BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
COMMITTEE ON NATURAL RESOURCES
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"***Fossil Fuel Development: Protecting Taxpayers and Eliminating Industry Giveaways***"

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Chairman Lowenthal, Ranking Member Gosar, and members of the subcommittee, I am Dan Bucks, former Director of the Montana Department of Revenue. Thank you for the invitation to testify today on federal royalty administration.

By way of background, I served as Montana Revenue Director from 2005-2013. I also served as Deputy Director of the department from 1981-1988. During these periods, among other duties, I oversaw the administration of natural resource production taxes and mineral royalty auditing and provided leadership to strengthen those activities and the rules for administering them. In the early 1980s, I led the effort for Montana to become one of the first states to join the cooperative federal-state mineral royalty auditing program initiated by then Interior Secretary James Watt. Between 1988 and 2005, I served as the Executive Director of the Multistate Tax Commission where I assisted states in addressing complex issues of taxation of interstate and international commerce in the context of a variety of fiscal systems. Earlier, from 1971 to 1977, as a policy advisor to a South Dakota governor, I advised on a range of subjects, including tax, energy and environmental issues.

My testimony will focus primarily on H.R. 4364, sponsored by Rep. McAdams (D-UT-4) and Rep. Rooney (R-FL-19). In particular this testimony will comment on issues related to oil and gas development on federal lands. Additional comments will be made with regard to related legislation, H.R. 2711, H.R. 3225, and H.R. 4346 .

Achieving a Fair Return from Federal Oil and Gas for the American People

H.R. 4364 will update fiscal terms for fossil fuel development to better ensure that the American people receive a fair return on the resources they own. The key provisions of this bill regarding oil and gas royalty rates, lease bids and rental fees would not be necessary if the Department of the Interior (Interior) had done its job properly and effectively over the past century. Unfortunately, the Interior Department has failed to serve the American people by denying them a fair return on oil and gas resources developed on federal land. Despite having the authority to update royalty rates, minimum lease bids and rental rates to reflect inflation and changing market and production conditions, Interior has refused to do so. As a result, Congress must once again, as it has in past, step forward to do the work Interior should long since have accomplished.

Interior has neither updated bid rates, nor rental rates to reflect inflation, thus allowing the value returned to the American people to decline. In 1987, Congress set the minimum bid rate at $2 an acre. Today, those two 1987 dollars are worth only 87 cents. Likewise, the 1987 $1.50 per acre rental rate for the first five years of a lease is now worth only 65 cents. Interior could have preserved the value of these minimum rates by applying inflation adjustments by rule. Instead, Interior effectively allowed the value received by the citizens they are supposed to serve to deteriorate and handed that value over to oil and gas companies for no good reason whatsoever.

H.R. 4364 will quite properly reset these minimum bid and rental rates to reclaim the value that Interior allowed to slip away from the citizens who own these resources. Given that Interior cannot be trusted, when left to its own devices, to make adjustments for inflation in the future, the bill wisely mandates that such adjustments be made every four years. Consideration could be given, however, to adjusting those rates even more frequently.

Another topic related to lease bids deserves mention. Both current law and Interior's policies fail to ensure that oil and gas leases are granted on a fully competitive basis. Without true competition, leases will too often be sold at less than fair market value. There are at least three problems with the current bidding process with clear solutions that have been proposed in related legislation, H.R. 3225, sponsored by Rep. Levin (D-CA-49):

1. Current law authorizes Interior to grant leases through noncompetitive negotiations. By definition, noncompetitive leasing will not achieve fair market value, and the legal provisions allowing such leasing should be eliminated. H.R. 3225 eliminates non-competitive leasing in a reasonable way
2. Interior conducts lease sales—whether in person or over the Internet—through open auctions. As the CBO has identified, such open auctions are open to collusion that lowers bid prices below competitive levels. Thus, the CBO estimated switching to sealed bids would yield an estimate $100 million increase in revenue over 10 years by more consistently achieving fair market value results.[1]
3. Interior is mandated to accept minimum bid prices even if there is reason to believe that the price is below fair market value for a lease. Interior should be given authority to reject minimum bids below fair market value. Further Interior should be instructed to evaluate and test "inter-tract leasing procedures" that foster competition among all bidders at a lease sale. Such procedures can be used to establish a statistically valid benchmark market price for that sale which can be used to reject any lower bids.[2]

