

June 2019

New Mexico's Boom That Cost Billions: How Federal Oil & Gas Policies Fail Taxpayers

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

\$20 million in lost royalty revenues from gas waste, 2008-2017.

\$5.2- Billion in est. revenue loss under the federal 12.5% royalty, FY2009-2018.

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

\$19 million in lost rental revenue from outdated rental rates for federal leases, FY2009-2018.

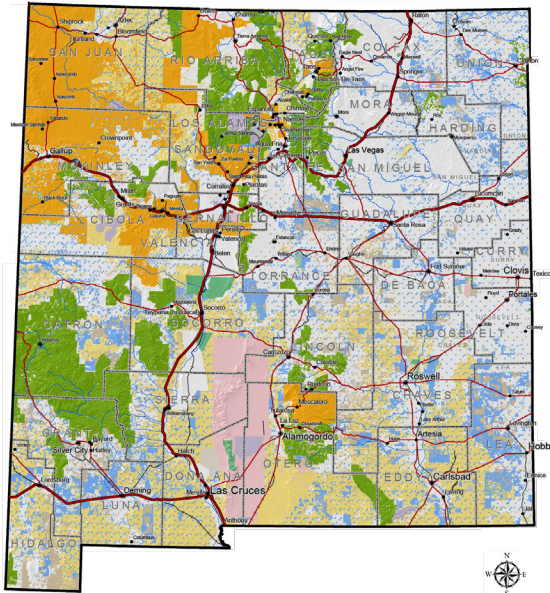
Federal taxpayers own significant oil and natural gas reserves on federal lands throughout New Mexico and other Western states. The Bureau of Land Management (BLM) within the Department of the Interior (DOI) manages these reserves and is directed by law to collect fair market value from their development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to ensure taxpayers receive a fair market value for these resources because its land management policies are weak and outdated.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

- Annual rental rates and the minimum bid price for oil and gas leases that have not changed in more than 30 years;
- Antiquated procedural carve-outs that allow companies to lease federal land without paying any bid;

- 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 many state lands; and,
- Natural gas waste that's ignored on federal lands while BLM refuses to charge producers for it.

Federal oil and gas development in New Mexico illustrates how BLM's bad policies can cost taxpayers billions of dollars in lost revenue. Production on federal lands in New Mexico generates significant receipts, and lucrative reserves within limited acreage have created a competitive market for federal oil and gas leases. Yet because of BLM's low onshore royalty rate and permissive approach to natural gas waste, taxpayers have lost more than \$5 billion over the last decade. States receive roughly half of federal receipts from resource development within their borders, so New Mexico taxpayers lost out on roughly \$2.5 billion in revenue.



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| Federal Surface Management | | State Trust Lands | |
| Bureau of Land Management | USDA Forest Service | Surface Estate | |
| Bureau of Reclamation | Fish and Wildlife Service | Subsurface Estate | |
| Department of Agriculture | Bureau of Indian Affairs/Tribes | Surface and Subsurface Estates | |
| Department of Defense | National Park Service | | |
| Department of Energy | County Boundaries | | |

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

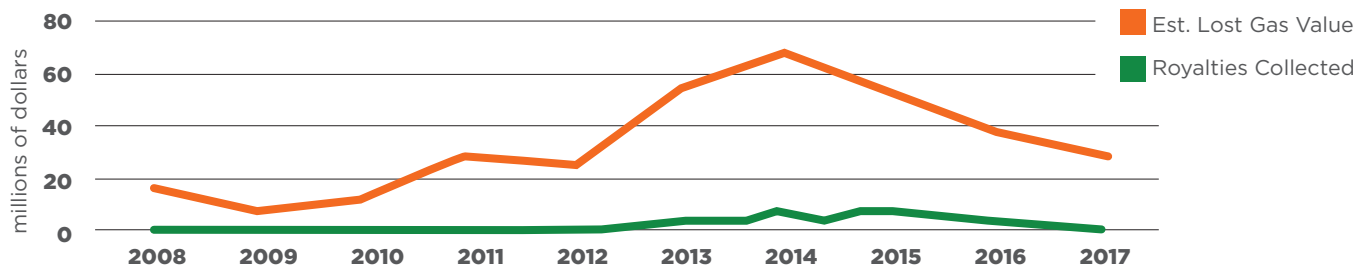
the atmosphere. While this trend is pervasive, producers have wasted natural gas nowhere as much as in New Mexico.

Over the 10-year span from 2008-2017, oil and gas operators reported wasting 86.6 billion cubic feet (bcf) of gas in New Mexico, or more than 40% 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 emissions of methane—a potent greenhouse gas—will also create additional liabilities for taxpayers.

Of the 86.6 bcf of federal gas wasted in New Mexico during the last decade, the Office of Natural Resources Revenues, or ONRR—a separate DOI sub-agency—only collected royalties on 47.5 bcf, or 55%. That is, while producers

Figure 1. Federal Gas Waste in New Mexico: Royalties v. Est. Gas Value



wasted gas worth an estimated \$320 million, ONRR collected only \$20 million in royalties on it, potentially leaving another \$20 million on the table (see Figure 1).

Methane is most commonly wasted when it comes to the surface through an oil well, and losses are therefore closely tied to the rate of oil production. In New Mexico, 93% of federal oil in the state was from Eddy and Lea counties over the last 10 years. Correspondingly, these two counties accounted for 99% of royalty-bearing methane waste on federal lands.

