TAXPAYERS for COMMON SENSE

O & G REPORT

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Gaming the System: How Federal Land Management in Nevada Fails Taxpayers

69 federal oil & gas leases out of the 22,000 authorized since 1953 ever entered production.

97.3% of the 890,000 acres in authorized leases lay idle at the end of 2018.

$50 million in lost revenue from outdated rental rates: FY2009-2018.

70% of all acres leased noncompetitively for oil and gas developement in the last decade were in Nevada.

1 of the 2,400 noncompetitive oil and gas leases issued since 1999 in Nevada entered production.

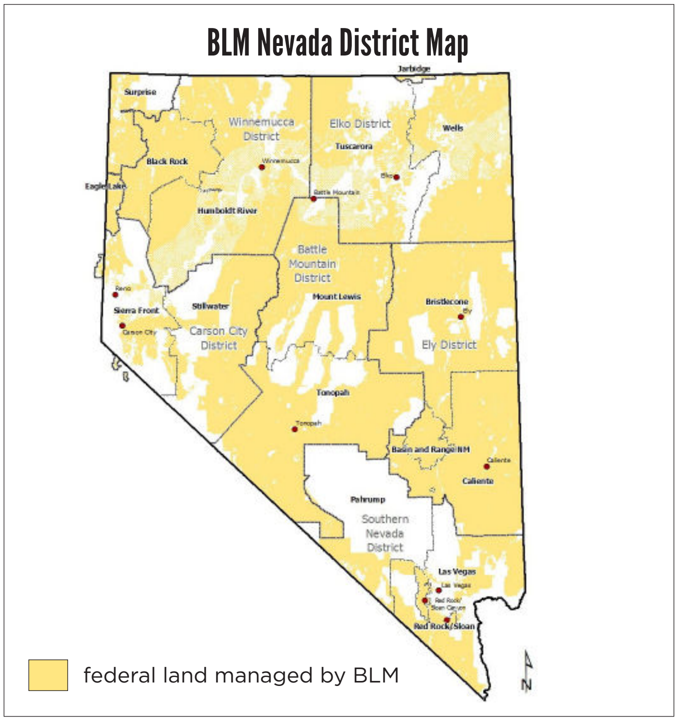
85% of all parcels sold at auction received the minimum bid of $2/acre, 2014-2018

Federal taxpayers own significant oil and natural gas reserves on federal lands in Nevada and other Western states. The Bureau of Land Management (BLM) within the Department of the Interior (DOI) manages these reserves and must by law collect fair market value from their development and sale. But the agency is failing to ensure taxpayers receive a fair market value for these resources because its land management policies are weak and outdated. The vast majority of federal land in Nevada is leased through a noncompetitive process and only a tiny fraction of oil and gas leases ever produce anything. By leasing millions of acres of federal land in Nevada noncompetitively and without any reasonable expectation of production, the BLM is violating its mandate to ensure taxpayers receive fair market value for these resources.

The BLM's oil and gas program in Nevada is a picture of contradiction. More land is offered for lease at competitive auction than in any other state except Alaska — 2.7 million acres between 2013 and 2018. But few parcels actually sell competitively — just 11% in the last five years. Despite the low rate of bidding at competitive auctions, leasing is extensive because the industry takes advantage of the law's default noncompetitive leasing process — the 2.04 million acres leased noncompetitively in Nevada since 2009 were 70% of the nationwide total. But with all that land under lease, oil and gas production is still extremely limited — just 36 leases covering 2.7% of leased acres were producing at the end of 2018.

The result is a system where other, more optimal, uses of federal land are precluded by extensive oil and gas leasing. The millions of acres currently locked up in nonproducing oil and gas leases are not available for any other use — even though the BLM is required to strike a balance among the competing values of recreation, grazing, timber, watershed protection, wildlife and fish, and wilderness. Some of this same land may have significant recreational value, have ecological significance as refuge for certain wildlife, or for other resource development, including mining, solar, or wind. But once land is awarded for an oil and gas lease, it is controlled by the leaseholder.

