April 15, 2021

Comments to the Department of the Interior on the Federal Oil and Gas Program Review

Taxpayers for Common Sense (TCS) submits the following comments in response to the Department of the Interior's request for input as part of its comprehensive review of the federal oil and gas program required in Executive Order 14008.

TCS is a national non-partisan budget watchdog that has been working on behalf of the nation's taxpayers since 1995. TCS works to ensure taxpayers receive a fair return on all resources extracted or developed on federal lands and waters. Revenues from resource development represent an important source of income for the federal government and must be collected, managed, and accounted for in a fair and accurate manner.

Federal lands throughout the Western United States contain vast deposits of valuable oil and gas resources. The U.S. government holds millions of acres of these lands in trust for federal taxpayers, the true landowners. Resources on the Outer Continental Shelf also represent significant federal assets. The combined production from federal land and water makes U.S. taxpayers major market participants – one in 10 cubic feet of all gas produced in the U.S. last fiscal year, and one in five barrels of all oil, was extracted on federal leases. Yet the Department of the Interior settles for second-rate terms for federal production.

The Department of the Interior has a fiduciary responsibility to ensure taxpayers receive a fair return on the extraction and sale of federal oil and gas by maximizing competition for leases and setting the rent, royalty rate, and other lease terms at the highest level the market will bear. Responsible lease management also means making the industry interests that profit from federal resource development post sufficient bonds and cover the costs of reclamation and pollution liabilities connected to fossil fuel extraction.

Taxpayers have been losing money to the broken federal oil and gas system for decades. The policies and practices in place at the Department are inadequate and grossly outdated. By prioritizing leasing at egregiously generous terms, the Department has only exacerbated taxpayer losses in recent years.

This is why we support the pause on all oil and gas leasing on federal lands and waters. It is time to reform the system and only restart leasing when a fair return can be guaranteed.

To this end, TCS calls on the Department of the Interior to: immediately update oil and gas lease terms including royalty, rental, and bonding rates; increase the minimum bid for both onshore and offshore leases; issue stronger rules for waste prevention and valuation; dramatically improve transparency systems; better prioritize which lands should be made available for lease and which are more appropriate for other uses; lease valuable land strategically; and limit all reclamation, pollution, and climate liabilities associated with federal oil and gas development.

TCS anticipates providing more detailed input when DOI proposes specific actions but encourages the agency review to consider the following aspects of the federal oil and gas program.

Background

From 2017 to 2020, the Trump Administration offered 25 million onshore acres for lease for oil and gas development. This action flooded the market with vast stretches of federal land and drove down the price companies were willing to bid for leases. By 2019, the acreage on offer in an average sale outside Alaska was more than double what it had been over the eight years of the prior administration, and – not surprisingly – the average bid per acre received was less than half what it had been.

During the pandemic, oil and gas bids slid even further—returning just one-third what the average bid had been from 2009 to 2016. Nearly half of all parcels offered for lease by the Trump Administration did not receive any bids. And many others received only one bid, usually for the statutory minimum of $2 per acre. Two dollars! And while the Trump Administration certainly made matters worse, unfortunately for taxpayers, the underlying problems with the leasing program have been around for decades.

A Fair Return Requires Reforming Lease Terms

Onshore Royalty Rates

The federal onshore royalty rate of 12.5 percent was set by the Mineral Leasing Act of 1920 and has never been updated. Since the royalty rate is a set percentage, it does not cost taxpayers by failing to keep up with inflation like other lease terms. In nominal terms, federal leases generate more revenue now due to higher commodity prices than they did 100 years ago. Instead, the stagnant rate has cost taxpayers by failing to keep up with the market. The largest oil and gas producing states now charge oil and gas companies significantly higher rates for development rights on state lands, as does the Bureau of Ocean Energy Management for leases in federal waters.

The State of Texas started charging a 25 percent royalty for most new oil and gas leases on state lands more than 30 years ago. In 2007, the Bush Administration increased the federal offshore royalty rate to 16 2/3 percent for leases in waters deeper than 400 meters, then to 18.75 percent for all offshore leases in 2008. In the same year, the State of Utah School and Institutional Trust Lands Administration (SITLA) raised their standard royalty rate for new leases to 16 2/3 percent. The State of Colorado has raised its royalty rate for oil and gas leases twice: to 16 2/3 percent in 2011, then to 20 percent in 2016.

Leasing Jurisdiction	Oil & Gas Royalty Rate[4]
California	Negotiated lease-by-lease, but generally no less than 16.67 percent[iii]
Colorado	20 percent[iv]
Montana	16.67 percent[v]
New Mexico	18.75-20 percent[vi]
North Dakota	16.67 or 18.75 percent depending on the county[vii]
Oklahoma	18.75 percent[viii]
Texas	20-25 percent[ix]
Utah	16.67 percent[x]
Wyoming	16.67 percent[xi]
Private Lands	Generally, 12.5-25 percent[xii]
Federal Lands	12.5 percent, sometimes less[xiii]

In each case, the market absorbed the increase in royalty rate without measurably reducing oil and gas production. If the market is bearing a higher rate, each new federal onshore lease issued with the 12.5 percent rate is a lost opportunity. By neglecting to raise it using its current statutory authority, the Bureau of Land Management (BLM) is costing taxpayers significant potential revenue. To illustrate the revenue effect, if all onshore oil and gas production had been subject to the higher 18.75 percent rate, taxpayers could have received up to $12.4 billion more in royalty revenue from 2010 to 2019. The BLM is failing to fulfill its fiduciary duty to taxpayers by continuing to charge a royalty rate out of step with the broader leasing market.

Minimum Bids

Onshore

The current minimum bid of $2 per acre was set in 1987 and has not kept pace with inflation. Many bidders have taken advantage of the low rate. In 2019 and 2020 alone, more than 550 leases covering roughly 660,000 acres of federal land received the minimum bid. The low rate also incentivizes speculation, tying up federal land from other potential uses. [A Government Accountability Office (GAO) report](#) found that only 1.9 percent leases sold at the $2 minimum bid from FY2003 to FY2009 ever entered production and generated royalties.

Had the minimum bid been $5 per acre, taxpayers could have gotten $2 million in additional revenue over the last two years. Had it been $10 per acre, taxpayers could have gotten $5 million in additional revenue. Raising the minimum bid for federal leases and pegging it to inflation would both prevent devaluation of federal exploration and development rights over time and better deter private interests from locking up federal land without developing it.

Offshore

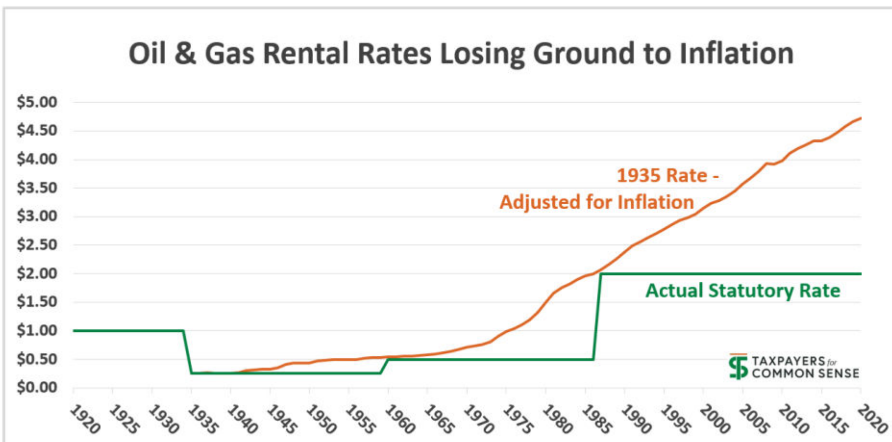
In the Gulf of Mexico (GOM), where Outer Continental Shelf (OCS) leasing is focused, minimum bid levels have been updated at times, but are due for an increase. The Minerals Management Service (MMS) raised the minimum bid for all leases in water 400 meters deep or deeper to $37.50 per acre by 2004. In 2011, the Bureau of Ocean Energy Management (BOEM) held the first sale with $100 per acre as the minimum bid for leases in water 400 meters deep or deeper, where it has remained since. After a decade, BOEM should increase the minimum bid level again, at least to keep pace with inflation.

For leases in waters less than 400 meters deep, the minimum bid level has remained unchanged at $25 per acre since 1987. This means taxpayers are guaranteed less than half what they were for GOM leases more than three decades ago. BOEM needs to remedy the situation and consider raising the minimum bid level back to $150 per acre for all GOM leases, where it was set in the 1980s.

Rent

The annual rent the BLM charges lessees on federal land has also remained flat since 1987. Using BLM statistics for the number of acres leased but not producing, TCS estimates that the failure of rental rates to keep up with inflation has reduced rental revenue by roughly $30 million per year over the last decade. Because first-year's rent is due when a parcel receives a bid to be leased at auction, increasing the rate now will bring in additional revenue with each new lease sale.

In addition, the BLM should consider a more dramatic escalation of rental rates over the life of onshore leases, similar to rent schedules for offshore leases. The rent for leases in waters up to 400m deep climbs by a factor of four between the first and eighth year of the lease. Lastly, the BLM could incentivize diligent development more directly by assessing a separate fee on nonproducing parcels.



Bonding

Current bond minimums, at $10,000 for individual lease coverage, $25,000 for statewide coverage and $150,000 for nationwide coverage are insufficient to cover well reclamation costs.

According to a GAO report, the average value of bonds held by the BLM in 2019 was $2,122 and does not reflect the full reclamation costs of the wells the bonds cover, which can range from $20,000 to $145,000 per well. The GAO also noted that 84 percent of bonds covering 99.5 percent of wells are insufficient to cover even the lower estimate of reclamation cost at $20,000 per well. GAO estimated the reclamation costs for orphaned wells, and inactive wells at risk of becoming orphaned, was $46.2 million in 2018 and more wells are at risk of becoming orphaned in coming years. If the bonds held by the BLM do not provide full financial assurance for reclamation completion, the financial burden of cleaning up orphaned wells will inevitably fall to taxpayers.

The bond minimums, set in the 1954 and 1960, have never been adjusted for inflation. Consequently, the real value of the minimum bonds has dropped significantly. When it was established in 1960, the $10,000 minimum bond for an individual lease provided the equivalent of $87,436 in coverage in 2020 dollars. Similarly, to provide the same coverage as when they were set in 1954, the statewide bond minimum would have to be $240,531 in 2020 dollars, and the nationwide bond minimum would have to be $1,443,184. Low bond minimums incentivize oil and gas operators not to reclaim wells when it is more costly to clean up well sites than to simply forfeit the bonded amount.

Further, bond coverage is disconnected from the factors that determine actual reclamation liabilities, like the number of wells controlled by a lessee. This favors big oil and gas companies that own large number of wells statewide or nationwide. For example, an operator that runs 10 wells in a state and one that runs 100 can pay the same amount for a statewide bond, $25,000. Bond minimums also do not reflect other well characteristics such as well depth and location that would affect reclamation costs.

Rules as Taxpayer Safeguards

The BLM 2016 final rule titled “Waste Prevention, Production Subject to Royalties, and Resource Conservation,” has faced a gauntlet of challenges from courts and the agency itself under the last administration and now stands vacated in large part. The underlying need for a rule to limit the waste of natural gas from production on federal lands and charge royalties on it remains urgent. Data obtained through Freedom of Information Act (FOIA) requests indicate operators reported wasting 260-290 billion cubic feet of gas on federal lands from FY 2010 to FY 2019. TCS estimates that gas was worth roughly $1 billion, and the Office of Natural Resources Revenue (ONRR) collected royalties on just one third of it.

The standards reinstated in the absence of the 2016 Rule, the Notice to Lessees 4A (NTL-4A) written in 1979, created the current problem and cannot be left in effect. Providing certainty to operators and taxpayers and remedying the situation must be a top priority for the BLM. Given the sweeping effect of the October 2020 Wyoming District Court ruling, and the court’s misreading of the 2016 Rule, DOI should appeal the decision and seek to have the 2016 Rule reinstated before making any modifications necessary for its longevity.

At the very end of the previous administration, ONRR issued a final rule for federal oil and gas valuation that would significantly reduce taxpayer receipts and undermine important valuation standards. When ONRR subsequently delayed the rule’s effective date in February, TCS welcomed the action as an opportunity for the DOI and ONRR to reconsider the recent changes to valuation policy. The costly determination that deepwater gathering costs can be deducted from resource value, the reimposition of “soft caps” on allowances, the renewed availability of extraordinary processing allowances, many other provisions of the 2020 Rule, and ONRR’s stated justifications for them are corrosive to the responsible management of taxpayer assets. TCS encourages ONRR to rescind the 2020 Rule and anticipates submitting more extensive comments for any such action.

Time for Transparency

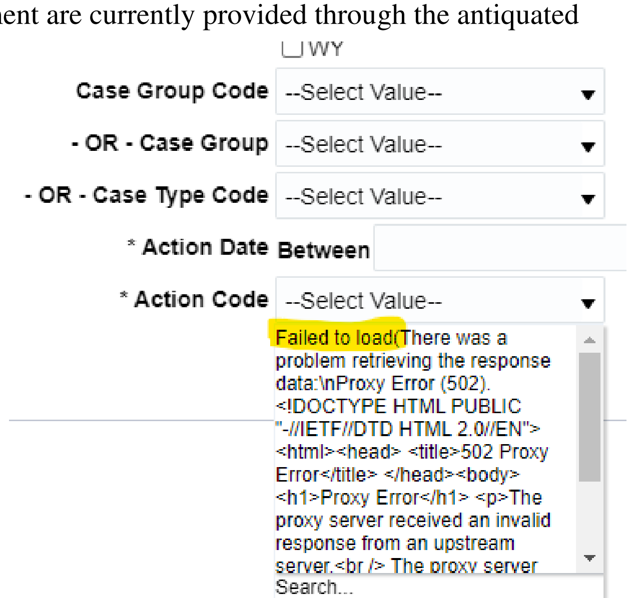
In addition to reviewing leasing policies and their implementation, TCS strongly urges DOI and BLM to review their systems for providing transparency into the federal oil and gas programs. As owners of federal land and water and the resources they contain, taxpayers deserve to know what is being developed, by whom, what we're getting for the resources, what local effects production operations have, and how liabilities connected to development are limited. Current data and notification systems fail this standard.

Keeping track of oil and gas leasing and production requires extensive documentation. The availability of documentation and data for offshore leasing is encouraging and proves that such transparency is not beyond DOI's grasp. Though several beneficial steps have been taken in recent years and certain upgrades are in progress, the tracking systems for the onshore federal oil and gas program remain fractured and inefficient.

The National Fluids Lease Sale System (NFLSS) is a good first step toward centralizing lease sale preparation and administration information but leaves a lot to be desired. Historical lease sale information is still scattered on separate BLM pages and standardization and aggregation of data is still missing. Each BLM office should report the same information – the Utah Office's current practices should be a guide – and statistical summaries of lease sales should be provided at regular intervals. Posting all lease sale results on dozens of PDFs provides work for watchdog organizations but is highly inefficient. In addition, the failure to require each party nominating parcels for lease to disclose their identify remains unjustified.

Once a lease is issued, data about its management and operations on it are only provided through the Automated Fluid Minerals Support System (AFMSS) and the Legacy Rehost 2000 (LR2000). The AFMSS provides a very basic level of information about drilling permits, but much more can be done. For example, the State of Utah's Department of Natural Resources - Division of Oil, Gas and Mining provides vastly superior functionality for attaining similar information. Not only is the production history for each well easily attainable, but links are also provided to digital copies of all documentation associated with the well, including permit applications and approval paperwork.

Instead, metadata on federal well and lease management are currently provided through the antiquated LR2000. Its problems and shortfalls would take pages to fully explicate. After years spent working with LR2000 data, several themes are clear: it is inaccessible, inconsistent, inaccurate surprisingly often, and grossly insufficient. Whole hosts of actions are often summarized with one code entered on one date. BLM offices in different regions often use different codes or action remarks to document the same event. The extent and helpfulness of explanatory remarks differs widely from office to office and from one period in the database to another. Some actions should automatically change case disposition and do not, and some codes that should be accompanied by others stand alone.



In short, the LR2000 is a chaotic records management system in need of an overhaul. Making the data accessible is of foremost concern, followed by improving the quality of data, enhancing its content, and making it communicate with other data systems. Ideally, trying to query the data would not produce error codes with regularity (see picture above), it would produce results that fully explain what actions BLM staff have taken, and provide documentation at each step. Cases created by segregation, interest assignment, and connection to well data need improved tracking protocols in particular.

Often, the only authoritative source of information about onshore leases is published in the Public Land Statistics and Oil and Gas Statistics. These are annual releases posted with data that is half a year old at best. The failure to publish leasing data monthly, or at least quarterly, demonstrates data collection and processing wildly out of step with the modern age.

On the production and revenue side, RevenueData.gov is a valuable resource that is continually improving. Ongoing initiatives to add disposition data and sales value data to the site are essential to enabling effective oversight of development of taxpayer resources. However, the availability of data at only an annual interval is a fundamental shortcoming of the platform. All of the major oil and gas producing states produce production data monthly. DOI should look to their example, particularly the Colorado Oil & Gas Conservation Commission and New Mexico Oil Conservation Division.

Land Use and Strategic Leasing

Under the Mineral Leasing Act, as amended, the BLM is required to hold lease sales for eligible lands at least quarterly. But the BLM has wide discretion to determine which lands are eligible and should use that authority to choose where leasing should be prioritized over other land uses and to auction off leases with valuable deposits strategically.

Statute mandates that BLM take actions to ensure the ultimate recovery of resources as well as deliver a fair return for taxpayers on those resources. To achieve both and best serve taxpayers, BLM should adjust its leasing practices to market conditions. There is no running clock for resource development and the return to taxpayers can be increased by policies that allow for flexibility. Selling when industry prospects are high also limits the likelihood of companies stranding assets. The inverse, increasing industry's undeveloped reserves when prices are low also hurts the industry by reinforcing the price environment.

Strategic leasing would focus the BLM's limited resources. Holding extensive lease sales in Nevada, for example, where production is limited, bidding is minimal, and noncompetitive leases are common, is irresponsible. Regions where lease sales consistently fail to recoup administration costs should be abandoned.

Under the Mineral Leasing Act, parcels that are not bid on during a competitive lease sale are made available for noncompetitive leasing for a two-year period following the auction. This discourages auction participation and incentivizes speculation. Oil and gas companies acquire parcels, either directly or through speculators, without ever developing them to inflate their undeveloped acreage numbers reported to investors. The noncompetitive system allows companies to aggrandize their production prospects at low cost, even when the leased lands have little to no potential for development.

According to the 2020 GAO report on onshore competitive and noncompetitive lease revenues, noncompetitive leases make up 27.5 percent of all acres leased but only brought in 11.2 percent of total revenues from FY2003 to FY2019. In fact, only 1.2 percent of noncompetitive leases issued from FY2003 to FY2009 ever entered production and generated royalties during their 10-year primary terms. In our report, Gaming the System: How Federal Land Management in Nevada Fails Taxpayers, we found that at the end of 2018, 97.3 percent of all acres in authorized leases in Nevada lay idle and only 1 of the 2,400 noncompetitive oil and gas leases issued since 1999 ever entered production. In another egregious example, one company obtained 228 noncompetitive leases covering 113,000 acres in Montana in 2017 and 2018, often by filing noncompetitive offers the day after lease sales.

As long as noncompetitive leasing remains an alternative per the Mineral Leasing Act, the BLM cannot ensure full market value is received for onshore oil and gas leases. Until legislation can be enacted ending the practice, increased focus on leasing in places and market moments when parcels are likeliest to get a bid and not enter the noncompetitive pool will limit taxpayer losses. In the interim, increased transparency and reporting on noncompetitive lessees is needed.

Conclusion

Taxpayers deserve a federal oil and gas leasing system that is market-savvy, strategic, transparent, and that limits liabilities. TCS welcomes the leasing pause and program review as an opportunity for DOI to fix broken policies that have lingered for decades and provide the needed reforms for the program's success in the future. These comments are not exhaustive of all aspects of the program needing attention. TCS eagerly awaits the opportunity to weigh in on future proposals to finally ensure oil and gas development on federal lands and waters delivers a fair return to taxpayers and holds industry accountable for the costs and liabilities of its operations.