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[1] Congressional Budget Office, "Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands," April 2016. While Interior's change to internet auctions are an improvement over in-person sales, sealed bids remain superior in fostering competition among bidders.
[2] The rejection of a minimum bid that is below market value could be based on valid, appraisal analysis. However, another effective basis for rejecting below value basis could be found through an "inter-tract bidding" process assisted by statistical analysis of bid levels to ensure at least an average probability of lease development. Under inter-tract bidding, buyers, while submitting bids for specific tract, in effect compete with each other for all tracts offered at a given sale. Bids less than a certain percentage below the median bid

H.R. 3225 also proposes reducing the frequency of lease sales and capping the size of tracts offered. Interior has offered some plausible criticisms of these procedures in testimony on H.R. 3225, so those provisions may require some further analysis. However, Interior's criticisms of the other three numbered proposals above are not persuasive and include a disturbing allegiance to selling leases at bid and rental levels and royalty rates that are clearly below market value.

Interior also cites, as a basis for rejecting reforms in H.R. 3225, recent increased revenues from lease sales under current practices. However, those revenue numbers are misleading because they are distorted by the massive increase in tracts offered by the current administration for sale, with a high rate of offered sales failing to attain minimum bid levels. Many of these failed lease sales are shunted into non-competitive leases at bargain rates. More tracts sold at "fire sale," below market value prices can yield more total revenue in any given fiscal period. However, such results violate the fair market value standard required by federal law. In these circumstances, the total revenue numbers actually mask irresponsible leasing that is contrary to law and the public interest and that will produce long-term problems of non-producing leases that block other beneficial uses of the land and create potential environmental issue without generating future economic and revenue benefits.

Interior should be reminded that its job is not to maximize short-terms revenues through ill-considered mass leasing, but to ensure that each lease and each amount of oil and gas produced yields a fair market value return to the public. Further, each lease is to be established and operated in a manner that fulfills the social and environment goals embodied in the multiple use standard for federal land management required by law and that minimizes adverse harm to the public from oil and gas production. Total revenue is not an indicator that any of these legal standards are being achieved.

The committee should consider combining the three listed provisions above from H.R. 3225 with H.R. 4364 because all of these proposals work together to further the goal of attaining a fair market value return for the American people from the minerals they own. This comment should also not be considered to be a judgment regarding the non-fiscal provisions of H.R. 3225, which should be evaluated on their own merits.

Turning now to the matter of royalty rates. The current 12.5% onshore royalty rate for oil and gas produced from federal lands has remained unchanged since 1920—a century ago. Interior has not established a regular process of evaluating this royalty rate despite being asked to do so by the Government Accountability Office (GAO). These facts alone make the

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in a sale would be rejected. That "certain percentage" would be established on either a national or regional basis through statistical analysis of past sales to determine the "percentage below the median" bid level where the probability of actual development of the resource is less than the national or regional rate of development. Thus, authority proposed in H.R. 3225 for Interior to reject bids below fair market value could be exercised through use of appraisals, inter-tract bidding, or some other objective, professional process.

12.5% suspect as being out-of-date and set at a below market level that shortchanges the American people. Indeed, further analysis proves that is exactly the case.

The proposed 18.75% royalty rate in H.R. 4364 for federal onshore oil and gas is conservative, first step to remedy Interior's century long failure to adjust royalty rates upwards. By leaving the rate at 12.5% instead raising it to the well-justified 18.75% level, Interior is giving away every third barrel of crude oil and cubic foot of natural gas to fossil fuel corporations –free of charge and at the expense of the American people.

As the technology of oil and gas extraction improves, the cost of production per the amount of oil or gas produced decreases. As these extraction costs decline, royalty rates need to be steadily adjusted upward. That is because the share of value of the crude oil and natural gas marketed from leases that is owed to the oil and gas producer is only the amount necessary to cover the costs of production plus a normal profit. The remaining share of the value of the marketed crude oil and gas is to be paid to the owners, in this case the American people. So, as production costs fall, the percentage royalty rate needs to increase to ensure a fair return to the public.