Oil and gas leasing on federal lands in Nevada provides minimal oil and gas production and fiscal return for taxpayers. Due to annual rental



rate and minimum bid prices that haven't been updated in more than 30 years, taxpayers have lost more than $50 million in revenue in the state over the last decade. Allowing for noncompetitive leasing that evades the minimum bid requirements for leases acquired at auction has cost taxpayers an additional $4 million over the last 10 fiscal years (FY2009-2018). States receive roughly half of federal receipts from resource development within their borders, so Nevada taxpayers lost out on $25-30 million of this revenue over the last decade.

In addition to generating less revenue, the noncompetitive leasing process has other deleterious effects. Results from lease sales in Nevada over the last decade indicate that noncompetitive leasing is undermining the competitive leasing system established by Congress in 1987. Private interests benefit from holding noncompetitive leases for speculative prospects or inflating reports to investors without compensating taxpayers. And ultimately, noncompetitive leasing locks up millions of acres of federal land in Nevada that could be put to other uses.

In sum, the BLM's administration of oil and gas leasing in Nevada shortchanges taxpayers and mismanages federal land use.

Leasing

Over the last six years (2013-2018), the BLM held 19 competitive sales for oil and gas leases in Nevada. In those, more than 1,500 parcels comprising roughly 2.7 million acres of federal land were offered for lease, more than in any other state except Alaska. In those sales, however, only 15% of acres were bid on, and at prices that were among the lowest in the country.

In fact, results from recent BLM lease sales indicate an anemic competitive market in Nevada. Of the 691 parcels that received a bid in one of the 34 auctions held between 2009 and 2018, more than half received the minimum acceptable bid of $2/acre. Moreover, 76% of parcels sold for $10/acre or less. The trend has worsened in recent years. Of the 132 parcels that received bids in the last five years (2014-2018), 85% were sold for the minimum acceptable bid, and 96% were sold for $10/acre or less. The average bid/acre received over that period was $3.04 in Nevada, the worst rate for BLM lease sales in any state.[1] For comparison, in New Mexico — the most competitive market for federal oil and gas — leases garnered an average bid of $6,590/acre in those five years. The terrible competitive market for oil and gas leases in Nevada is due in large part to the *noncompetitive* leasing process.

For parcels that don't receive bids and go unsold at auction, companies can submit offers — the very next day — to acquire drilling rights *through a noncompetitive process*. The procedural oddity is a vestige of the system in place before federal oil and gas leasing was overhauled in 1987. It allows oil and gas companies, or speculators, to gain title to a federal oil and gas lease without paying the minimum bid of $2/acre required to win a lease at auction. Private interests have taken advantage of this difference and used the noncompetitive system prolifically in Nevada. (For background on the noncompetitive leasing system, see the report Appendix.)

In Nevada, the BLM issues more oil and gas leases through the noncompetitive process than through competitive auction. Federal leasing in the state thereby offers a case study on the many

[1] Results tabulated only for states with more than 10 parcels sold from 2014 to 2018.

drawbacks of the noncompetitive process and its real costs to taxpayers. Competitive oil and gas lease sales attract minimal interest, but huge swathes of federal land are tied up in oil and gas leases issued noncompetitively that generate little return to taxpayers. Turnover of federal leases is high, and they **almost never** enter into production of oil and gas.

