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BUREAU OF COMPETITION

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

ST. MORTIMER

June 24, 1987

Mr. Reid T. Stone
Minerals Management Service
Department of the Interior
11 Golden Shore, Suite 260
Long Beach, CA 90802

Dear Mr. Stone:

This letter provides the comments of the staff of the Federal Trade Commission 1/ on proposed regulations of the Minerals Management Service concerning prelease prospecting within the Outer Continental Shelf (OCS) for marine mining minerals other than oil, gas and sulfur. 52 Fed. Reg. 9758 (Mar. 26, 1987).

We have some concerns about the possible competitive effects of proposed regulation 30 C.F.R. § 280.12(b), which provides that certain geological and geophysical data be made public six months after a lease is issued. Depending on the nature and extent of the information to be disclosed, this provision could have a serious adverse impact on the incentives to prospect and to bid on leases. We also comment on three additional issues that were raised for discussion in the Issues and Alternatives preamble to the proposed rules. These matters relate to possible rules that may be included in future rulemaking proceedings. We believe that caution needs to be exercised to ensure that the possible additional rules do not unnecessarily impede the competitive process.

1/ These comments represent the views of the Federal Trade Commission's Bureaus of Competition, Consumer Protection, and Economics, and are not necessarily those of the Commission or of any individual commissioner. The Commission has, however, voted to authorize the staff to present these comments to you.

The Commission has an interest in promoting efficiency and maintaining competition in the development and extraction of the nation's natural resources. In addition to the Commission's antitrust enforcement program in the minerals industries, the Commission has specific statutory responsibilities under the Deep Seabed Hard Mineral Resources Act, 30 U.S.C. 1413 et seq., to review the antitrust implications, if any, of applications submitted to the National Oceanic and Atmospheric Administration (NOAA) for deep seabed minerals exploration licenses and commercial recovery permits. 2/

One of the stated purposes of the proposed rules is to encourage the development of an offshore mining industry in order to reduce the nation's dependency on foreign sources of strategic materials, such as cobalt, manganese and nickel. The proposed rules are intended to regulate only prelease prospecting (although certain of them address issues involved in the subsequent leasing of prospected areas), and additional regulations will be proposed by the Minerals Management Service (MMS) both for leasing and for post-lease exploration, development and production activities. According to proposed regulation 30 C.F.R. § 280.1 and supplementary information provided by the MMS, 52 Fed. Reg. at 9760, a prelease prospecting permit does not give rise to any rights or interests in any minerals or to any preferential rights to leases, and the OCS Lands Act, 43 U.S.C. 1331 et seq., requires that leases of OCS minerals be awarded on the basis of competitive bidding. With these points in mind, we turn to the proposed rules.

Proposed Rule Provisions

Under proposed regulation 30 C.F.R. § 280.12(b), all geological and geophysical (G&G) data submitted to MMS with respect to any area that is subsequently leased will be made publicly available six months after a lease is issued. We believe that this disclosure provision may adversely affect incentives to engage in prospecting and in bidding for marine mining leases.

2/ Pursuant to that statute, the Federal Trade Commission provided comments concerning the competitive implications of granting deep seabed exploration licenses to four international consortia by letter dated September 30, 1982, to NOAA. The Commission's Bureau of Competition and Economics commented on regulations proposed by NOAA regarding application procedures for deep seabed commercial recovery permits by letter dated March 25, 1983, to the Ocean Minerals and Energy Division of NOAA.

The desirability of such early disclosure of confidential or proprietary information depends upon the balance of costs and benefits in each particular situation, which depends in turn upon the kind of information at stake. For example, disclosing the location of a test site may have different competitive and economic effects on prospecting firms than disclosing detailed geologic data or information respecting proprietary technology or data analysis techniques. The kind of information that will be disclosed under the proposed regulations is not entirely clear, however. 3/ We therefore recommend that the regulations be clarified to state more precisely the extent to which specific data on G&G findings would be subject to disclosure so that the kind of information involved can be considered in weighing the costs and benefits of disclosure.

