CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 26, 2006

H.R. 4761
Deep Ocean Energy Resources Act of 2006

As ordered reported by the House Committee on Resources on June 21, 2006

SUMMARY

H.R. 4761 would make several changes to programs related to the development of federally owned resources, particularly oil and natural gas. The legislation also would provide new authority to spend receipts from mineral leases.

On balance, CBO estimates that enacting H.R. 4761 would increase net direct spending by about $900 million in 2007, $3.2 billion over the 2007-2011 period, and $11.0 billion over the 2007-2016 period. The bulk of those effects would reflect changes in receipts from leases of submerged lands on the Outer Continental Shelf (OCS) and the distribution of such receipts.

H.R. 4761 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO expects that enacting this legislation would benefit a number of state, local, and tribal governments.

CBO will provide a separate analysis of H.R. 4761's impact on the private sector.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 4761 is shown in the following table. The costs of this legislation fall within budget function 300 (natural resources and environment), 800 (general government), and 950 (undistributed offsetting receipts).

	Outlays in Billions of Dollars, by Fiscal Year											
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-2011	2007-2016
CHANGES IN DIRECT SPENDING												
Changes in the Terms of Oil and Gas Leases												
Fee on deepwater OCS leases	0	-0.8	-0.8	-0.9	-1.2	-1.1	-1.2	-1.7	-1.9	-1.7	-3.8	-11.4
Fee on nonproducing leases	0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	-1.1
New price thresholds for royalty relief for certain leases	0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.5	1.2
Change in royalty rate for new OCS leases	*	*	*	*	*	*	0.1	0.1	0.2	0.2	-0.1	0.5
Compensation for certain nonproducing leases	0	0.6	0.6	*	*	*	*	*	*	*	1.2	1.2
Other changes to lease terms	*	*	*	*	*	*	*	*	*	*	*	0.1
Expand Federal Areas Subject to Mineral Leasing	0	-0.3	-0.2	-0.5	-0.3	-0.3	-0.5	-0.6	-0.7	-0.8	-1.2	-4.0
Changes in Authority to Spend Federal Mineral Receipts												
Repeal of certain OCS receipt-sharing programs	-0.3	-0.3	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-1.4	-2.0
New OCS receipt-sharing with states	0.8	0.9	1.4	1.2	1.7	2.0	2.3	3.0	3.4	3.8	6.1	20.7
Other federal programs	0.4	0.4	0.5	0.5	0.6	0.6	0.6	0.7	0.8	0.9	2.3	5.9
Total Changes	**0.9**	**0.5**	**1.2**	**0.0**	**0.7**	**1.2**	**1.2**	**1.4**	**1.8**	**2.3**	**3.2**	**11.0**
Memorandum:												
OCS Receipts Under Current Law [a]	-8.3	-10.5	-9.8	-10.0	-10.1	-9.4	-11.0	-10.9	-10.9	-11.2	-48.7	-102.1

NOTES: Details may not sum to totals because of rounding.

OCS = Outer Continental Shelf.

Budget authority is equal to outlays for most programs that involve collection and spending of OCS receipts.

* = Between -$50 million and $50 million.

a. The current-law estimates are from CBO's March 2006 baseline. The receipt estimates are net of payments to states to share proceeds from leases located within specified distances of their coastlines.

BASIS OF ESTIMATE

H.R. 4761 would make several changes to programs related to the development of federally owned resources, particularly oil and natural gas in submerged lands on the Outer Continental Shelf. The legislation would change the financial terms of certain OCS leases, authorize new oil and gas leasing in certain areas of the OCS, and provide new authority to spend receipts from both OCS and onshore mineral leases.

On balance, CBO estimates that enacting H.R. 4761 would increase net direct spending by $11 billion over the 2007-2016 period. That estimated impact is dominated by new spending for direct payments to states totaling about $20.6 billion over the 2007-2016 period. For this estimate, CBO assumes that H.R. 4761 will be enacted near the start of fiscal year 2007. Estimates for key provisions are described below.

