Analysis

March 2024

Federal Oil & Gas Leasing Reform Will Benefit Taxpayers

For decades taxpayers have lost out due to an outdated oil and gas leasing system. The U.S. government, which manages the oil and gas resources on our nation's federal lands, must ensure that taxpayers receive a fair return from their development. However, outdated leasing processes and below-market fees have failed to provide a fair return, instead burdening us with growing financial liabilities.

In 2022, Congress passed a suite of fiscal reforms to the federal onshore oil and gas leasing system. Now, the Department of the Interior is taking an important step for taxpayers by: 1) proposing an update to decades-old bonding requirements, 2) focusing federal resources for oil and gas leasing in areas that will yield the greatest results for taxpayers, and 3) codifying the reforms passed by Congress. The proposed changes will ensure taxpayers receive a fair return from the development of federally owned resources and are not left with costly liabilities from orphaned wells.

The proposed rule would codify Congressional reforms to:

- ✓ Increase the century-old royalty rate.
- ✓ Increase rental rates, unadjusted for inflation since President Reagan's era.
- ✓ Increase the outdated minimum bid that gave away land for a mere $2/acre.
- ✓ Create a new expression of interest fee which can limit speculation and recoup administrative costs.
- ✓ Eliminate noncompetitive leasing that allowed millions of acres to be leased for essentially $0/acre.

And implement new reforms, including:

- ✓ Raising outdated bonding minimums that currently cover 1-10% of reclamation costs.
- ✓ Raising processing fees to recoup administrative costs.
- ✓ Adjusting rental rates and the minimum bid for inflation after August 2032 to help prevent rates from becoming obsolete again.
- ✓ Directing leasing away from low production potential areas to prevent valuable land from being locked into nonproducing leases.
- ✓ Instituting stricter reporting requirements for operators of temporarily abandoned and shut-in wells to avoid burdening taxpayers with reclamation costs.

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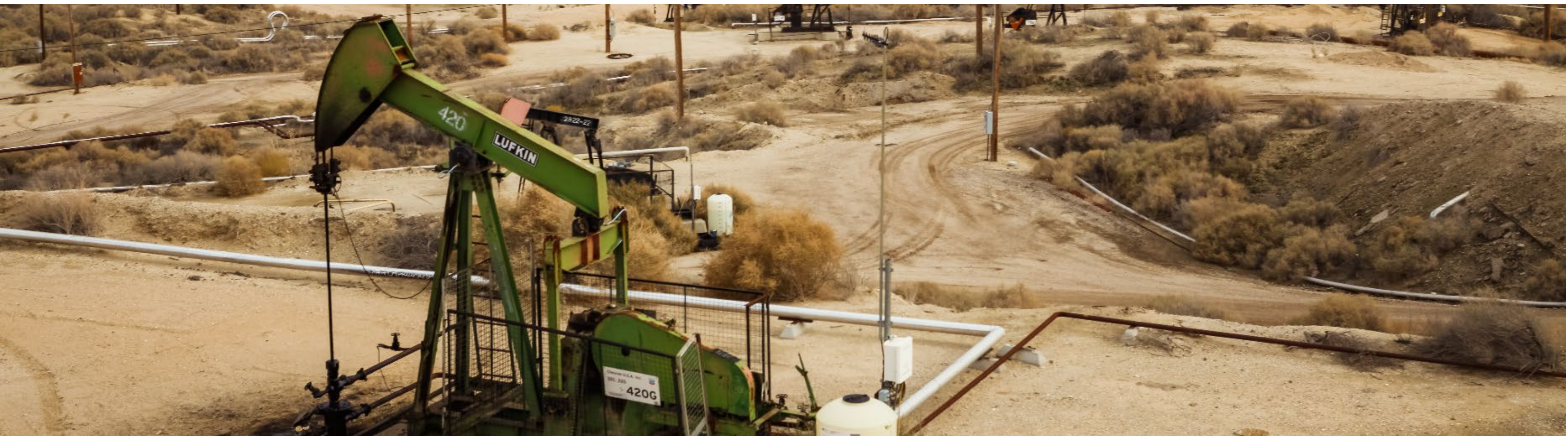

The Proposed Rule Will Increase Revenue for Taxpayers

For decades, the federal government and taxpayers have lost billions of dollars in potential revenue from outdated and below-market oil and gas leasing terms. The leasing reforms included in the Department of Interior's proposed rule will raise revenue for both federal and state taxpayers and reduce liabilities from orphaned wells. Had oil and gas production on federal lands over the last decade been charged the new federal royalty rate of 16.7%, taxpayers would have received more than $10 billion in additional revenue from FY2013-2022, along with revenue from other updated leasing terms. Implementing this proposed rule will also protect taxpayers from the potentially $6.15 billion in reclamation costs we currently face from under-bonded wells on federal land.

Taxpayers in states with both high and low levels of oil and gas production will benefit from reform. While potential revenue gain is highest in states with significant oil and gas production, states with limited potential for oil and gas development also suffer when land is locked into nonproducing leases and kept from other valuable uses.