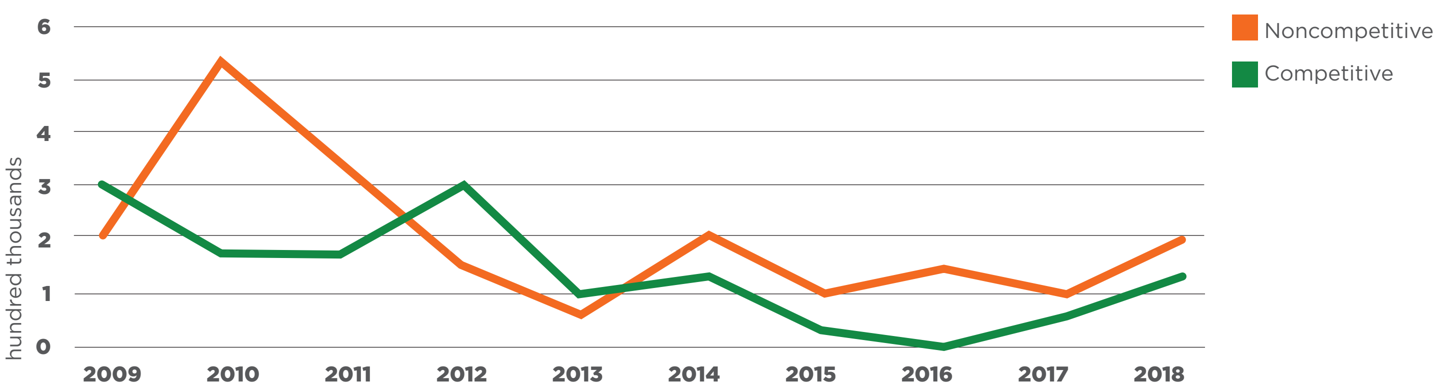
During the last 20 years, the BLM leased roughly half of all parcels and 60% of all acres through the noncompetitive process in Nevada. The practice as a portion of all leasing has increased in the last five years. From 2014 through 2018, the BLM authorized 467 oil and gas leases comprising 1.04 million acres in Nevada. Of those, 283 parcels comprising 735,239 acres were leased noncompetitively, accounting for 60% of all parcels, and 70% of all acres leased. In this regard, Nevada led the country. Of all 2.9 million acres of federal land BLM leased noncompetitively for oil and gas development over the last decade, 70% were in Nevada.

This extensive use of the noncompetitive system has undermined competitive lease auctions in Nevada. The BLM Nevada state office held 34 competitive lease sales over the last decade (2009-2018). The office releases statistics on how many noncompetitive offers it received for parcels the day after a lease sale. Available records show that the BLM received nearly 300 noncompetitive offers for more than 230 parcels. This means that of the 797 noncompetitive leases issued in the last decade in Nevada, nearly 30% received offers ***the day after a competitive lease sale***. Further, records indicate that at least 60 parcels received multiple noncompetitive offers the day after a lease sale.[2]

The most direct fiscal effect of issuing leases noncompetitively is the loss of revenue from bonus bids that would have otherwise been collected at auction. In the Federal Onshore Oil and Gas Leasing Reform Act of 1987, Congress directed the BLM to hold competitive auctions for all oil and gas leases on federal lands. Congress also stipulated that the BLM could not accept a bid for a lease below $2 per acre in those auctions.[3] While the explicit valuation of $2 per acre for federal land is remarkably low, especially accounting for inflation since 1987, noncompetitive leasing denies taxpayers even this revenue.

Over the last ten fiscal years (FY2009-2018), the BLM issued 827 noncompetitive leases for drilling rights on 2.07 million acres of federal land

Figure 1. Federal Acres in Nevada Leased for O&G Development: Noncompetitive vs. Competitive



[2] Records indicate that some of these parcels received multiple offers from the same company the day after a lease sale. This might suggest an attempt to rig the prescribed drawing for leasing priority that occurs when multiple noncompetitive offers are submitted for the same parcel on the day after a sale – like purchasing multiple raffle tickets.
[3] The minimum bid price was only fixed at $2 for the first two years after the law was enacted. Thereafter, the Secretary of the Interior was free to raise the minimum bid level if he or she found it was necessary "to enhance financial returns to the United States [...and] to promote more efficient management of oil and gas resources on Federal lands." Unfortunately, the minimum bid price has not been raised above $2 per acre, diminishing returns to taxpayers (see below).


Goshute Canyon Wilderness, Nevada. Source: BLM

in Nevada. If each of these parcels had been sold at competitive auction for the minimum bid of $2 acre, and the lease owners had paid the applicable administrative fee under the competitive process, rather than the filing fee required for noncompetitive offers, taxpayers would have earned roughly $4 million more in revenue. Approximately half of this would have been distributed to Nevada taxpayers.