While we do not have the expertise to assess various types of G&G data, we can suggest some of the possible benefits and potential long run costs associated with disclosing various kinds of confidential information. On the benefit side, public access to some kinds of G&G data may reduce the cost of further prospecting. For example, data identifying the exact location of prospecting work might be helpful in assessing the extent of geologic structures in adjacent areas and in reducing uncertainty about the value of those tracts. 4/ Specific data on G&G findings on leased tracts would be even more helpful in those

3/ It appears that the data to be released under proposed regulation 30 C.F.R. § 280.12(b) will be the same data that prelease permittees must submit to MMS under proposed 30 C.F.R. § 280.8. However, § 280.8 is somewhat ambiguous respecting the reporting of specific data on G&G findings (as opposed to positional data). For example, provision 280.8(a)(6) appears to leave some potential reporting requirements for future determination. With this uncertainty, it is difficult to predict what competitive effects would result from release of G&G data supplied under §280.8. We understand from MMS staff that at least some of the data to be released by MMS would be considered confidential by prospecting firms. As we discuss in the text, however, the disclosure of different kinds of confidential information can have different kinds or degrees of competitive effects.

4/ It has been suggested that reductions of uncertainty about the value of subsequent tracts could increase the competitiveness of bidding on those tracts, thus increasing government revenue. D. K. Reese, Competitive Bidding for Offshore Petroleum Leases, Bell Journal of Economics (Autumn 1978), Vol. 9 No. 2, at 369-84.

respects. Even if a firm that wishes to prospect an adjacent area could generate that data on its own through access to a leased tract (as possibly contemplated by proposed 30 C.F.R. § 280.7), public access to the data would make the prospecting and evaluation of the adjacent areas more economical. Therefore, disclosure might tend to encourage more prospecting, at least in the short run, and more bidders on subsequent leases.

As a second example, disclosure of proprietary information that would tend to reveal an innovative exploration technique or data analysis approach would be likely to facilitate employment of those techniques by other firms.

On the negative side, early disclosure ^{5/} of confidential information would tend, over the longer run, to inhibit investment in prospecting to various degrees, depending on the kind of information disclosed. Thus, positional data and (probably to a greater extent) specific G&G findings concerning the leased tract may provide valuable information concerning adjacent or nearby tracts that the permittee firm is still prospecting. Disclosure of such information would decrease the value of the firm's exploration efforts. Our experience in reviewing applications for exploration licenses under the Deep Seabed Hard Mineral Resources Act indicates that companies can be very sensitive to public disclosure of even positional data. Faced with disclosure of confidential information, firms might be encouraged instead to let others do more of the initial prospecting, and then "free-ride" in the form of bids for leases to adjacent areas. Therefore, early disclosure of confidential information could tend to inhibit aggressive prospecting.

In addition, to the extent that the public disclosure would tend to reveal a proprietary exploration technique or data analysis approach that was developed by the permittee and provides superior insight into the value of particular tracts, early release of such information would result in reducing the firm's earnings from its innovation. This could occur in two ways. First, the market value of the exploration technique or

^{5/} We are assuming that the proposed disclosure rule applies to data submitted to MMS by all prospectors in a specific area, whether or not they get the lease. Another interpretation is that only the data of the firm that wins the lease will be disclosed. In the latter case, the disclosure provision could encourage companies not to win the first lease if it was a small part of the total area to be leased. Rather, the preferred strategy likely would be to hold information back and use it in subsequent auctions. This could reduce the number of bidders, at least in early auctions.

data analysis approach would be eliminated. Second, the firm would lose some advantage it had gained in assessing adjacent or nearby tracts. For both of these reasons, early disclosure of such information could tend to inhibit both long run investment in research and development and aggressive prospecting.

In light of the potential costs, we urge that the MMS carefully consider any concerns raised by prospective permittees regarding the disclosure of confidential information six months after a tract is leased. Among the factors that should be considered in determining the optimum period for which confidential information should be protected are: (1) the nature of the information (e.g., whether disclosure would tend to reveal proprietary technology), (2) the effect of disclosure on the incentive to prospect or to innovate, (3) the effect of the regulation on the number of bidders for early and "late" auctions (on adjacent tracts), and (4) the cost of attempting to replicate the information if it is not made publicly available.

After analysis of these factors, it may well be determined that a somewhat longer moratorium on disclosure of confidential information, with perhaps different moratorium periods for different categories of confidential information, may enhance the incentives to prospect and to bid on leases without adversely affecting any interest in public disclosure. 6/ This would

6/ For example, under the regulations concerning exploration of the OCS for oil, gas and sulfur, geological data and information submitted to the MMS is not subject to disclosure to the public until 10 years after the date of issuance of the permit under which the data and information was obtained. 30 C.F.R. § 251.14-1(c)(2). Those regulations do not provide for disclosure of the information when a lease is issued, except in the case of geological data and information obtained from drilling a deep stratigraphic test. In the latter case, the data and information are protected for 10 years after the completion date of the test or 60 calendar days after the issuance of the first OCS oil and gas lease within 50 geographic miles of the test site, whichever is sooner. 30 C.F.R. § 251.14-1(c)(3). Similar moratorium periods apply to geophysical data and information. See 30 C.F.R. § 251.14-1(d).

