TAXPAYERS *for* COMMON SENSE

O & G REPORT

September 2020

Waste in Wyoming:

Below-Market Rates, Oil & Gas Industry Giveaways, and Billions of Dollars in Lost Revenue

$4.0 billion in lost revenues under the federal 12.5% royalty, FY2010-2019

70% of all leases granted COVID-19 royalty relief were in Wyoming.

$120 million in lost revenue from outdated rental rates, FY2010-2019.

40% of all leases sold at auction had bids of $10/acre or less in FY2019.

119,287 acres leased noncompetitively in FY2019, the most in 20 years.

Federal taxpayers own significant oil and natural gas reserves on federal lands throughout Wyoming and other Western states. The Bureau of Land Management (BLM) within the Department of the Interior (DOI) manages these reserves and is directed by law to collect fair market value from their development and sale. The agency is failing to ensure taxpayers receive a fair market value for these resources because its land management policies are insufficient and outdated.

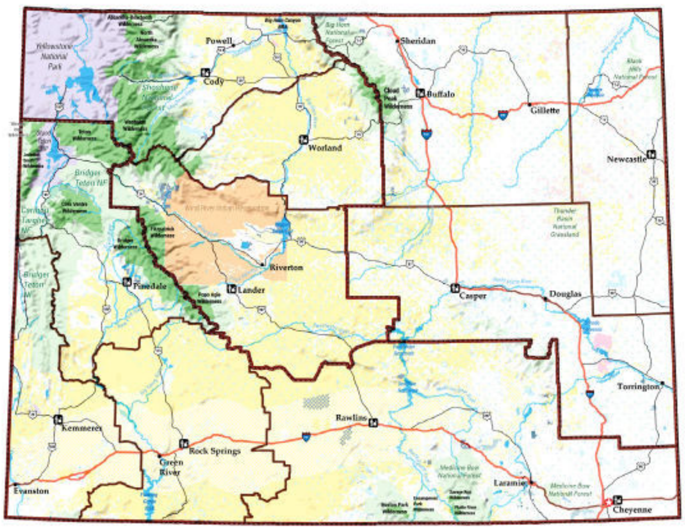
Problems within the federal oil and gas leasing system have led to billions of dollars in lost revenue and simultaneously saddled taxpayers with associated pollution costs and long-term liabilities. This report will focus on the costs imposed by the following BLM policies:

- Royalty rates on the sales value of oil and gas extracted from federal lands that lag the rates imposed on production from federal waters and Wyoming state lands;
- Annual rental rates and the minimum bid price for oil and gas leases that have not changed in more than 30 years; and
- Antiquated procedural carve-outs that allow companies to lease federal land without paying any bid.

Wyoming is a major producer of federally owned oil and natural gas. In 2010, Wyoming produced roughly one-third of all oil and one-half of all natural gas developed from the federal mineral estate. By area, federal leasing in Wyoming is unsurpassed. With 8.9 million acres at the end of fiscal year 2019,[1] Wyoming had twice as much land under federal lease for oil and gas development than the next closest state, New Mexico, and accounted for one third of all onshore federal acres leased.

Unfortunately for the residents of Wyoming, and federal taxpayers, oil and gas companies

[1] All years reported below are federal fiscal years, except where noted.



Federal land managed by BLM. Source: BLM

are paying far less for the right to remove and sell oil and gas from these lands than they pay to state and private interests. This is because neither the Bureau of Land Management nor Congress has updated the royalty rate these companies pay since 1920. Not only do oil-rich states and private landowners frequently charge more than the federal government for drilling on their land, the federal government charges more for drilling in federal waters. If oil and gas producers in Wyoming had paid the federal offshore royalty rate for production on federal lands over the last decade, taxpayers — the owner of these resources — would have collected approximately $4 billion more. Half of this would have gone to the state. Combined with losses from other BLM policies, Wyoming taxpayers have lost out on roughly $2 billion in additional revenue since 2010.