All evidence suggests that by relying on noncompetitive leasing, the BLM's oil and gas program in Nevada has not promoted the development of resources on federal lands for the mutual benefit of taxpayers and private parties. Instead, by minimizing the cost to acquire federal oil and gas leases, the noncompetitive leasing process has enabled private interests to take advantage of the system and taxpayer-owned lands for their own ends. In fact, according to BLM records, of the 21,997 federal oil and gas leases authorized in Nevada over the last century, only 69 leases have ever entered production. Of those, only one was issued within the last 20 years.

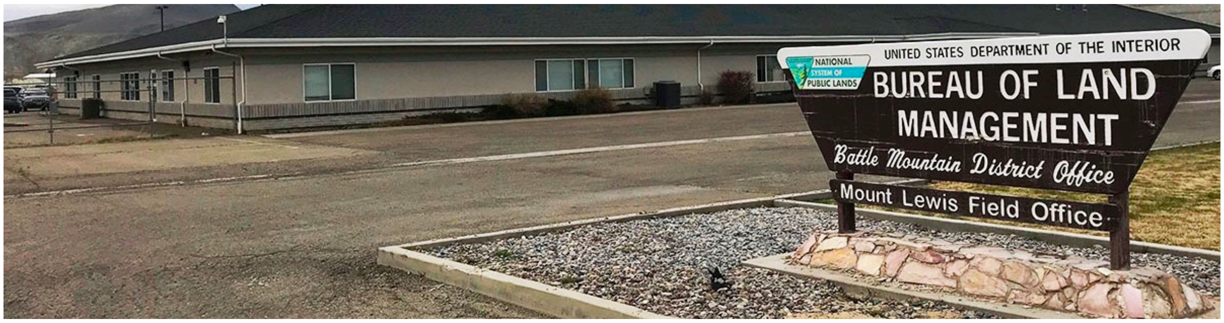
At the end of 2018, only 36 leases covering 24,400 acres in Nevada were considered producing leases. The newest among these leases was authorized in 1998. All but seven were authorized before 1976. The producing leases, furthermore, are owned by a relatively small group of companies. Chief among them are Makoil, Grant Canyon Oil & Gas, Questar Exploration & Production, and Kirkwood Oil & Gas. This raises the question: What are the dozens of other companies that have acquired federal leases over the last 20 years doing with them?

According to BLM records, lease owners frequently transfer leases among themselves. Of the 4,658 leases authorized since 1999, more than 2,044 were transferred from one owner to another. The high rate of transfers points to one driver of federal leasing in Nevada: speculation. Certain companies and interests take advantage of the low acquisition and ownership costs for federal leases to amass sizeable lease holdings in the state. Their aim is to profit by re-selling some fraction of the leases to major producers who might want to take a gamble and actually explore for oil and gas reserves on the federal land.

This strategy is best personified by Larry Moyer and Stephen Smith, who were the first and third top leaseholders in Nevada at the end of 2018. Together, the two held 115 net leases covering more than 275,000 net acres[4] — more than a quarter of all acreage under lease at year-end. Neither man engages in the production and development of oil and gas. Instead, according to **recent reporting**, the two shop their parcels to companies at industry conferences, hoping to profit by selling the development rights on federal land they won, predominantly, through the noncompetitive process.

The second biggest leaseholder in Nevada illustrates why oil and gas companies might acquire parcels, either directly or through speculators, without ever developing them. Noble Energy Inc. is a publicly-traded international oil and gas producer with a market capitalization of more than $10 billion. At the end of 2018, it held more than 85 net leases covering more than 130,000 acres of federal land. According to the company's annual financial statement for 2018, this represented more than a third of its undeveloped acreage in the United States.

[4] Oil and gas leases in Nevada are often jointly held by multiple lessees. The BLM (and this report) calculates net ownership by adding up the percentages of leases and acres each lessee holds. 'Net leases' and 'net acres' thereby reflect only a lessee's proportional lease interests. For example, a lessee with a 10% ownership stake in 20 leases with 2,000 acres would have 2 net leases covering 200 net acres.