New Mexico and Wyoming, the country's largest producers of oil and gas on federal land, representing a combined 74% of oil and 69% of natural gas produced on federal lands over the last decade,[1] would have generated even greater revenues for both federal and state taxpayers with a 16.7% federal royalty rate. New Mexico and Wyoming could have raised an additional $5.4 billion and $2.4 billion, respectively, between FY2013 and FY2022.[2]

High rates of federal leasing have also left these and other states vulnerable to liabilities from orphaned oil and gas wells. Inadequate bonding coverage for producing oil and gas wells on federal land across the country leaves taxpayers at risk of massive reclamation costs. The estimated reclamation cost of the 31,186 producible wells on federal lands in New Mexico at the end of FY2022 far exceeds the bond coverage held by the BLM, leaving a potential shortfall of $1.05 billion in costs that may fall to federal taxpayers.[3]

In states like Montana and Nevada, noncompetitive leasing, low minimum bids, and other below-market rates have allowed large swaths of federal land to be locked into nonproducing leases for minimal returns. In Nevada, more than 95% of federal land leased for oil and gas development sat idle at the end of FY2022, with little hope for future development; of all federal oil and gas leases issued in that state since 1953, only 0.3% ever entered production.[4] In Montana, nearly half of all federal land leased for oil and gas development since 2000 was leased noncompetitively, with only 0.1% of these noncompetitive acres entering production.[5]

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[1] U.S. Department of the Interior Office of Natural Resource Revenue, "Natural Resource Revenue Data", accessed June 2023. https://revenuedata.doi.gov/?tab=tab-production

[2] Lost royalty revenue estimates are calculated by TCS using ONRR data. Source: U.S. Department of the Interior Office of Natural Resource Revenue, "Natural Resource Revenue Data", accessed May 2023.

[3] Taxpayers for Common Sense, "New Mexico's Boom That Cost Billions II," May 2023. https://www.taxpayer.net/energy-natural-resources/new-mexicos-boom-that-cost-billions-ii/

[4] Taxpayers for Common Sense, "Gaming the System II: Oil & Gas Leasing in Nevada is Trouble for Taxpayers," July 2023. https://www.taxpayer.net/energy-natural-resources/gaming-the-system-ii/

[5] Taxpayers for Common Sense, "Mounting Losses II: Federal Oil and Gas Leasing Costs Montana Millions," February 2024. https://www.taxpayer.net/energy-natural-resources/mounting-losses-ii/

Before the 2022 reforms, the federal government had taken limited action to discourage companies from holding federal leases without utilizing the associated resources. The proposed rule aims to disincentivize speculative leasing and direct leasing to appropriate locations, increasing the likelihood of development on federal leases and allowing lands with low potential to be better utilized for other needs.

The federal oil and gas leasing system has been failing taxpayers. Without reform, taxpayers will continue to lose out on valuable potential revenue and be left with mounting financial liabilities.

Reforms Fix Outdated Policies That Have Fallen Short for Taxpayers

Below Market Royalty Rates

Operators are required to pay taxpayers a set percentage of the value of federal resources produced. Congress has recently increased the federal onshore oil and gas royalty rate to 16.67% until August 2032, subsequently making this the statutory minimum. This marks an increase from the prior rate of 12.5%, unchanged since its establishment in 1920. The updated 16.67% rate aligns more closely with market rates and is expected to boost federal and state revenue. States like Texas, Pennsylvania, Oklahoma, North Dakota, and New Mexico, significant oil and gas producers, already impose a 16.67% or higher royalty rate for state land production. In federal waters, the royalty rate is 18.75%.

From FY2013-2022, oil, gas, and natural gas liquids production on federal lands generated $30.9 billion in royalty revenue for federal and state taxpayers. Had the current 16.7% rate been applied during this period, taxpayers would have received an additional $10.3 billion in revenue.[6]

Inadequate Bonding Minimums

Oil and gas producers on federal land are responsible for ensuring well plugging and site cleanup is completed post-production. Producers must post a bond before drilling begins, covering potential reclamation costs should they abandon wells or go bankrupt.

Current bond minimums, dating back to the 1950s and 1960s, are insufficient, failing to incentivize proper well reclamation. The Department of the Interior (DOI) estimates reclamation costs at approximately $71,000 per well, yet the Government Accountability Office reported an average bond value of only $2,122 per well in 2019. This gap leaves taxpayers footing the bill for millions in reclamation costs.

As of the end of FY2022, there were 89,350 producible and service well bores on federal land. Assuming the DOI's average bond value from 2019, these wells hold bonds totaling $189.6 million. However, at the DOI's average reclamation cost, existing federal bonds fall short, potentially leaving taxpayers with potentially $6.15 billion in future costs without bonding reform.[7]

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[6] This calculation assumes all federal oil and gas leases in production during this period were subject to a 12.5% royalty rate. Although an 18.75% royalty rate was imposed in a lease sale in June 2022, it's improbable that these leases produced oil and gas and incurred a royalty within the FY2013-2022 timeframe.