With respect to geological data and analyzed geological information derived from post-lease drilling for oil, gas and sulfur on the OCS during the primary term of a lease, the regulations were recently amended to provide for disclosure to the public either two years after the data is submitted to MMS or 60 days after a lease sale of an adjacent or nearby tract, any

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provide the firm that generated the data more time either to use the data for further prospecting and leasing activities of its own, or to recover part of its investment by selling the information to others.

Issues and Alternatives

Three additional issues that, according to the announcement, may be included in future rulemaking proceedings may have competitive implications: (1) whether special financial incentives to encourage prospecting and post-lease activities may be appropriate in this industry, and, if so, in what form, for which specific minerals, and under what conditions; (2) whether the regulations should limit eligibility for prospecting permits to U.S. nationals; and (3) whether any other limitations, such as minimum standards of financial or technological capability, are appropriate.

1. Subsidizing one or a group of OCS minerals over others may be useful in helping to achieve national self-sufficiency in those subsidized minerals. We recognize that an important objective of the proposed regulations is to facilitate such self-sufficiency. At the same time, we observe that solely from a competition and economic standpoint, subsidies can result in adverse consequences unless there is some deficiency in the market (a "market failure") that would make subsidies necessary. First, subsidies result in prices for the subsidized product that are below real cost, leading to overconsumption of the subsidized product. ^{7/} In addition, if the subsidy diverts exploration activity and resources away from non-subsidized minerals, the result may be both less competition and lower investment in the non-subsidized sector than would be expected given normal

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part of which is within 50 miles from the well, whichever is later. 30 C.F.R. § 250.3(b). The prior regulations permitted disclosure of such data to the public upon expiration of the lease or 2 years after submission of the data, whichever was less. In amending this provision, the MMS noted that geological data and information from an existing lease are important in evaluating the potential of nearby tracts. 52 Fed. Reg. 13235, 13236 (April 22, 1987). Geophysical data and information, and interpreted geological information, are protected for 10 years from the date of submission. 30 C.F.R. § 250.3(a).

^{7/} T. Scitovsky, Welfare and Competition (rev. ed. 1971), at 69-73, 246-47.

economic forces. ^{8/} This, in turn, could result in slower development of the non-subsidized mineral industries, thus tending to favor existing producers in those sectors over possible new entrants. Finally, provision of a subsidy tends to favor those firms that are more skilled in obtaining government grants than in finding actual minerals. We therefore urge that the MMS carefully weigh the need for subsidies against their possible adverse competitive and economic consequences.

2. We perceive no compelling reason to exclude foreign firms from the prelease prospecting stage of mining development, unless the generation or possession of geological and geophysical data by foreign entities is considered by itself to present a national security risk. The proposed rules are explicit that no mineral rights are acquired at the prospecting stage so foreign ownership of mining tracts is not at issue. Although MMS indicates that it probably will limit leases to U.S. nationals, foreign firms may still wish to compete at the prospecting stage, either in order to sell their prospecting results to U.S. firms or, if the final leasing regulations permit, to join with a U.S. firm at the lease and development stage. The exclusion of foreign entities that might possess a technological or cost advantage in OCS exploration techniques could raise the costs of prospecting and retard the ultimate development of marine mining.

3. We caution against limiting permit eligibility on the basis of the applicant's financial or technological capability, unless there is a demonstrable need for such limitations. ^{9/} Unnecessary financial or technological requirements often create artificial barriers to new entrants and could do so in prelease prospecting within the OCS.

We are not aware of any need for special financial or technological requirements for permit eligibility. There is no apparent reason why permit applicants cannot decide for themselves whether they are financially and technologically capable of undertaking a prospecting venture. Even if some firms make a misjudgment in that regard, the nonexclusivity of prospecting permit areas would allow other firms to explore promising areas that were assigned to the less capable firms.

^{8/} This would be the case if, for some reason, exploration activity in the non-subsidized sector cannot resume its "normal" level within a short time.

^{9/} For example, the need for technological capability requirements may be demonstrated where improper prospecting is likely to result in significant "external" costs, such as environmental damage.

Therefore, the entry of less capable firms should not result in inadequate prospecting overall. On the contrary, we expect that open entry would encourage vigorous competition and more complete prospecting coverage. Therefore, we recommend that there be a presumption in favor of open entry, as generally permitted by the proposed regulations.

We appreciate this opportunity to provide you with our comments on your proposed regulations.

Sincerely yours,


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Director
Bureau of Competition