If the rates are not increased as production costs per unit of oil and gas decline, extraction companies receive an unjustified windfall that is not needed for production purposes and therefore typically goes in large part to their wealthiest shareholders and top executives. This windfall does not increase jobs or production because it is not needed to cover the costs of extraction plus a normal profit, which is the actual determinant of what will be produced. Instead, the windfall is an improper transfer of revenue from the American people to the owners and executives of oil and gas companies.

So, the failure of Interior to evaluate and increase the onshore royalty rate over the past century is a serious breach of the public trust. State governments, in contrast, have done a far better job of serving their citizens by periodically testing the market and increasing royalty rates for oil and gas produced on state-owned lands. The attached report details the contrast between the diligence of the states and the negligence of the Interior regarding oil and gas royalty rates.[3]

The median level of state oil and gas royalty rates among major producing states in the West and South is currently 19.375%, with rates varying between 16.67% and 25%. Texas, the largest producing state, has charged a top rate of 25% for over thirty years. Louisiana, a leading natural gas state, has for over 40 years attained an average lease rate exceeding 23%. Colorado and New Mexico have recently increased their top rates to 20%. Leasing and production continue to boom in these states with the highest rates. Instead of higher royalty rates discouraging production, the pattern is for higher state royalty rates to accompany higher production.

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[3] Bucks, Dan, "A Fair Return for the American People: Increasing Oil and Gas Royalties from Federal Lands," March 2019.

The GAO examined economic studies of the potential impact of increasing the federal onshore royalty rate and determined that federal oil and gas revenues would increase because the positive impact of a higher rate increase would easily counter any negligible production decreases.[4] Indeed, the pattern of state experiences suggests it is likely there would be no decreases in production at all from increasing the federal royalty rate to 18.75%. That rate would match the federal offshore rate and would be below the median of current state rates. Thus, the provision in H.R. 4364 to increase the minimum federal royalty rate to 18.75% is prudent and well-justified.

Even more important are the provisions requiring Interior, on a regular basis, to publish and evaluate federal royalty rates in relation to the weighted average level of state royalty rates and to report to Congress on the results of that comparison. Those provisions would ensure accountability to Congress by Interior to diligently review and consider additional increases in royalty rates. Further, these provisions would implement the 2018 GAO recommendations to Interior to establish a regular and effective royalty review process.[5] This process would end Interior's century-long failure to consider increasing royalty rates increases as relative production costs decline

Reducing Methane Waste Makes Fiscal and Environmental Sense

The issue of methane waste is significant from both a fiscal and environmental perspective. H.R. 2711 is a critical proposal that provides multiple benefits to taxpayers and the environment. It ensures that all methane produced from federal lands is measured, which in turn enables that gas to be subject to royalty payments. In turn, the final section of H.R. 4364 directs that all produced methane on federal lands will bear a royalty obligation. Together, these two bills ensure that the American people will be properly paid for the value of all methane produced. H.R. 2711 also requires that methane emissions from all U.S. production be controlled and reduced, a vital step in combatting global warming given that methane is a greenhouse gas 84 times as potent as carbon dioxide.

Ensuring Reclamation of Lands Disturbed by Oil and Gas Production

It is irresponsible in fiscal, economic, social and environmental terms to allow oil and gas producers to disturb federal lands without reclaiming them. The costs of damages to these lands should not be transferred to the federal government or to the public in terms of the loss of use of the lands or pollution or hazards that may flow from them. H.R. 4346 makes reasonable reforms to ensure that sufficient reclamation occurs. As provided in the bill, drilling should not commence before reclamation plans are in place. Bonding requirements are strengthened. Those producers that have failed to clean up their prior leases are prohibited from acquiring new leases. That is a strong, but common-sense measure to ensure compliance with reclamation standards. The only recommendation for the bill

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[4] U.S. Government Accountability Office, "Oil, Gas, and Coal Royalties: Raising Federal Rates Could Decrease Production on Federal Lands but Increase Federal Revenue," GAO-17-540, June 2017.
[5] U.S. Government Accountability Office, "Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment," GAO-08-691, September 2008.

would be to require periodic reports to Congress on the status and effectiveness of reclamation activities to provide the basis for enhanced congressional oversight of these activities.

Thank you for this opportunity to comment on legislation of great significance to the American people and the lands and resources they own.

Attachment: Report by Dan Bucks, “A Fair Return for the American People: Increasing Oil and Gas Royalties from Federal Lands,” March 2019.