Bureau of Land Management Battle Mountain District Office, Central Nevada. Source: BLM

Noble acquired leases for the vast federal acreage from 2009 to 2012, then dug exploratory wells in 2013 and 2014 before abandoning the project in 2015. Yet it continues to hold and pay rent on many of the leases more than three years later. By doing so, Noble is able to show investors an inflated amount of acreage under lease at minimal cost. Noble only had to pay an estimated $2 million to acquire and hold the federal leases in Nevada still active at the end of 2018. This represents less than 0.07% of Noble's reported Undeveloped Leasehold Costs, even though the Nevada acreage makes up more than 7% of its undeveloped acreage worldwide. In short, federal leases in Nevada are a disproportionately cheap way for Noble and other companies to aggrandize their prospects for investors, even when there's little to no expectation of development.

Losses from Other Lease Terms

In addition to royalties, BLM also charges companies rent to capture the value of privileged access to federal land, and collects bonus bids that reflect the value of exclusive rights to develop certain parcels of federal land. Neither the annual rental rate nor the minimum acceptable bonus bid has been adjusted since 1987.

Congress first established a formal system for leasing federal land to develop oil, gas, coal and other resources through the Mineral Leasing Act (MLA) of 1920. For oil and gas leases attained by permit or through competitive bidding, the original MLA set the annual rental rate at "not less than $1 per acre per annum." Through later legislation, Congress enacted changes to the rental rate over time. In 1935, the rent due for oil and gas leases was reduced to $0.25 per acre. In 1960, it was increased to $0.50 per acre. Finally, in 1987, Congress set the current rates at "not less than $1.50 per acre per year for the first through fifth years of the lease and not less than $2 per acre per year for each year thereafter."

Through these periodic amendments to the MLA, Congress had effectively accounted for inflation. For example, the rental rate increases in 1960 and 1987 approximately reflected the 1935 rate of $0.25/acre adjusted for inflation in those years. By not updating the rates since 1987, however, Congress has neglected to account for inflation for longer than any period since the MLA was enacted in 1920. And the Secretary of the Interior has also failed to use the discretion provided in the law to increase the rates administratively. As a result, rent collection now yields roughly half of what it would have under inflation-adjusted rates.

Over the last ten fiscal years, FY2009-2018, DOI collected $44.4 million in rent for oil and gas leases in Nevada. If the 1987 rental rates had been annually adjusted for inflation, as measured by the Bureau of Labor Statistics, DOI could have collected $94.9 million in rental payments over the decade.[5] That is, taxpayers have lost approximately $50 million in rental revenue from rental rates that were set more than 30 years ago.

[5] In FY2008-2019, 2.8 million acres were under lease, on average. In a typical year, only 1.3% percent of acreage was within leases that had entered production, for which rental fees are waived by the royalty payments associated with production. Of the acreage not in production, roughly 60 percent was leased within the previous five years and thereby subject to the lower statutory rental rate of $1.50/acre. Using these acreages, TCS calculated how much rent could have been collected under inflation-adjusted rates, assuming no change in overall leasing.

In addition, DOI collected $12.1 million in bonus bids from competitive oil and gas lease sales from FY2009 to FY2018. As noted above, many of the parcels sold in these sales received the minimum acceptable bid of $2 per acre, which was first set in 1987. If that rate had simply been adjusted for inflation, whereby it would have reached the $3 per acre threshold in 2000 and the $4 per acre threshold in 2012, DOI could have collected more than $1 million more from FY2009 to FY2018. If the minimum bid had been set at a more reasonable $10 per acre, DOI could have collected up to $8 million more.

Conclusion

Federal lands and the vast resources they offer are precious assets for taxpayers. Managing these assets in the public interest demands that the Bureau of Land Management administer oil and gas development strategically on federal lands in Nevada and across the country. Current policies fail this standard and cost taxpayers millions of dollars in lost revenue.