From 2010 to 2015, oil production and gas waste in the region trended upward together. Beginning in 2016, however, **reported gas waste dropped precipitously, while oil production plateaued and then continued to rise.** New Mexico state data document the same drop in gas waste in Eddy, Lea, and surrounding counties.¹ **Yet, while state data indicate the trend reversed and emissions jumped by 14% from FY 2017 to FY 2018,² federal royalties on lost gas continued to fall.**

Methane waste inexplicably falling in 2016 and 2017 before rebounding in 2018 suggests that producers were beginning to comply with the BLM's stricter 2016 waste rule before reversing course when it was replaced. Moreover, the continued decline of federal royalty collections on lost gas in the midst of higher statewide emissions in FY 2018 suggests the new, weaker methane rule will lead to more waste and fewer royalties from drilling on federal lands in New Mexico.

ONRR's royalty data provide some indication of just how much taxpayers could lose from BLM's replacement rule. New Mexico reported 26.4 bcf of gas lost in Eddy, Lea, and surrounding counties in FY2016, slightly less than the 28.5 bcf reported in FY 2018. But ONRR collected \$6.3

million in royalties on gas lost in those counties in FY 2016, or three times more than the \$2.2 million it collected in FY 2018. The difference of \$4 million suggests that BLM's newest methane waste could cost taxpayers far more than expected.

Production & Royalties

Over the last 10 fiscal years, FY 2009-FY 2018, oil and gas companies produced 8 trillion cubic feet of natural gas from federal lands in New Mexico, more than any other state except Wyoming. Over the same period, oil production from federal leases boomed, increasing nearly fourfold, with a cumulative total of 554 billion barrels sold, making New Mexico the largest producer of federal oil.

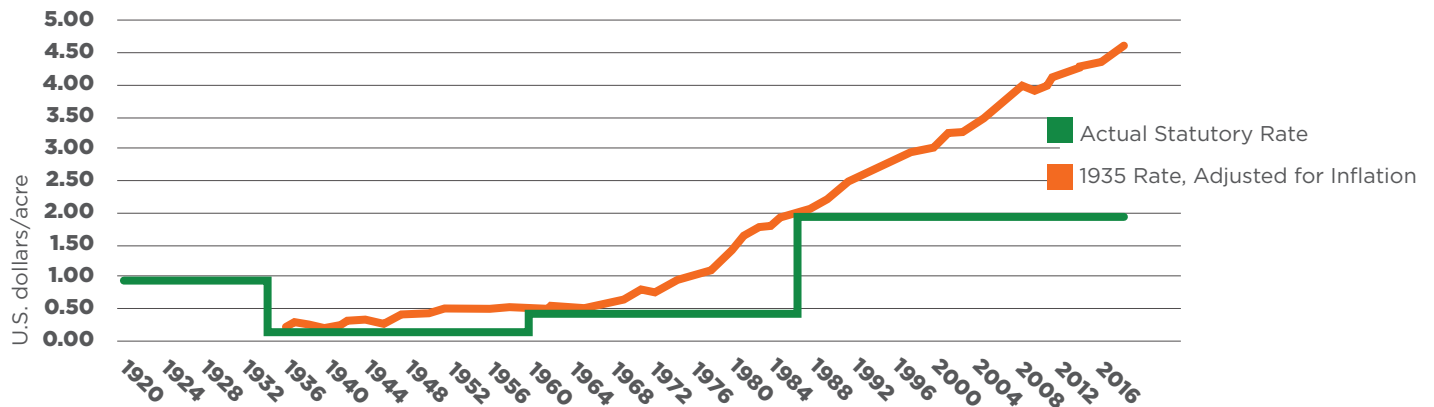


Oil and Gas Rig, © BLM New Mexico

¹ Data for New Mexico's Energy, Minerals and Natural Resources Department's (EMNRD) Districts 1 and 2

² Trends reported for EMNRD Districts 1 and 2 for the federal fiscal year, rather than the New Mexico fiscal year.

Figure 2. Federal Oil & Gas Lease Rental Rates, Actual v. Inflation-Adjusted



From the sale of oil, gas, and natural gas liquids (NGL) produced in New Mexico, ONRR collected \$8.4 billion in royalties over the last decade. Nearly half was shared with the state. 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% 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 New Mexico State Land Office 18.5% - 20% 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, 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 New Mexico, it’s also less than the 18.75% producers pay for oil and gas developed from federal waters.³

Most federal production comes from leases issued decades earlier, so 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 between \$13.7 billion and \$14 billion, or \$5.2-\$5.5 billion more in New Mexico alone. Which means New Mexico taxpayers would have received \$2.5 billion 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.⁴

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.

³ 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.

⁴ CBO. “Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands.” April 2016. Page 23

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 (see Figure 2). 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 \$19.8 million in rent for oil and gas leases in New Mexico. If the 1987 rental rates had been

annually adjusted for inflation, as measured by the Bureau of Labor Statistics, ONRR could have collected \$39 million in rental payments over the decade.⁵ That is, taxpayers have lost approximately \$19 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 on federal lands in New Mexico and across the country.

Current policies fail this standard and have led to billions of dollars in lost revenue from development in New Mexico alone 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 New Mexico, in the years to come.

⁵ In FY2008-2019, 4.8 million acres were under lease, on average. In a typical year, 79 percent of acreage was within leases that had entered production, for which rental fees are waived by the royalty payments associated with production. Of the acreage not in production, roughly 25 percent was leased within the previous five years and thereby subject to the lower statutory rental rate of \$1.50/acre. Using these acreages, TCS calculated how much rent could have been collected under inflation-adjusted rates, assuming no change in overall leasing.

