September 2019

Giving It Away: How Utah Loses from Oil and Gas Development on Federal Lands

$1.4 BILLION in lost revenues under the federal 12.5% royalty, 2008-2017.

$3.2 million in lost revenues from gas waste, 2008-2017.

12.5% The federal onshore royalty rate; almost 1/3 lower than state rate for oil and gas.

25% of leases sold for $2 per acre, the legal minimum in 2009-2018.

$64 million in lost revenues from outdated rental rates, FY 2009-2018.

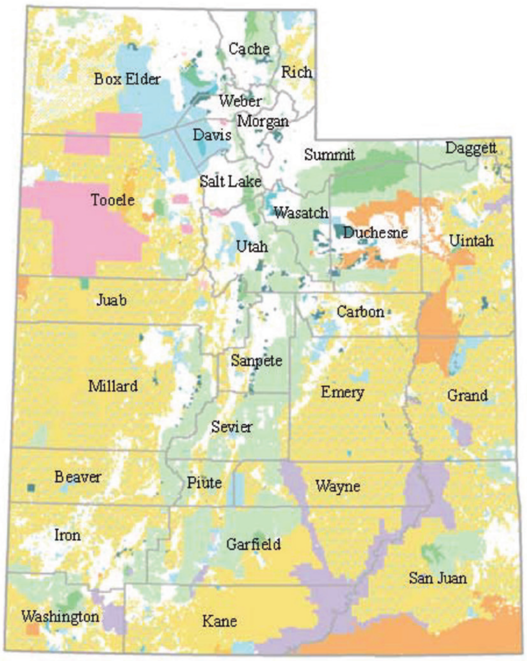
6.4 billion cubic feet of federal gas waste, 2008-2017—sixth in the country.

Significant oil and natural gas reserves exist on federal lands throughout Utah and other Western states. The Bureau of Land Management—a federal agency within the Department of the Interior—regulates these reserves and is mandated by law to collect fair market value from the development and sale of these oil and gas resources. However, the Bureau of Land Management has failed in its mandate to ensure taxpayers receive a fair market value due to weak, decades-old management policies.

Pervasive problems within the federal oil and gas leasing system have led to billions of dollars in lost revenue nationally. This additional revenue could be used to address pollution costs and long-term liabilities caused by oil and gas development and consumption. This report will focus on the Bureau of Land Management (BLM) policies, many of which have remained unchanged for decades, that have resulted in lost revenues for both the federal treasury and the state of Utah, such as:

- the annual rental rates BLM charges, and the minimum bid for oil and gas leases that have not changed in more than 30 years;
- an antiquated procedural carve-out that allows companies to lease federal land without paying any bid in some cases;
- the royalty rate BLM collects on the sales value of oil and gas extracted from federal lands that lags behind rates imposed on production from federal waters and many state lands; and
- the weakened natural gas waste rule that fails to charge royalties for methane leaked during drilling on federal lands.

The federal government shares roughly half of revenues from federal oil and gas development with the states where the development takes place. These funds are an important source of revenue for the U.S. Treasury and the Western states where the majority of federal oil and gas



Federal land managed by BLM. Source: BLM

is produced. When the federal government fails to secure a fair return, the money left on the table deprives both federal taxpayers and states of significant revenue every year. Moreover, problems within the federal oil and gas leasing system have led not only to billions of dollars in lost revenue, but have also saddled taxpayers with associated pollution costs and other long term liabilities.

Federal oil and gas development in Utah illustrates how BLM's bad policies can cost federal and state taxpayers billions of dollars in lost revenue over time. Production on federal lands in Utah generates significant receipts. Yet, because of BLM's low onshore royalty rate, taxpayers have lost more than $1.4 billion from 2008 to 2017. And since states receive roughly half of federal receipts from resource development within their borders, Utah taxpayers lost out on more than $700 million in revenue.

Production & Royalties

Over the last 10 years, 2009-2018, oil and gas companies produced 2.6 trillion cubic feet of natural gas from federal lands in Utah. Over the same period, oil production totaled 107 million barrels sold, making Utah the fifth largest producer of federal oil. The majority of oil and gas production in Utah occurs in the northern half of the state. In 2018, more than half of all federal oil and three quarters of federal gas came from just Uintah county, located in the northeast.

