMS argued that it had presented sufficient evidence for the judge to reach a decision on whether to allow MMS to grant further suspensions. Senator Diane Feinstein of California has urged that the MMS conduct additional studies or, if not, have the leases terminated.\(^\text{12}\)

The House Resources budget reconciliation package would allow oil and gas lessees holding leases within 100 miles of the coastlines of California and Florida the option to exchange their leases for a new lease between 100 miles and 125 miles off the same state’s coastline. Lessees who want to exchange their lease will be given priority based on the amount paid in bonus bids for the original lease. If a partial lease tract is exchanged for a full lease tract, then an additional bonus payment would be required.

\textbf{Figure 2. MMS 5-Year Program Areas}

\(^{12}\) Inside Energy, August 22, 2005
Lease Development in the Gulf of Mexico

The MMS reports\textsuperscript{13} that there is great potential in the Central and Western GOM deepwater regions. And as a result of the Royalty Relief Act of 1995, there has been significant investment made (in bonus bids and annual rents) by major and independent oil and gas companies. However, very little exploration and development has yet to occur within the deepwater regions. The deepwater production in the GOM is promising and expected to grow significantly over the next 20 years. There are, however, a limited number of rigs available to drill and there are prospects elsewhere which could make any area available for leasing less likely to get developed in the short-term.\textsuperscript{14}

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

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

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

Barriers to Development

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

According to MMS officials interviewed by CRS,\textsuperscript{15} the major factor in determining exploration is the high cost of activity in the deepwater region, and also the relatively few rigs that are available to operate there. Financing oil exploration and development is an extremely complex process, frequently involving secondary markets for leases and farming.

\textsuperscript{13} Department of the Interior, MMS, Deepwater Gulf of Mexico 2004: America’s Expanding Frontier, OCS Report, MMS2004-021

\textsuperscript{14} Ibid, p.107

\textsuperscript{15} CRS analysts held frequent telephone conversations with MMS officials, and on January 18, 2005, met in person for a conference of several hours.
out development to obtain financing. According to MMS, no barriers exist to discourage or penalize innovative and flexible financing schemes.

**LEGISLATION**

**H.R. XXX (bill not yet numbered)**


**S. 726 (Alexander).**

Natural Gas Price Reduction Act. Several provisions focus on the OCS: A coastal state can request an estimate of the oil and natural gas lying seaward of the state; a state can opt out or consent to the current OCS moratoria; states or lessees would have the option to restrict OCS development to natural gas; states would receive at least 12.5% of all qualified production revenues, which would be distributed to those states with an approved Coastal Impact Assistance Plan; and royalty relief would be provided for lessees producing in deep water. Introduce April 6, 2005; referred to Committee on Energy and Natural Resources.

**S. 1765 (Landrieu)**

Louisiana Katrina Reconstruction Act. Chapter One, Domestic Offshore Reinvestment Act of 2005, Title VI would give 50% of the revenue generated from an OCS lease sale to the adjacent coastal state. From the state’s share, 35% would be paid directly to the political subdivisions in that state. The funds would be deposited into a trust fund, used for identified purposes, and allocated according to an established formula. Chapter 2 — Offshore Fairness Act of 2005 — would, among other things, extend the seaward boundaries of Louisiana from 3 geographical miles to 3 marine leagues contingent on the state meeting certain conditions within five years after the date of enactment of this law. Introduced September 22, 2005, referred to the Committee on Finance.

**FOR ADDITIONAL READING**