TAXPAYERS for COMMON SENSE

Comments by Ryan Alexander,

President, Taxpayers for Common Sense

at the third meeting of the

U.S. Department of the Interior - Royalty Policy Committee

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Good afternoon Chairman DeVito and members of the Royalty Policy Committee (RPC). I am Ryan Alexander, president of Taxpayers for Common Sense (TCS), a national, non-partisan budget watchdog organization.

Since 1995, it has been a top priority of my organization to ensure that taxpayers receive fair market compensation for natural resources extracted from federal lands and waters. An important source of revenue for the federal government, royalties and fees from resource development must be applied, collected, and accounted for in a fair and accurate manner. Taxpayers own the natural resources extracted from our nation's lands and waters and must receive a fair return for these assets.

Over the last two decades, TCS has produced detailed research and analysis documenting billions of dollars in lost taxpayer revenue due to a largely opaque leasing and royalty collection system that frequently undervalues our natural resources and keeps decisions and information from public view.

The Royalty Policy Committee has a unique opportunity to address the problems plaguing our system and propose reforms that will help get taxpayers what we are due.

The waste of taxpayer-owned natural gas. Currently, taxpayers are losing out on hundreds of millions of dollars in royalty-free natural gas that is leaked, vented, or flared from drilling operations on federal land. In 2015, operators reported losing 36 billion cubic feet of natural gas on federal land, more than three times what was lost in 2006. And by the Bureau of Land Management's (BLM's) admission, those volumes are under-reported. According to our recent analysis of Office of Natural Resources Revenue (ONRR) data, taxpayers received no royalties for roughly 90 percent of the natural gas vented or flared on all federal lands in the last decade. We have not seen the RPC address this issue yet.

The BLM recently proposed a new rule to address the royalty treatment of lost gas, but it would only perpetuate the problem. In particular, the proposed rule introduces a concept of "wasted oil and gas" whereby taxpayer-owned oil and gas isn't wasted if the cost of capturing it is more than the value of the resources captured. That is, instead of more carefully setting standards for when operators can reasonably be expected to prevent waste, the BLM chose to simply re-define "waste." To the contrary, the definition of waste is universal – it's whenever assets or resources aren't put to their most productive use. To make the concept of waste dependent on the profitability of its prevention by any operator, no matter how inefficient, is a terrible deviation from the BLM's responsibility to manage public resources in the public interest. We urge this committee to examine the issue and propose a definition of waste that prioritizes the full recovery of resources, rather than the profits of oil and gas companies.

The undervaluation of federal resources. In addition to determining when royalties should be imposed on federal resources, how to value those resources is of utmost concern to taxpayers. Last year, ONRR repealed a rulemaking regarding the valuation of federal oil, gas, and coal, which was finalized in 2016 after a five-year process. The rule was imperfect, but it would have corrected a number of problems in the current system, such as how coal sold in non-arm's-length transactions is valued, when index prices should be used for valuing natural gas, and what transportation allowances are appropriate. The rule's repeal reduced royalty collections.

Yet at its last meeting, this committee endorsed recommendations that exclusively represent the industry's objections to the rule, and would further entrench problems in the valuation system. Several pages from the justification materials for one recommendation were taken straight from one coal company's comments on the rulemaking.

Onshore and Offshore Royalty Rates. We were glad to see that the Department of the interior (DOI) has not embraced the RPC recommendation to lower offshore royalty rates. Lowering the royalty rate would have dramatically reduced taxpayer revenues for decades to come. The RPC should focus instead on applying the 18.75 percent royalty rate across all offshore leases. Additionally, the RPC should propose an onshore royalty rate increase. According to the Congressional Budget Office, "Raising the royalty rate for onshore parcels to 18.75 percent to match the rate for offshore parcels would generate $200 million in net federal income over the next 10 years…." And, "…the subsequent decrease in production on federal lands would in all likelihood be small or negligible"

Coal Royalty Rate Decisions. In response to a 2013 inquiry from Congress, ONRR released a limited data set that indicated the BLM had granted nearly 30 royalty rate reductions to coal leases on federal lands in the prior two decades. Little is known about why these reductions were granted, how many coal leases have reduced royalty rates now, and how much this is costing taxpayers in lost royalty revenue. The RPC should examine DOI's current practice of reducing royalty rates for coal leases and propose protocol for how reductions requests should be justified and when they should be granted going forward.

Idle Oil and Gas Leases. At present, large sections of federal lands and waters set aside for oil and gas production sit idle, in part, because Interior policies don't do enough to encourage diligent development. At the end of fiscal year 2017, half of all onshore acres leased for oil and gas production sat idle. As of May of this year, the same was true for 70 percent of active offshore oil and gas leases. Some lag between a lease issuance and the beginning of exploration and development activities is expected. But allowing companies to lock up parcels of land without developing them contradicts the multiple-use principle that guides DOI's management of federal lands. It can also prevent more eager producers from bringing important energy resources to market.

Unfortunately, rather than preventing the stockpiling of idle federal lands and waters, current DOI policies encourage it. In states like New Mexico and Texas, rental rates are raised after three to five years if a lease is not yet in production. The BLM, however, sets its rental fees irrespective of a lease's producing status, and at rock bottom rates of $1.50 and $2.00 per acre. This committee should examine how the BLM could alter its rental pricing to better encourage oil and gas development on federal lands. To encourage offshore development, this committee should also explore setting a fee on nonproducing parcels – a policy suggested by legislators of both parties in years past. Setting such a fee could raise significant federal revenue for taxpayers. In 2016, The Congressional Budget Office estimated that a

$6/acre fee on nonproducing leases would yield $200 million in revenue over 10 years, with a negligible effect on production.