This federal oil and gas production in Utah generated $1.9 billion in royalty revenues over the last decade. This represents roughly eight percent of the $24.3 billion collected nationwide. Of the $107 million in oil and gas royalties collected by the Office of Natural Resources Revenues, or ONRR, in 2018, more than 60 percent came from Uintah county.

Though sizable, the royalties collected by ONRR do not capture the "fair market value" of the taxpayer-owned oil and gas resources sold. The low royalty rate of 12.5 percent for federal leases generally does not capture as large a portion of resource proceeds as the market would bear.

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 Utah Trust Lands Administration a royalty rate of 16.67 percent. The 12.5 percent royalty rate on federal lands was first set by Congress as the legal minimum almost 100 years ago, yet 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 Utah, it's also less than the 18.75 percent producers pay for oil and gas developed from federal waters.[1]

If the prevailing federal offshore royalty rate of 18.75 percent had been imposed on the same quantity of onshore production from 2008 to 2017, ONRR would have collected an additional

[1] The effective royalty rate is often measurably less than 12.5%. After transportation and processing deductions, ONRR typically collected only 10% on sales of NGL from federal lands over the last decade, for example. ONRR issued new rules that would have decreased those deductions and increased royalty collections in 2016, but they were repealed in 2017 under the new administration before taking full effect. A federal district court judge ruled in April 2019 that ONRR's repeal violated the Administrative Procedures Act and reinstated the 2016 rules, potentially increasing future oil and gas royalty collections.

$1.4 billion in Utah alone. Which means Utah taxpayers would have received roughly **$700 million more** in disbursements from ONRR. And because the royalty rate would be comparable to those charged by the state, shifts in production from federal to state lands would be minimal.

Over the 15-year period FY 2004-2018, the state of Utah has produced oil and gas from an average of 40 percent of leases at any given time. This leaves 60 percent of lease idle and unproducing, above the national average in that time period. At the end of FY 2018, there were 1.5 million acres of nonprodcuing federal lands in the state of Utah that remained locked up. Many of these leases will sit idle througout the 10-year term of the lease, producing no federal or state revenues and preventing other activities such as hunting and recreation from occuring on the land.

Lease Sales

The BLM's federal oil and gas leasing program provides two opportunities for taxpayers to make the vast majority of the total revenue a given lease will generate. First, from royalties based on oil and gas production as discussed above; secondly, by conducting a competitive lease sale, which in some state offices take place as frequently as four times per year. BLM falls short in providing taxpayers with an adequate return from both revenue streams.

When deciding what parcels of land will be offered in a competitive lease sale, the Utah state office will take into account suggestions from private companies regarding what tracts of land (called parcels) should be offered for lease. The office will then conduct environmental assessments, and finally post the parcels it will be offering for lease sale.

During the lease sale private companies bid against one another for the right to lease each parcel. The company with the highest bid wins the lease. This is a one-time payment and provides the private company with the exclusive rights to develop oil and gas on the parcel of federal land for a period of ten years.

Oil and Gas Rig. Source: BLM

Per acre bid revenues for the 10-year period 2009-2018 were low in the state of Utah. In calendar year 2018, the BLM state office offered over 420,000 acres for lease and received bids on almost 340,000 or 80 percent. Those parcels generated $7.6 million in high bids. That equates to just over $22 an acre, a small amount of money for our limited federal lands.

Of the parcels that received bids in that 10-year period, half received bids that were $10 per acre or less. And a quarter were leased for only $2 per acre, the minimum amount allowed under current law.