Leasing millions of acres to private interests that have not historically demonstrated diligence in developing oil and gas resources on federal lands locks up hundreds of thousands of acres from other, more optimal uses. The noncompetitive leasing process allows private interests to abuse the system for their own ends without compensating taxpayers. The broken system of noncompetitive leasing and lease terms set more than 30 years ago all but guarantee taxpayers do not receive a fair return for the oil and gas resources we own and the federal lands that contain them.

But the Bureau of Land Management is not beholden to the decisions from decades past. The agency has existing statutory authority to independently change rental rates, minimum bid prices, and the amount and location of acreage it offers for lease. Congress can also call for much needed oil and gas reforms. It is time to move to responsible oil and gas leasing practices for oil and gas development that protects the taxpayer interest for years to come.

BLM land near Spring Creek, Nevada. Source: BLM

Appendix: Background on Noncompetitive Leasing

Before 1987, the Bureau of Land Management (BLM) was only required to lease federal land for oil and gas development competitively if the land overlaid a "known geologic structure of a producing oil or gas field."[1] The BLM would calculate a minimum acceptable bid for these parcels after estimating potential oil and gas production, future commodity prices, production costs, and other factors. The BLM would then hold a competitive auction for the parcel and award the lease to the highest qualified bidder who met or exceeded the minimum bid.

BLM leased all other parcels noncompetitively. If multiple parties submitted noncompetitive offers for a parcel, the BLM would hold a lottery to determine who could lease it.[2] The BLM was criticized for its minimum acceptable bid calculations as well as its determinations of which parcels to lease competitively. Ultimately, most parcels — more than 95 percent — were issued noncompetitively[3] and the BLM often failed to collect the fair market value of federal leases for taxpayers.

In 1987, Congress enacted the Federal Onshore Oil and Gas Leasing Reform Act[4] specifically to improve the fiscal return from oil and gas leasing. As its biggest reform, the law required the BLM to offer up all parcels available for oil and gas development in competitive lease sales. BLM state offices hold such lease sales, where registered bidders compete in live auctions for dozens of parcels, at regular intervals throughout the year. The highest bidder wins the rights to lease the parcel and then must pay the BLM the final bid amount — the "bonus bid" — plus first year's rent for the parcel, and a small administrative fee, currently set at $165 for FY2019.[5]

After an auction, if a parcel hasn't received a bid, the law requires that it be made available for noncompetitive leasing. Companies or other parties may submit noncompetitive offers for the parcel the very day after a lease sale is held. If multiple offers are submitted, the BLM holds a drawing to see who gets the right to lease the parcel. If no offers are submitted on the first day, the parcel is eligible for noncompetitive lease for the next two years, and the BLM must award a lease to the first eligible party to submit an offer. If the parcel is leased, the new lessee is only required to pay a filing fee currently set at $425, and first year's rent.[6] No bonus bid is collected for parcels leased noncompetitively.

[1] Mineral Lands Leasing Act of February 25, 1920; 41 STAT. 437-451, Sec. 17. Available at: **https://www.loc.gov/law/help/statutes-at-large/66th-congress/session-2/c66s2ch85.pdf**
[2] U.S. Department of the Interior, Bureau of Land Management. Pub. No. 678-609. "The Federal Simultaneous Oil and Gas leasing System." 1983. Available at: **https://ia801707.us.archive.org/15/items/federalsimultane00unse/federalsimultane00unse.pdf**
[3] U.S. General Accounting Office (GAO). RCED-89-108: "MINERAL REVENUES: Implementation of the Federal Onshore Oil and Gas Leasing Reform Act of 1987." May 8, 1989. **https://www.gao.gov/products/RCED-89-108**
[4] Enacted as Subtitle B in Title V of the "Omnibus Budget Reconciliation Act of 1987," P.L. 100–203; 101 STAT. 1330-256
[5] U.S. Department of the Interior, Bureau of Land Management. Final Rule, "Minerals Management: Adjustment of Cost Recovery Fees," September 28, 2018. 83 FR 48957. **https://www.govinfo.gov/content/pkg/FR-2018-09-28/pdf/2018-21298.pdf**
[6] Ibid.