Changes in the Financial Terms of Oil and Gas Leases

H.R. 4761 would modify the terms of certain leases issued by the Department of the Interior (DOI). Taken together, CBO estimates that these provisions would increase offsetting receipts (thereby reducing direct spending) by a total of $9.4 billion over the 2007-2016 period.

Fee on Deepwater OCS Leases. Section 6 would impose a new fee on lessees producing oil or gas in deep waters of the OCS unless the lease includes limits on the firm's eligibility for royalty relief when oil and gas prices exceed price thresholds specified in the bill ($40.50 per barrel of oil and $6.75 per million Btu of natural gas, both in 2006 dollars). This "conservation of resources" fee would be set at $9 per barrel of oil and $1.25 per million Btu for natural gas and would apply retroactively to volumes produced since October 1, 2005. The Secretary of the Interior would be required to renegotiate certain leases issued in the Gulf of Mexico from December 1, 1995, through December 31, 2000, if requested by the lessee. The bill would require the Secretary to issue regulations implementing the fee within one year after enactment of the bill. The bill also specifies that proceeds from the fee would be treated as offsetting receipts for the purposes of budgetary accounting.

This provision would apply to certain deepwater leases issued in 1998 and 1999 that provided royalty relief regardless of the market price of oil or gas. Based on information from the DOI regarding future production from those leases and CBO's current forecast of future oil and gas prices, CBO estimates that those lessees would pay an additional $11.4 billion over the next 10 years, assuming they opted to pay royalties instead of the proposed fee.

Under CBO's price assumptions, the proposed fee would cost lessees more than royalty payments under renegotiated leases. Thus, we expect that most lessees would exercise the bill's option for renegotiating the affected leases that do not include price thresholds.

CBO anticipates that companies would wait until after the rules are issued to decide which option they prefer, based on their expectations about future prices and production. Thus, we expect that any payments would most likely begin in fiscal year 2008. For this estimate, CBO assumes that the department would allow the companies to spread the amounts due on their 2006 and 2007 production over a four-year period.

Fee on Nonproducing Leases. Section 6 also would impose a new "conservation of resources" fee on new and existing leases that are not in production, retroactive to October 1, 2005. The bill would direct the Secretary to set this fee at no less than $1 per acre and no more than $4 per acre, and would specify that the payments be classified as offsetting receipts for purposes of budgetary accounting. For this estimate, CBO assumes that the Secretary would set the fee at the midpoint of the range, or $2.50 per acre. Based on historical data on the amount of nonproducing acreage on the OCS, we estimate that implementing this fee would increase offsetting receipts from areas leased under current law by about $500 million over the next five years and about $1.1 billion over the 2007-2016 period.

New Price Thresholds for Certain Royalty Relief. Under this bill, firms holding deepwater leases issued between 1996 and 2000 could renegotiate those leases to incorporate the price thresholds specified in the bill. The opportunity to renegotiate would apply to all such leases, including those that already limit eligibility for royalty relief when prices exceed certain levels. Because the price thresholds in the bill are higher than the prices reflected in the existing lease contracts—especially for natural gas—CBO expects that most firms would choose to renegotiate their existing leases. Raising the price thresholds in the contracts would reduce the likelihood that a lessee would have to pay royalties if prices decline in the future. CBO estimates that enacting this provision would reduce royalty collections by about $1.2 billion over the next 10 years, based on our current outlook for future energy prices and expectations regarding price volatility.

Change in Royalty Rate for New OCS Leases. Under current law, the royalty rate for production on the OCS varies depending on the depth of the water. Lessees generally pay a 12.5 percent royalty on revenues from oil and gas produced in waters more than 400 meters deep, and 16.7 percent in more shallow water. Section 6 would require a uniform royalty rate for all OCS production from new leases.

For this estimate, CBO assumes that the Secretary would set the royalty rate at 12.5 percent for new leases, rather than increasing the rate paid in deeper waters. (Under current law the royalty rate cannot be less than 12.5 percent.) CBO expects that lowering the royalty rate on new leases in shallow water would reduce federal royalties, but would also increase bonus bids for new leases in that area because of the increased profitability of those leases. Using CBO's baseline assumptions regarding bonuses and royalties that will be derived from such leases, we estimate that enacting this provision would increase offsetting receipts by about $100 million over the next five years (reflecting higher bonus bids in the near term) but would increase direct spending by about $500 million over the 10-year period (reflecting the net effect of royalty losses once production begins on the leases).