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

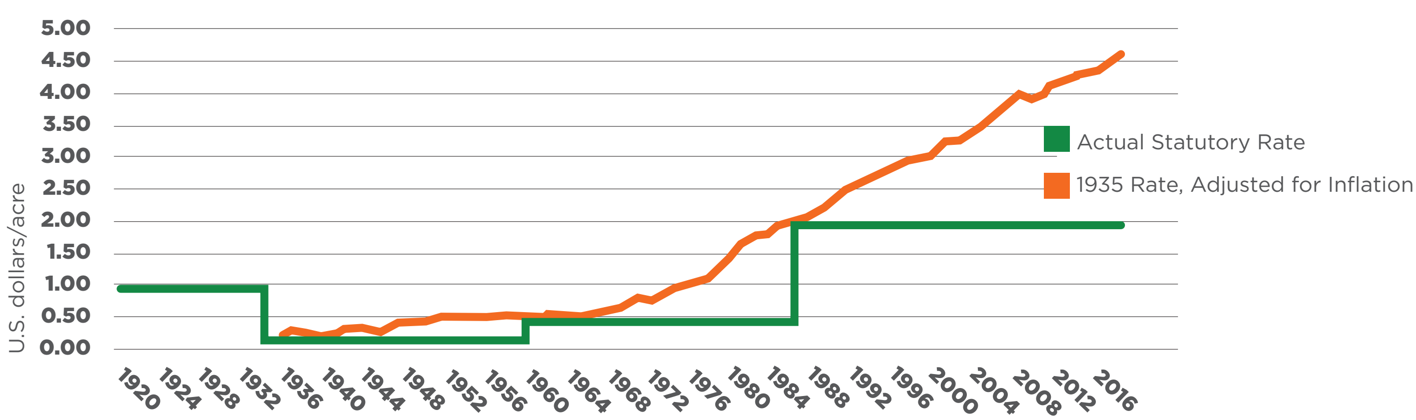
Over the last ten fiscal years, FY2009-2018, ONRR collected $31.6 million in rent for oil and gas leases in Utah. If the 1987 rental rates had been annually adjusted for inflation, as measured by the Bureau of Labor Statistics, ONRR could have collected $95 million in rental payments over the decade. That is, taxpayers have lost approximately $64 million in rental revenue from rental rates that were set more than 30 years ago.

Lost Gas

With the advent of new technologies and techniques like fracking and horizontal drilling, production of natural gas and, in particular, oil has boomed in the U.S. over the last 10-15 years. As producers raced to drill more wells on federal lands, they began burning off (flaring), or simply releasing (venting), huge volumes of natural gas, which is mostly made up of methane, into the atmosphere. Over the 10-year span from 2008-2017, oil and gas operators reported wasting 6.4 billion cubic feet (bcf) of gas in Utah, that is about 3 percent of all methane waste reported on all federal lands nationwide. BLM's rules for waste on federal leases for most of that period were written in 1979, long before fracking and horizontal drilling even existed. BLM's administration of the antiquated rules has not only failed to prevent prolific venting and flaring, it has allowed operators to largely avoid paying royalties on the wasted gas.

Oil and gas companies pay royalties on the minerals they remove from private, state, or federal lands to compensate the owner of these resources. In 2016, the BLM issued new rules to curtail gas waste during drilling on federal leases and to collect more royalties on lost gas. The Trump Administration rescinded these rules and issued a much weaker one in 2018 that removes any incentive for companies to capture valuable gas resources. As a result of the new rule, not only will fewer royalties be collected, but the increased

Figure 1. Federal Oil & Gas Lease Rental Rates, Actual v. Inflation-Adjusted




Oil and Gas Rig. Source: BLM

emissions of methane—a potent greenhouse gas—will also create additional liabilities for taxpayers.

Of the 6.4 billion cubic feet of gas lost in Utah from 2008-2017, ONRR collected royalties on just 39 million cubic feet, or 0.6 percent. If producers had been charged for all wasted gas, ONRR could have collected roughly $3.2 million, rather than the 15,000 in actual receipts.

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 on federal lands in Utah and across the country.

Current policies fail this standard and have led to large amounts of lost revenue from development in Utah and other Western states over the last decade. But 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, rental rates, and treatment of natural gas waste. By updating lease terms for federal oil and gas development now, the Bureau of Land Management can substantially increase the returns to the Treasury, and the amounts disbursed to the state of Utah, in all years to come.