Production & Royalties

Wyoming has long been a leading source of federal oil and gas production. In 2010, roughly one-third of all oil and one-half of all natural gas developed on federal lands came from Wyoming. Over the last decade, oil and gas companies produced 369 million barrels of oil and 15.7 trillion cubic feet of natural gas from federal leases in the state, making it the second largest source of onshore federal oil after New Mexico and a bigger producer of federal gas than any other state.[2]

Within Wyoming, federal production is concentrated in three major oil and gas basins: the Greater Green River Basin, the Powder River Basin, and the Big Horn Basin. In the mid 2000's — before the fracking boom — federal oil production was divided roughly evenly between the three. The volume of oil from the Big Horn in the northwest has since declined, however, while Powder River Basin production has spiked. Over the last decade, crude production in Converse County alone has increased by more than 10 times, and together with counties in the northeast, now accounts for roughly 60 percent of the state's federal oil. Gas production on federal lands, meanwhile, is heavily concentrated in Sublette and Sweetwater Counties in the Greater Green River Basin in the southwest. In 2019, one quarter of all onshore federal natural gas production nationwide came from Sublette County.

From the sale of Wyoming oil, gas, and natural gas liquids, the federal Office of Natural Resources Revenue (ONRR) collected $730 million in royalties in 2019, and $7.9 billion over the last decade. Nearly half of this was shared with the state. Though these royalties from Wyoming production constituted a third of the U.S. total over the last decade, the revenue does not capture the fair market value of the taxpayer-owned oil and gas resources sold.

The royalty rate of 12.5% for federal leases is demonstrably lower than what the leasing market bears from other landowners, and what the market share of federal production in Wyoming would allow. In calendar year 2018, natural gas from federal lands made up 80 percent all production in Wyoming.[3] Federal acres and auctions also dominate the leasing market. During Wyoming's 2018 fiscal year,[4] for example, the Wyoming Office of State Lands and Investments offered 265,000 acres of state trust land for oil and gas lease, of which 165,000 acres received bids.[5] In that time, the BLM offered 550,000 acres, and got bids for oil and gas leases covering 520,000 acres.

---

[2] All production and revenue data downloaded from the Office of Natural Resources Revenue statistics portal—**RevenueData.gov**

[3] Total Wyoming production from: U.S. Energy Information Administration (EIA), "Natural Gas Gross Withdrawals and Production," **https://www.eia.gov/dnav/ng/ng_prod_sum_a_EPG0_FGW_mmcf_a.htm**

[4] Runs from July 1, 2017 to June 30, 2018.

[5] Figures are rounded. Wyoming Office of State Lands and Investments, "FY18 Strategic Plan Annual Report." **https://drive.google.com/file/d/1tvu7lNhgzb9oQP2KTP2DNJgQa-eSQjZI/view**

In many cases, the same producers extract and sell the same quality oil and natural gas from wells on state lands just miles away from federal leases, and pay the Wyoming Office of State Lands and Investments 16.67% of those resources' sales value. The 12.5% royalty rate on federal lands was first set by Congress as the legal minimum almost 100 years ago, and BLM has not raised it since. The rate not only lags behind those charged by most states with large oil and gas industries, like Texas, Oklahoma, Colorado, Wyoming, and New Mexico, it's also less than the 18.75% producers pay for oil and gas developed from federal waters.

Most federal production comes from leases issued decades earlier. Overhauling the royalty regime would yield little in the short-term, but over the next few years and beyond taxpayers could see a notable increase in receipts. For comparison, if the prevailing federal offshore royalty rate of 18.75% had been imposed on the same quantity of onshore production over the last decade, ONRR would have collected approximately $4.0 billion more in Wyoming alone. Which means Wyoming taxpayers would have received roughly $2 billion more in disbursements from ONRR. And because the royalty rate would be close to that charged by the state, shifts in production from federal to state lands would be minimal.

COVID-19 Royalty Relief

In April, the BLM quietly issued new guidance to operators of federal oil and gas leases on how to apply for expedited royalty relief during the COVID-19 pandemic. The guidance stated that if a relief application was approved, a federal lessee would be allowed to pay a smaller percentage of the value of oil and gas produced from their lease than the statutory minimum 12.5 percent, for a period of up to 60 days.