[7] At an average reclamation cost of $71,000/well, 89,350 wells across federal land carry an estimated $6.34 billion in potential future reclamation costs. Less the $189.6 billion in estimated total bond amount held by DOI (using $2,122 average bond value per well held by BLM in 2019, per the Government Accountability Office), uncovered reclamation costs of $6.15 billion may fall to federal taxpayers.

Outdated Rental Rates

Oil and gas operators on non-producing federal leases must pay annual rent. The minimum oil and gas rental rates for leases issued between August 2022 and August 2032 have been increased to $3/acre for the first 2 years, $5/acre for years 3-8, and no less than $15/acre for years 9-10. Previously, rates had been stagnant at $1.50/acre or $2/acre since 1987.

Between FY2013-2022, before the implementation of updated rental rates, federal and state taxpayers received $261 million in rental revenue from leases on federal land. Had these rates been adjusted annually for inflation (to $3.69/acre and $4.92/acre in FY2022), taxpayers would have gained an additional $292 million.[8] The increased current rates would likely have generated even greater revenue.

Low Minimum Bids

Operators must bid a minimum amount to lease federal land. The previous minimum bid at auctions for federal oil and gas leases was $2/acre. The DOI has the authority to set higher rates, but this has not been exercised since 1987. In 2020, about 37% of the 544,000 acres sold at auction went for the minimum bid. The updated minimum bid is now $10/acre until August 2032.

Noncompetitive Leasing Loophole

Operators could bypass bidding by submitting noncompetitive offers for unsold leases. This practice reduces taxpayer revenue and hinders other productive uses of federal land. A Government Accountability Office (GAO) analysis from FY2003 to FY2019 showed that while noncompetitive leases comprised 38% of all leased acreage, they generated only 11% of revenue. In contrast, competitive leases generated $14.3 billion, compared to $1.8 billion from noncompetitive leases. [9] Furthermore, from FY2003 to FY2009, only 1.2% of noncompetitive leases entered production within the first decade.[10]

Burdensome Administrative Costs

The Bureau of Land Management (BLM) may charge additional fees during the leasing process. Raising processing fees, such as increasing the competitive lease application fee from $185 to $3,100, will help cover BLM's administrative costs. An expression of interest fee also discourages companies from nominating lands they do not intend to develop, alleviating some of the administrative burden.

Leasing in Areas Unlikely to be Developed

Offering federal land with low oil and gas development potential is not beneficial for taxpayers. It leads to non-producing leases and precludes other uses. Private entities or speculators often acquire leases to profit from reselling leasing rights, while oil companies might obtain them to inflate undeveloped acreage figures. Such speculative leasing seldom results in production.

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[8] This calculation uses inflation adjustments against the average FY1988 CPI-U. Source: U.S. Bureau of Labor Statistics, "Consumer Price Index Historical Tables for U.S. City Average," accessed May 2023. https://www.bls.gov/regions/mid-atlantic/data/consumerpriceindexhistorical_us_table.htm

[9] Government Accountability Office, "Oil and Gas: Onshore Competitive and Noncompetitive Lease Revenues," November 2020. https://www.gao.gov/products/gao-21-138

[10] Ibid.

Reforms Won't Hurt Production or Consumers at the Pump

The proposed rule's main change, outside codifying reforms passed by Congress, is updating bonding minimums. Past state-level reforms, such as Wyoming's increased bonding requirements in 2015, did not adversely affect the oil and gas industry. For example, oil production on Wyoming's state land peaked in 2018 with hundreds of new wells drilled by many oil and gas companies, including smaller "mom and pop" operations, despite these increased bonding requirements. [11]

The most significant reform by Congress, raising royalty rates, is unlikely to impact gas prices or the oil and gas industry. Global market forces determine oil prices, and increased federal royalty rates would not affect existing leases or current production. These higher rates apply only to new leases, which often take years to develop. Most federal oil and gas production comes from leases issued decades ago.[12]

History demonstrates that the market can absorb royalty rate increases without significantly affecting production. Texas, for instance, has charged a 25% royalty on new state land leases for over 30 years. In 2007, the Bush Administration increased the federal offshore royalty rate to 16.67% for leases in waters deeper than 400 meters, then to 18.75% 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 16.67%. The State of Colorado has raised its royalty rate for oil and gas leases twice: to 16.67% in 2011, then to 20% in 2016.

In conclusion, these reforms will likely not affect industry or gas prices, but they will generate more revenue in the long run and better protect taxpayers from future reclamation costs.

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[11] Accountable US, "Oil & Gas Bonding Reform Is A Common-Sense Solution to A Significant Problem: Just Look At Wyoming," September 2023. https://accountable.us/wp-content/uploads/2023/09/20230918-Wyoming-Bonding-Case-Study-FINAL.docx.pdf

[12] Taxpayers for Common Sense, "Oil & Gas Reform Won't Raise Prices at the Pump," October 2021. https://www.taxpayer.net/wp-content/uploads/2021/10/OG-Reform-and-Gas-Prices-Primer.pdf