Compensation for Certain Nonproducing Leases. Section 17 would direct the Secretary of the Interior to repurchase and cancel certain federal leases and to compensate the lessee for the amount that the lessee would receive in a restitution case for material breach of contract. The bill would compel the Secretary to make these payments after receiving a written request from the lessee and making certain findings. Under the bill, eligibility for compensation could be based on several factors, including:

- If the lessee was denied certain permits or approvals despite compliance with applicable laws (except for compliance with the Coastal Zone Management Act),

- If a federal agency failed to act on an application for permits or approvals within a specified period of time, or

- If a federal agency attached conditions to a lease that were unacceptable to the lessee and not specifically allowed under the terms of the lease.

The lessee would not be required to exhaust other administrative venues before requesting resolution under this section.

Based on the status of certain litigation involving OCS leases off the coast of California, CBO estimates that enacting this provision could cost the federal government about $1.2 billion over the next 10 years.

Other Provisions Affecting Payments from Lessees. Other provisions in the bill would reduce the amounts paid to the government by lessees, relative to current law. For example, the bill would prohibit the Department of the Interior from charging fees related to federal actions on offshore or onshore leases that were not established in final regulations prior to issuance of the lease. It also would allow lessees to exchange, within two years of enactment, existing oil and gas leases that are located within 100 miles of the coasts of California or Florida for certain tracts being offered for lease in other areas. Finally, the bill would allow those holding a producing lease to relinquish any portion of the lease deemed productive in exchange for a royalty incentive on the portion retained by the lessee. CBO estimates that enacting these provisions would increase direct spending by between $50 million and $100 million over the 2007-2016 period.

Expand Federal Areas Subject to Mineral Leasing

Under H.R. 4761, the Secretary of the Interior would offer some OCS areas for leasing that otherwise may not have been leased over the next 10 years under current policies. Subject to state decisions about the potential leasing of some of the new areas, CBO estimates that leasing these new areas would increase federal receipts from bonuses, royalties, rental payments, and conservation of resources fees by a total of $4 billion over the next 10 years.

Under current law, moratoria generally prohibit new leasing and pre-leasing activities in most OCS areas outside of the western and central Gulf of Mexico (leasing occurs in small parts of the eastern Gulf of Mexico and the Alaskan OCS). Under current law, those moratoria are in effect through June 2012. As a result, CBO does not expect significant receipts from new offshore leases to be generated in the moratorium areas—under current law—over the next 10 years.

Upon enactment of the bill, the moratoria would no longer apply to areas more than 100 miles from the coast or to certain areas within the central Gulf of Mexico planning area. In addition, states would have some discretion over whether to allow new leasing for oil or natural gas within 100 miles of their coastline. Leasing would be prohibited within 50 miles of the coast in areas previously under leasing restrictions unless a state requests that the area be opened leasing. The Secretary of the Interior would be required to lease areas between 50 and 100 miles of the coast after June 30, 2009, unless a state submits a petition requesting that the area be withdrawn from leasing for a period of up to five years. State petitions to allow or prohibit leasing would be subject to various procedural requirements.

CBO estimates that gross proceeds from bonuses for new OCS leases paid by winning bidders and royalties from the associated production would total about $1.2 billion over the 2007-2011 period and $4 billion over the 2007-2016 period. That estimate relies on studies prepared by DOI on the oil and gas resources that might be produced in areas where CBO expects new leasing would occur, particularly the eastern Gulf of Mexico, the Pacific OCS, the Atlantic OCS, and the Alaskan OCS. Although CBO cannot predict the extent to which states would choose to allow leasing within the 100-mile limit, CBO assumes that there is a 50 percent chance that most states would allow some leasing to occur. Under the deadlines specified in the bill, CBO expects that some leasing in new areas would occur toward the end of fiscal year 2007, resulting in additional receipts starting in 2008.