Oil and Gas Measurement. One of the Planning, Analysis, and Competitiveness Subcommittee recommendations presented at this meeting proposes that DOI rewrite Onshore Orders for Site Security, Oil Measurement, and Gas Measurement (43 CFR 3173-75) and adopt, as replacements, industry standards published by the American Petroleum Institute (API) and Gas Processors Association (GPA). This subcommittee recommendation is surprising because the cited Onshore Orders were recently revised in response to a recommendation from an RPC subcommittee in 2007, and specifically incorporated many of the API and GPA standards. In these recent rulemakings, furthermore, after including dozens of the API and GPA standards, the BLM was careful to note where the standards were either inadequate – neither prescribes how transducer performance specifications should be set, for example – or unsuitable for BLM's purposes. Not only does the new recommendation fail to acknowledge this history (despite directions to the contrary), it also neglects to cite any specific reason why the extensive adoption of the API and GPA standards in the recent rulemakings was insufficient, or harmful.

In addition, the suggestion that the BLM should put aside the result of rulemakings carried out by the BLM with ample opportunity for public input, in favor of standards set by a third party with little or no opportunity for public input, seems to entail the abdication of the agency's authority and responsibility to act on the public's behalf.

We are not opposed to another review of the adequacy of the measurement standards, but more justification is needed to explain why such a review is necessary. If such a review is conducted, there should be a thorough assessment of whether the industry requirements are rigorous enough to meet the requirements of federal law, and why the BLM's prior determination of the standards' inadequacy is no longer valid. Automatically reverting to industry standards without a clear understanding of its impact is not in the taxpayer interest.

Royalty Relief. Maximizing the recovery of public oil and gas resources from a reservoir after production begins on a given lease is beneficial to oil and gas producers, energy markets, and taxpayers. We fully support the recommendation that DOI clarify the process for how operators can apply for and receive royalty relief for end-of-life assets under current statutory authority. The committee's new recommendation that DOI's review of the royalty relief process should examine how new technologies could factor into the justification for royalty relief also makes sense. It is imperative, however, that any review of the royalty relief process, or any subsequent changes made to that process, should not lower the standards for justifying or granting royalty relief. The benefit of royalty relief should be granted only when an operator has sufficiently demonstrated that the economic benefits of production (including previous production) are insufficient to cover documented costs. Decreasing the royalty rate on production that would have otherwise occurred is completely contrary to the taxpayer interest and we caution the RPC from insisting on any changes to current protocols that would encourage such practice.

Faulty Assumptions on Oil and Gas Revenue. The RPC's recommendation to expedite the leasing of Arctic National Wildlife Refuge (ANWR) lands during their last meeting in Houston did not include a full debate on the potential revenue and liabilities expedited leasing would carry for taxpayers. It is also ignores current market conditions and interest in development, and will likely lead to more undervalued oil and gas leases sitting idle. TCS has written extensively on the subject, and our analysis has shown that drilling in ANWR will not provide nearly the amount of revenue for taxpayers promised. Using extremely generous assumptions for industry interest and bidding rates – both well above historical averages in Alaska's North Slope region – taxpayers would receive less than five percent of what is currently expected. Instead of expediting oil and gas leasing in ANWR, DOI should take a step back and look at the data.

DOI Transparency. The DOI is entrusted to manage federal natural resources on the public's behalf, but determining whether its actions actually serve the public interest is often impossible because of the department's stunning lack of transparency. Data that would provide insight into natural resource production and management on federal lands is often inaccessible or available only at the summary level. We have abundant first-hand experience requesting data and other information from DOI sub-agencies that should be readily available and being unnecessarily shunted into the FOIA request process, where our requests have at times languished for years.

This lack of transparency has direct bearing on the return DOI achieves for the development of federal resources, and thus should be of great concern to the RPC. It's impossible for the RPC to advise the Secretary on whether the public is receiving "the full value of the natural resources produced from Federal lands," as its charter indicates, when the process for determining coal royalty rate reductions, the adequacy of bonus bids for onshore oil and gas leases, the fair market value of federal coal, and numerous other decisions are shrouded in mystery. To inform its future work, the RPC should immediately encourage DOI to provide more information on these resource management processes. To better safeguard the public interest through transparency into the future, the RPC should also develop disclosure standards for all DOI decisions that affect taxpayers' return on federal resource development. Those standards should include recommendations for the breadth, depth, and availability of data that the DOI should provide the public.

Full and Balanced Debate. To ensure these issues and others receive full and fair debate, the RPC must include a diverse set of perspectives. Unfortunately, the committee's recommendations to date solely reflect industry concerns and do not discuss or address taxpayer concerns of waste, mismanagement, and undervaluation. TCS believes industry should have a seat at the table and their concerns should be heard, but right now the RPC is only addressing and supporting industry recommendations. This is a tremendous disservice to the American taxpayer and the Department of the Interior.

We hope going forward the committee will be able to put aside their private or professional interests and put the nation's resource owners–federal taxpayers– first.

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