By the end of July, the BLM had awarded relief to 375 leases covering 211,000 acres in Wyoming, representing more than 70 percent of all leases granted relief nationwide. Unlike other states, where BLM reduced royalty rates to varying levels, every single lease granted relief in Wyoming had their rate reduced to just 0.5 percent, a 96 percent reduction from the statutory minimum rate. In August, Department

Used with permission.

of the Interior (DOI) officials went on record to announce that the royalty relief program for oil and gas leases on federal lands had closed. The full scope of leases affected, and the program's total cost to federal and state budgets, will only be fully understood in the months to come. It is clear, however, that Wyoming taxpayers will have lost more revenue because of the program than taxpayers in any other state.

Leasing

Under federal law, the BLM is required to hold quarterly sales for leases in all states where federal land is eligible for oil and gas development, like Wyoming.[6] Over the last decade, the BLM held 42 competitive sales for oil and gas leases in Wyoming. In those, 4,685 parcels comprising 4.93 million acres were offered for lease, more than any other state except Alaska. Oil and gas interests bid comparatively little for those leases, however, and often used BLM's antiquated noncompetitive process to get federal leases without bidding at all.

In all BLM lease sales in the continental U.S. over the last decade, oil and gas companies bid

[6] Mineral Leasing Act of 1920, as amended, §17(b); 30 U.S.C. 226(b)

Used with permission.

on roughly 62% of available acres. In Wyoming, producers bid on 87%, suggesting high industry interest in the lucrative Wyoming basins. Yet bidding amounts were consistently low. In comparison to other high-producing states like New Mexico and North Dakota, where bids averaged roughly $3,970 per acre and $1,570 per acre respectively, the average bidding rate for Wyoming acres since 2010 was just $160. In 2019, companies bid just $120 per acre on average.

Average bidding revenue was reduced by the relatively high rate of parcels with bids at the minimum legal level or at $10 per acre or less. In recent years, the trend has only worsened. In the first half of the last decade (FY2010-2014), one in seven acres sold at federal auction received the minimum bid of $2 per acre, and roughly two in seven sold for $10 per acre or less. Last year, more than one in five had a minimum bid, while two of every five sold for $10 per acre or less. In total, 1.4 million acres were leased for $10 or less over the last decade.

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 per acre required to win a lease at auction.

Over the decade starting in 2010, the BLM issued nearly 200 noncompetitive leases covering 290,000 acres of federal land in Wyoming, the second most in any state after Nevada. More than 40 percent of that acreage, furthermore, was leased in 2019.[7] The option to acquire leases noncompetitively undermines the BLM's competitive auctions, and has likely contributed to the low revenues the BLM has generated from recent sales.

Losses from Other Lease Terms

In addition to royalties and bidding at lease auctions, the BLM also charges companies rent if they are not actively developing a lease for holding federal land and preventing other uses of it. Neither the annual rental rate nor the minimum acceptable bonus bid has been adjusted since 1987.

[7] Leasing totals downloaded from the Bureau of Land Management, LR2000 database—**https://reports.blm.gov/reports/LR2000**

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 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. As a result, rent collection now yields roughly half of what it would have under inflation-adjusted rates.

Over the last ten years, ONRR collected $102 million in rent for oil and gas leases in Wyoming. If the 1987 rental rates had been annually adjusted for inflation, as measured by the Bureau of Labor Statistics, ONRR could have collected roughly $220 million in rental payments over the decade. That is, taxpayers have lost nearly $120 million in rental revenue from rental rates that were set more than 30 years ago.

Conclusion

Federal lands and the vast resources they offer are precious assets for taxpayers. The weight of the public trust and the current federal budget picture demand that the Bureau of Land Management maximize the fiscal return by administering oil and gas development strategically throughout the federal mineral estate in Wyoming and across the country.

Current policies fail this standard and have led to billions of dollars in lost revenue from development in Wyoming alone over the last decade. The Bureau of Land Management is not beholden to the decisions from decades past. The agency has existing statutory authority to independently change each of the policies discussed here, including royalty rates, minimum bid levels, and rental rates. By updating lease terms for federal oil and gas development now, the Bureau of Land Management can substantially increase the returns to the U.S. Treasury, and the amounts disbursed to the state of Wyoming.