Other provisions in the bill would authorize new types of leases on the OCS, including leases that only allow for the development of natural gas resources (but not oil) within 100 miles of the coastline, leases for different vertical or horizontal areas within a tract, and leases to extract oil and gas from restricted areas by means of extended reach or similar drilling methods. CBO does not have sufficient information at this time on the technical feasibility or market value of such arrangements to assess the timing or magnitude of any additional receipts from such types of leases.

Changes in Authority to Spend Federal Mineral Receipts

CBO estimates that other provisions of H.R. 4761 would increase net direct spending of OCS and onshore receipts by about $900 million in 2007 and $24.5 billion over the 2007-2016 period. That estimate includes the effects of provisions that would repeal existing programs to share OCS receipts with states, establish a new program to share those receipts, and provide funding for other federal programs.

Repeal of Existing Programs to Share OCS Receipts with States. Under current law, certain coastal states receive 27 percent of receipts from leases on OCS land located within specified distances of their coastlines. In addition, from OCS receipts, current law provides $250 million a year over the 2007-2010 period for payments to certain states to support efforts to restore and enhance coastal resources. H.R. 4671 would end both of those programs. CBO estimates that resulting savings would total over $300 million in 2007 and $2 billion over the 2007-2016 period.

New Program to Share OCS Receipts with States. H.R. 4761 would specify new requirements for sharing OCS receipts with states that would result in significantly larger payments than those provided under current law. In general, states would receive direct payments equal to 85 percent of the following amounts (the remaining 15 percent would be used for other federal programs, as described in the following section):

- From leases within 12 miles of shore, 75 percent of bonuses, royalties, and conservation fees;

- From leases beyond 12 miles of shore located within areas made newly available under H.R. 4761, 50 percent of bonuses, royalties, and conservation fees;

- From leases beyond 12 miles of shore located within areas where leasing is permitted under current law, 6 percent of bonuses, royalties, and conservation fees generated in 2006, increasing to 50 percent by 2022.

CBO estimates that total payments under the proposed formulas would total about $800 million in 2007 and nearly $20.6 billion over the 2007-2016 period, with payments continuing in perpetuity beyond that time. Over the next 10 years, we estimate that roughly $18.9 billion of payments would come from leases we expect to generate receipts under current law, taking into account proposed changes to the fiscal terms of such leases. We estimate that the balance of payments—$1.7 billion—would come from leases issued pursuant to H.R. 4761.

Other Federal Programs. The legislation would authorize the Secretary to spend, without further appropriation action, a portion of the proceeds from new OCS leases as well as specified percentages of amounts that would be collected under current law from onshore and offshore mineral leases. Funding would support programs to enhance natural resources; provide financial support to certain colleges, universities, and vocational schools; develop geologic information; and make payments to certain states and counties to support rural schools. Based on historical spending patterns for activities similar to those proposed, CBO estimates that new direct spending under the legislation would total about $400 million in 2007 and about $5.9 billion over the 2007-2016 period, with additional spending continuing for many years after 2016.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 4761 contains no intergovernmental mandates as defined in UMRA. CBO expects that enacting this legislation would benefit some coastal states and localities by providing for greater sharing of federal receipts from oil and gas leases in the Outer Continental Shelf. These and other states also would benefit from various grants and payments authorized by this bill.

Enacting this bill also would give coastal states greater input about whether mineral leasing will be allowed in waters near their coasts. It would give states the opportunity to petition the federal government to remove existing restrictions on leasing within 50 miles of their shores, but would require such a petition, agreed to by the governor and legislature, for a state to maintain restrictions in the zone between 50 and 100 miles from shore.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

CBO will provide a separate analysis of H.R. 4761's impact on the private sector.

ESTIMATE PREPARED BY:

Federal Costs: Kathleen Gramp (OCS provisions) and
Megan Carroll (onshore mineral receipts)
Impact on State, Local, and Tribal Governments: Marjorie Miller
Impact on the Private Sector: Tyler Kruzich

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis