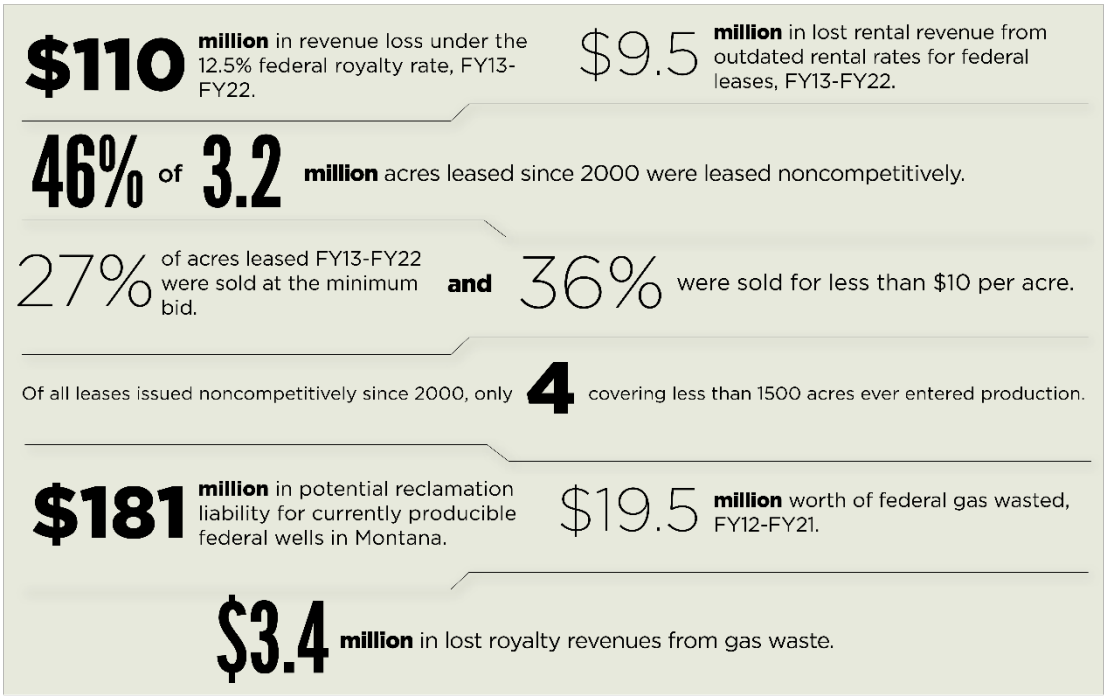
TAXPAYERS for COMMON SENSE

O&G REPORT

February 2024

Mounting Losses II:

Federal Oil and Gas Leasing Costs Montana Millions

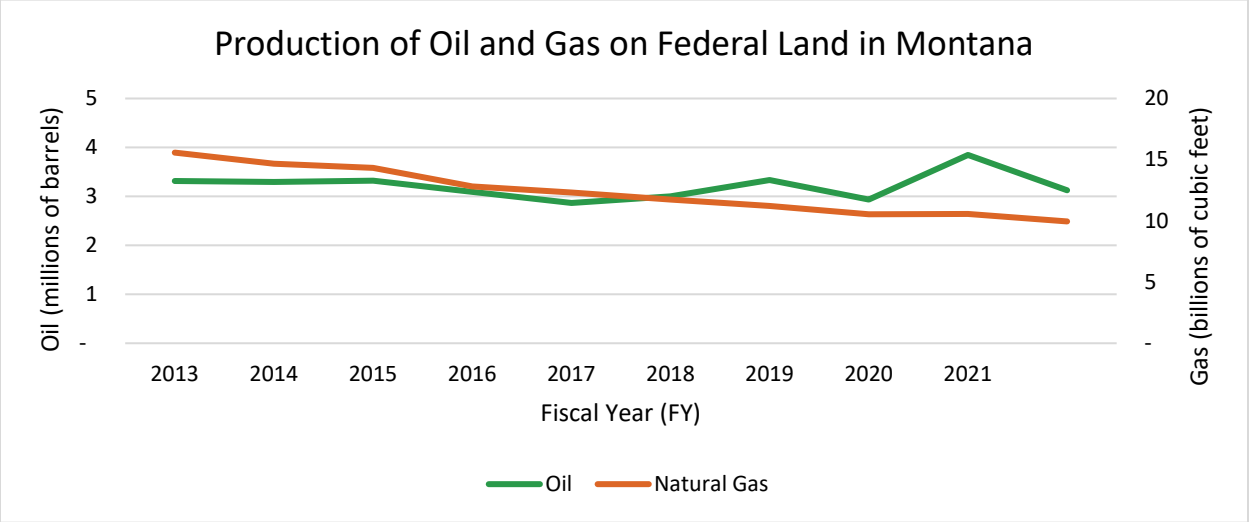


Federal lands, along with the vast resources they contain, belong to American taxpayers. The Bureau of Land Management, part of the Department of the Interior (DOI), manages these resources. This includes leasing federal land to private entities for oil and natural gas extraction and development. The DOI must ensure taxpayers receive a fair return from the development of these valuable resources. However, the current onshore oil and gas leasing system doesn't meet this goal, instead burdening taxpayers with liabilities from orphaned wells and escalating federal climate costs.

Outdated and below-market federal rates have cost federal and Montana state taxpayers $123 million over the past decade. This has also left them with more than $180 million in potential reclamation liabilities due to inadequate federal bonding requirements. If the leasing system isn't reformed, taxpayers will continue to face losses from oil and gas operations on Montana's federal lands.

Federal Oil and Gas Production in Montana

At the end of FY2022, the Bureau of Land Management oversaw 1,981 leases for oil and gas development in Montana, encompassing 1.4 million acres of federal land.[1] 55% of these leased acres are sitting idle and not producing. From FY2013 to FY2022, Montana ranked as the 7th largest producer of oil and 6th largest producer of natural gas on federal lands.[2] During this time, federal lands in Montana yielded 32 million barrels of oil and 124 billion cubic feet of natural gas. This accounted for 1% of oil and 0.4% of natural gas production on federal lands.



This production should have generated revenues for both federal and Montana taxpayers since revenue for royalties and other leasing terms are shared with the state. However, antiquated and below-market leasing terms have curtailed vital revenue and allowed oil and gas operators to dodge their reclamation responsibilities, forcing taxpayers to foot the bill. Furthermore, vast amounts of land have been sitting idle and tied up in oil and gas leases that never resulted in production, when the land could have been put to other uses that might result in greater benefits for taxpayers.

The Federal Oil and Gas Program

The federal government could secure fair market value for taxpayers during the leasing process. Initially, the DOI auctions leases to the highest bidder in a live auction, and the resulting revenue is termed as "bonus bid" revenue. Afterward, the government charges leaseholders rent for holding the land pre-production. Once production starts, leaseholders pay a royalty, a fixed percentage of the production value. Under the previous system, taxpayers lost revenue at every step.

[1] "BLM Oil and Gas Statistics." Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics.
[2] "Natural Resources Revenue Data." U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.

For decades, the government maintained the same below-market royalty rate, rental rate, and minimum bid for onshore oil and gas leases. A royalty rate of 12.5% on federal lands was set by Congress over a century ago and remained static until recently. This was lower than the rates in federal waters (18.75%) and on many state lands (up to 25% in Texas and 16.67% in Montana). The previous rental rate for holding land not currently under development – $1.50/acre per year for years 1-5 of the lease and $2/acre per year after – and minimum bid – $2/acre – remained unchanged for decades before being updated last year.

Low rates and the practice of noncompetitive leasing enabled lease holders to retain federal land without engaging in development activities. Moreover, the federal government has taken limited action to dissuade companies from holding federal leases without utilizing the oil and gas resources associated with them. By the end of FY2022, almost 11.3 million acres of federal land (nearly half of all designated for oil and gas operations) remained idle. [3] Some of this land is held by entities with no intention of extracting resources but rather to profit from selling leasing rights or for alternative objectives. This situation decreases potential royalty revenues and limits the land's alternative uses.

After production, operators on federal land must plug their wells and restore the sites. To guarantee that the cleanup of these potentially hazardous and environmentally harmful sites is paid for, producers must post a bond before they start drilling. If a company abandons its wells on a federal lease or goes bankrupt, the bond is intended to cover the reclamation expenses. However, for leases on federal land, the required bond amounts have not changed in over 60 years and do not cover the full cost of cleanup. Consequently, taxpayers are left paying millions of dollars to reclaim thousands of abandoned wells scattered across federal lands.

Recent Reforms

Recent legislation updated many fiscal terms, heralding increased returns for taxpayers. The FY2022 budget reconciliation bill, enacted in August 2022, introduced significant changes for oil and gas leasing over the next ten years.

Under these reforms, the federal onshore royalty rate is set at 16.67% until August 2032. Rental rates are raised to $3/acre for the first two years, $5/acre for years three to eight, and then no less than $15/acre for years nine and ten; and the minimum bid has been raised to $10/acre. After August 2032, these will be the base rates, with rental rates and bids adjusted for inflation. Noncompetitive leasing has been abolished, and a fee has been introduced for entities nominating land for competitive lease sales, reducing speculative leasing.

Despite these positive changes, issues remain. Current policies still allow producers to waste taxpayer-owned natural gas without proper compensation, and bonding requirements leave taxpayers vulnerable to enormous reclamation costs.

[3] "BLM Oil and Gas Statistics." Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics.

DOI's current plans include additional updates to rules and policies to further secure fair returns. In late July 2023, the DOI proposed a rule to formalize reforms from the FY2022 budget reconciliation bill and other recommendations from its report on the Federal Oil and Gas Leasing Program.[4] In tandem with fiscal revisions, the proposed rule would increase the minimum lease bond amount to $150,000 and the minimum statewide bond to $500,000 and eliminate nationwide and unit bonds. The rule would also direct oil and gas leasing away from sensitive areas. These continued efforts aim to enhance taxpayer returns, protect them from oil and gas industry liabilities, and potentially reduce speculative leasing further.

The rule also clarifies the post-10-year minimum royalty rate. Although the DOI previously set higher rates, such as an 18.75% royalty rate for specific leases in June 2022, after August 16, 2032, it could increase this rate to better capture returns on federal lands.

Additional agency rulemakings on the horizon will help assure taxpayers a fair return on valuable oil and gas resources, such as improving the capture and royalty collection of vented and flared methane from federal wells.

Noncompetitive Leasing and Low Bids

Before the fiscal reforms implemented last year, noncompetitive leasing combined with low bids and no expression of interest fee allowed private entities or speculators to acquire leases on federal lands. They aimed to profit from reselling leasing rights to production companies. Oil and gas companies would sometimes obtain land parcels without intending to develop them, either by direct acquisition or by partnering with speculators. This strategy let them artificially inflate their reported numbers of undeveloped acreage, boosting their perceived production prospects. Even though these leased lands might have minimal to no development potential, this method is a cost-effective way for companies to enhance their growth prospects. Public lands leased speculatively rarely enter production.

For decades, vast acres of land in Montana were leased noncompetitively. Entities didn't even have to pay the $2 per acre minimum bid to hold public land for a primary term of 10 years. Out of the 3,716 leases covering 3.2 million acres leased in Montana since 2000, 1,305 leases spanning 1.5 million acres, or 46% of all acres leased, were acquired noncompetitively. [5] Only 4 of these noncompetitive leases ever entered production.

[4] Department of the Interior, Report on the Federal Oil and Gas Leasing Program. November 2021. https://www.doi.gov/sites/doi.gov/files/report-on-the-federal-oil-and-gas-leasing-program-doi-eo-14008.pdf
[5] Bureau of Land Management, Land & Mineral Legacy Rehost 2000 System (LR2000).

Highlands Montana Corporation
In December 2017, the Miles City field office of the Bureau of Land Management (BLM) held an auction for oil and gas leases, offering 204 parcels of land for lease that day and received bids on 55 of them. The day after the sale, the BLM field office reported that 132 of the remaining 149 parcels received noncompetitive offers, all made by Highlands Montana Corporation, a company that had not acquired a single federal oil and gas lease before FY2018. The BLM field office eventually issued all 132 noncompetitive leases, giving them the right to explore and develop oil and gas on 67,000 acres of federal land. But those December 2018 leases were only part of a bigger land grab by the company over the past year. According to BLM records, Highlands Montana has secured 227 oil and gas leases, covering more than 113,000 acres of federal land, across the state since the start of FY2018, all through noncompetitive offers.

Source: Taxpayers for Common Sense [6]

Along with noncompetitive leasing, a low minimum bid has allowed companies and speculators to scoop up federal lands at rock bottom prices. Of all acres leased at auction in Montana between FY2013-FY2022, 27% were sold for the minimum bid of $2 per acre, and 36% sold for less than $10 per acre.[7] In the most recent lease sale held in June 2022, one bidder acquired 62% of all acres sold at the minimum bid of $2 per acre. Leasing noncompetitively or for less than $10 per acre, among other factors, are signs that federal oil and gas leases might be unreasonably speculative. This is due to the high likelihood these leases will end without ever reaching production.[8] In comparison, the same lease sale in June 2022 in North Dakata received an average bid of $12,000 per acre and a high bid of $52,000 per acre on a single parcel, given the high level of current and potential oil production in the state.

Noncompetitive leases and leases sold for minimum bid shortchange taxpayers by reducing the revenue they receive from bonus bids and by preventing the use of valuable federal land for other productive purposes. An analysis of all federal oil and gas leases in effect from FY2003 to FY2019 by the Government Accountability Office (GAO) showed that noncompetitive leases made up about 38% of all acreage leased but only generated 11% of the revenue; competitive leases generated $14.3 billion while noncompetitive leases generated only $1.8 billion. [9] Moreover, of leases issued from FY2003 to FY2009, only 1.2% of noncompetitive leases and 1.9% of leases sold for the minimum bid of $2 per acre ever entered production during the first ten years of their lease.[10]

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[6] "Taxpayers Lose in Noncompetitive Montana Lease Sale," Taxpayers for Common Sense, November 2018. https://www.taxpayer.net/energy-natural-resources/taxpayers-lose-in-noncompetitive-montana-lease-sale/
[7] All information regarding acreage sold for the minimum bid or for less than $10/acre was calculated by TCS through BLM reporting on oil and gas lease auctions.
[8] "The Cost of Speculation on Oil and Gas Leases on Federal Land," Taxpayers for Common Sense, October 2017. https://www.taxpayer.net/wp-content/uploads/ported/images/downloads/LOCKED_OUT_Energy_Report.pdf
[9] "Oil and Gas: Onshore Competitive and Noncompetitive Lease Revenues," Government Accountability Office, November 2020. https://www.gao.gov/products/gao-21-138
[10] Ibid.

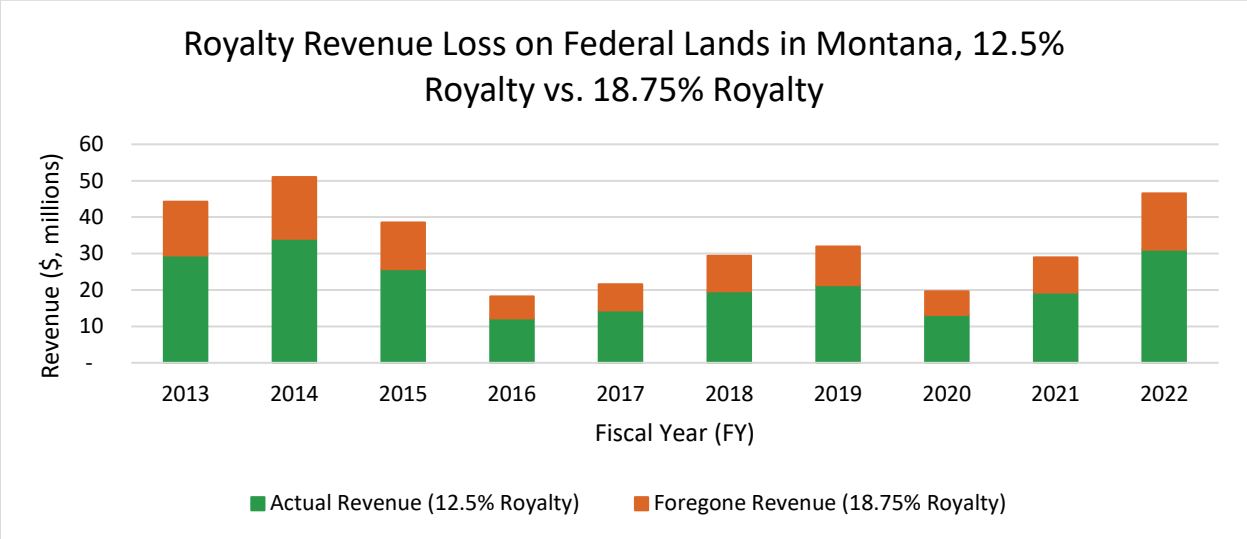
Leases that have not been utilized for oil and gas production hold the potential for various valuable uses that can benefit taxpayers, such as conservation efforts, recreational activities, or even alternative energy development, among other possibilities. Instead, outdated and ineffective federal leasing policies allow companies to lock up federal land and provide little return for taxpayers.

Revenue Losses from Onshore Leasing Terms

Although recent measures have updated the federal onshore oil and gas leasing system for the 21st century, they still fall short in safeguarding taxpayers and guaranteeing a fair return from selling taxpayer-owned resources. Without permanent changes, taxpayers risk losing millions more due to outdated and below-market royalty and rental rates. Current federal policies on lost gas and bonding favor the oil and gas industry, burdening the nation with increasing long-term liabilities.

Royalty Rate

From FY2013 to FY2022, the onshore federal oil and gas royalty rate was 12.5%. Established over a century ago, this rate was below market value, costing Montana taxpayers millions of dollars in potential revenue. Over the past decade, the Office of Natural Resource Revenue (ONRR) collected $220.2 million in royalty revenue from oil and gas operations on federal land in Montana, which was then divided between state and federal taxpayers.[11] If the current royalty rate of 16.67% had been applied during this period, taxpayers would have gained an additional $73.5 million.[12] If a royalty rate of 18.75%, which is more in line with rates in federal waters, had been applied, taxpayers would have earned $110.1 million more.

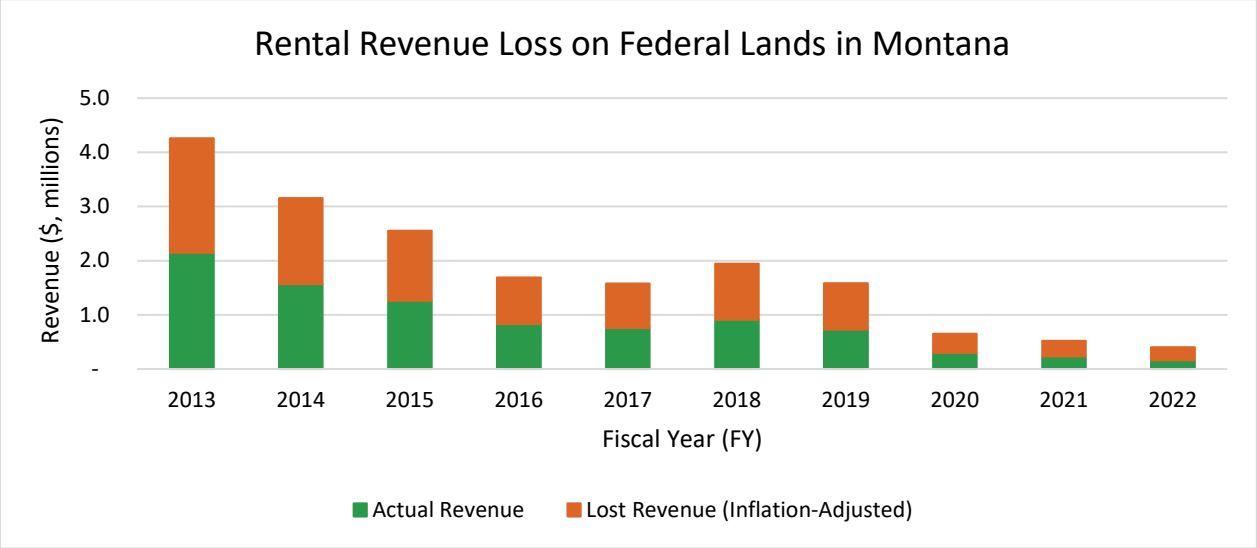


[11] "Natural Resources Revenue Data." U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.
[12] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.

Rental Rate

Outdated rental rates have also cost taxpayers. Over the past decade, leaseholders not actively producing oil or gas on federal leases were charged $1.50/acre for the first five years and $2/acre for the second half. These rates remained unchanged until August 2022, despite being set in 1987.

From FY2013 to FY2022, the federal government collected $8.9 million in revenue from rental fees in Montana.[13] If rental rates had been adjusted annually for inflation, taxpayers would have received $18.3 million, over double the revenue collected.[14] A proposed rule at the DOI would mandate that base rental rates be adjusted annually for inflation.



Federal Bonding Requirements

Outdated oil and gas bonding requirements have transferred the costs and responsibilities of orphaned well reclamation to federal taxpayers. Properly reclaiming oil and gas wells can cost hundreds of millions of dollars, a price federal minimum bonding requirements don't cover. The GAO reported the average bond value held by the DOI in 2019 was $2,122 per well.[15] However, the actual cost of reclaiming wells in Montana is significantly higher. Between 2018 and 2020, Montana plugged and reclaimed 14 orphaned wells at a total cost of $1.07 million or roughly $76,000 per well.[16] When federal bonds fail to cover the costs of well reclamation, taxpayers must pay the remaining costs.

[13] "Natural Resources Revenue Data." U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.
[14] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.
[15] "Oil and Gas: Bureau of Land Management Should Address Risks from Insufficient Bonds to Reclaim Wells." Government Accountability Office, September 18, 2019. https://www.gao.gov/products/gao-19-615
[16] "Idle and Orphan Oil and Gas Wells: State and provincial Regulatory Strategies 2021," Interstate Oil & Gas Compact Commission, 2021. https://iogcc.ok.gov/sites/g/files/gmc836/f/iogcc_idle_and_orphan_wells_2021_final_web.pdf

Producing wells with inadequate bonds create potential future liabilities for taxpayers. By the end of FY2022, 2,443 oil and gas wells were producing on federal land in Montana.[17] Based on previous reclamation costs, these wells might cost $186.4 million to reclaim.[18] If the average DOI bond value remains at $2,122 per well, taxpayers would need to cover $181.2 million in reclamation liabilities.

Moreover, federal taxpayers often cover the costs of reclaiming orphaned wells on state and private lands. The Infrastructure, Investment, and Jobs Act (IIJA, P.L. 117-58) allocated $4.275 billion for state orphaned well cleanup programs. Montana received $25 million in initial grants and is eligible for up to $5.14 million in formula grants.[19] In its application for funding, Montana reported 254 orphaned wells on state and private land,[20] but the Montana Board of Oil & Gas Conservation recently recorded 239 orphan wells across the state.[21] These orphaned wells, along with other producing wells on state and private lands, also pose potential reclamation costs that federal taxpayers might have to bear.

Royalty-Free Gas

During oil and gas production, operators often vent (release), flare (burn), or leak natural gas, emitting it into the atmosphere. Over the last decade, operators on federal land reported venting, flaring, or losing nearly 6 billion cubic feet of methane, worth an estimated $19.5 million, in Montana.[22] This natural gas should have generated a sizeable royalty revenue for state and federal taxpayers. However, between FY2012 and FY2021, ONRR collected $231,337 in royalties from vented or flared gas on federal land in Montana – just 1% of the value of all reported lost gas.[23]

Had the federal onshore royalty rate of 12.5% been applied to all reported lost gas during this period, taxpayers would have received an additional $2.2 million in revenue. If the current royalty rate of 16.7% had been imposed, taxpayers would have received an additional $3 million in revenue. And if a royalty rate more in line with what is charged in federal waters and on state

[17] "BLM Oil and Gas Statistics." Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics.
[18] Interstate Oil & Gas Compact Commission, "Idele and Orphan Oil and gas Wells: State and Provincial Regulatory Strategies 2021," https://iogcc.ok.gov/sites/g/files/gmc836/f/iogcc_idle_and_orphan_wells_2021_final_web.pdf
[19] "Biden-Harris Administration Invests $660 Million for States to Plug Orphaned Oil and Gas Wells through President's Investing in America Agenda." U.S. Department of the Interior, July 10, 2023. https://www.doi.gov/pressreleases/biden-harris-administration-invests-660-million-states-plug-orphaned-oil-and-gas-wells.
[20] "Through President Biden's Bipartisan Infrastructure Law, 24 States Set to Begin Plugging over 10,000 Orphaned Wells." U.S. Department of the Interior, June 5, 2023. https://www.doi.gov/pressreleases/through-president-bidens-bipartisan-infrastructure-law-24-states-set-begin-plugging.
[21] "Orphan Wells," Montana Board of Oil & Gas Conservation, Accessed July 10, 2023. https://bogapps.dnrc.mt.gov/dataminer/Wells/WellOrphans.aspx
[22] All information regarding methane emissions on federal lands was obtained through the Office of Natural Resources Revenue via a Freedom of Information Act Request by TCS. Gas value calculations used monthly average Henry Hub Natural Gas Spot Prices obtained from the Energy Information Administration. Source: https://www.eia.gov/dnav/ng/hist/rngwhhdM.htm
[23] "Natural Resources Revenue Data." U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.

land, 18.75%, had been imposed on all reported flared gas, taxpayers would have received an additional $3.4 million in revenue.

While the DOI has taken steps to minimize lost gas volumes, more action is needed. This includes accurately measuring and monitoring methane emissions, addressing and preventing equipment leaks, and implementing aggressive emissions reduction targets.

Conclusion

The federal oil and gas leasing system in Montana, and elsewhere in the country, is failing taxpayers. Over the last decade, federal and state taxpayers have lost $123 million in revenue in Montana from below-market royalty rates, outdated rental rates, and policies that have allowed billions of cubic feet of methane to be released royalty-free. Furthermore, low federal bonding minimums fail to cover the costs of well cleanup, leaving taxpayers with potentially $181 million in reclamation costs from currently producing wells on federal land in that state. Without reform, taxpayers will continue to lose out on valuable potential revenue and be left with mounting financial liabilities from the oil and gas leasing program in Montana.

Kevin-Sunburst Oil Field, MT | Jason Woodhead