



**Testimony of Tim Stretton, Policy Analyst  
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before the House Appropriations Subcommittee on Interior, Environment, and Related  
Agencies  
on “Increasing Accountability and Transparency for Oil and Gas Royalty Policy”  
February 6, 2020**

Chairwoman McCollum, Ranking Member Joyce, and Members of the Subcommittee, thank you for the opportunity to testify on the need to increase accountability and transparency for oil and gas royalty policy at the Department of the Interior’s Bureau of Ocean Energy Management. I am Tim Stretton, policy analyst at the Project On Government Oversight (POGO). POGO is a nonpartisan independent watchdog that investigates and exposes waste, corruption, abuse of power, and when the government fails to serve the public or silences those who report wrongdoing. We champion reforms to achieve a more effective, ethical, and accountable federal government that safeguards constitutional principles. For decades, POGO has shed the light on the need for the federal government to ensure the oil and natural gas industries are paying their fair share for the publicly owned resources they extract and profit from.<sup>1</sup>

Offshore drilling and the lease of publicly owned tracts of seafloor together constitute a significant revenue stream for the federal government, bringing in nearly \$90 billion between 2006 and 2018.<sup>2</sup> The Bureau of Ocean Energy Management administers offshore drilling rights and periodically holds auctions in which successful bidders obtain leases for tracts of the seafloor and rights to explore and drill for the underlying oil or gas deposits. These resources are owned by the taxpayer, so the bureau is legally required to ensure that taxpayers receive “fair market value” for the resources extracted by private industry, in part by collecting royalties on the sale of oil and gas produced from leases.<sup>3</sup>

But the bureau’s so-called “royalty relief” procedures often result in forgone royalty payments worth tens of billions of dollars. In a September 2019 report, the Government Accountability Office (GAO) also identified two additional procedures the Interior Department has engaged in for decades that may not have resulted in a full fair market value return for oil and gas leases: retroactively lowering its valuations of tracts of seafloor in order to accept bids that would be

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<sup>1</sup> See, for example: “Investigative Series: Drilling Down,” Project On Government Oversight, 2018-2019. <https://www.pogo.org/series-collections/drilling-down/>; *Getting Royalties Right: Recent Recommendations for Improving the Federal Oil & Gas Royalty System*, 110<sup>th</sup> Cong. 95 (March 11, 2008) (testimony of Danielle Brian, Executive Director, Project On Government Oversight). <https://www.govinfo.gov/content/pkg/CHRG-110hrg41378/html/CHRG-110hrg41378.htm>; POGO Staff, “Taxpayers Could Lose \$53 Billion From Oil Leases,” Project On Government Oversight, May 28, 2008. <https://www.pogo.org/analysis/2008/05/taxpayers-could-lose-53-billion-from-oil-leases/>

<sup>2</sup> Government Accountability Office, *Offshore Oil and Gas: Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, GAO-19-531 (September 2019), 1. <https://www.gao.gov/assets/710/702062.pdf>

<sup>3</sup> 43 U.S.C. § 1344 (2019). <https://www.law.cornell.edu/uscode/text/43/1344>

unacceptable under the bureau's stated procedures; and accepting lower bids because it unreasonably determined the tracts might be worth less in the future.<sup>4</sup>

### **Royalty Relief and Billions in Foregone Royalties**

The Bureau of Ocean Energy Management sets royalty rates for offshore oil and gas based on market conditions. The bureau also has several options to reduce or waive royalty payments in an attempt to increase production. But, as the bureau itself has found, its practices often mean taxpayers lose out on the fair return they're owed.<sup>5</sup> For example, from 1996 to 2000, the Interior Department leased tracts on which it did not collect royalties on the initial volume of oil or gas produced. As a result, the GAO found that companies tended to submit higher bids for those tracts, amounting to an estimated \$2 billion in public revenue the department would not have collected based on the pre-1996 royalty rate. But \$2 billion pales in comparison to what the government could have taken in through royalties. The GAO found that the leases that had been awarded between 1996 and 2000 with a guarantee of no royalties on initial volumes of production resulted in about \$18 billion in foregone royalties through 2018.<sup>6</sup>

### **Lowered Tract Valuations Behind Closed Doors**

When it auctions off tracts of seafloor, the bureau is supposed to reject bids that are lower than its own estimated value of the tracts' worth. Instead, the GAO found, when a bid comes in lower than the bureau's own valuation, rather than rejecting the bid, the bureau often lowers its initial valuation "to justify accepting bids it otherwise would reject," and then accepts the bid on the basis of the altered valuation.<sup>7</sup>

This would be rational if the government thought that rejecting bids would result in tracts not being sold, leading to forgone revenue, similar to a landlord not collecting rent on a vacant apartment building, but that's not the case. Rather, when the bureau rejected bids that were too low, industry would often submit higher bids for the same tracts in subsequent auctions, resulting in higher bid revenue for the government.<sup>8</sup> As the GAO noted, by resubmitting bids at higher amounts, companies signaled that they viewed certain tracts as more valuable than their initial bids had indicated. In other words, industry often purposely submits lowball bids, and the majority of the time, the government accepts them. But that doesn't give the taxpayer a fair return as the law requires.

The GAO found the bureau's practice of lowering its valuations "is nearly systematic" in cases where it had originally estimated that tracts were worth up to twice as much as the amount bid.<sup>9</sup> The GAO estimated that from March 2000 to June 2018, the bureau could have collected \$567

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<sup>4</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 42 [see note 2].

<sup>5</sup> Bureau of Ocean Energy Management, *Recommended Discount Rates and Policies Regarding Special Case Royalty Relief for Oil and Gas Projects in Shallow Water* (November 2019), 14.  
[https://www.boem.gov/sites/default/files/documents/oil-gas-energy/energy-economics/SW\\_SCRR\\_Discount\\_Rate\\_Paper.pdf](https://www.boem.gov/sites/default/files/documents/oil-gas-energy/energy-economics/SW_SCRR_Discount_Rate_Paper.pdf)

<sup>6</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 18 [see note 2].

<sup>7</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 27 [see note 2].

<sup>8</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 28 [see note 2].

<sup>9</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 34 [see note 2].

million in additional auction revenue if it had not lowered its valuations.<sup>10</sup> That’s \$567 million the government could have collected on land owned by the American people. In short, the extractive industry made the profit instead of taxpayers, with the government’s permission.

As POGO has previously noted, the bureau does not disclose when it awards drilling rights based on reduced valuations, and revising valuations is not part of the bureau’s published procedures.<sup>11</sup>

Because the practice of lowering valuations has resulted in the loss of hundreds of millions of dollars in public revenue—which will likely continue—this subcommittee has a vested interest in ensuring that the bureau makes public its revised valuations. Congress and taxpayers should know when and why the government adjusts its valuations to match industry’s before accepting a lower bid on a tract that it previously stated was worth more. In order to provide more accountability and transparency, this subcommittee should prohibit the use of funds to approve leases where the bureau retroactively lowered its valuations without public notice.<sup>12</sup>

### **Forecasts of “Unreasonably” High Depreciation**

The GAO’s report also highlighted problems with how the bureau considers two key measures of the worth of a tract of seafloor: the present value and the delayed value. The GAO found the bureau’s broad calculations and use of delayed valuation may have resulted in more than \$873 million in forgone additional bid revenue from March 2000 to June 2018.<sup>13</sup>

The present value is supposed to reflect the tract’s value at the time of the auction, and the delayed value should show what it would be worth if it were offered at the next auction. Calculating the delayed value is meant to help the bureau determine the cost of delaying the auction of a lease. If a bid is lower than the present value but higher than the delayed value, the bureau can accept it. But, the GAO found, the bureau has been projecting delayed values to be lower than they should be, leading the bureau to accept lower bids.

Until August 2017, the bureau held auctions once a year and typically forecasted a median loss of 23% of value by the next auction. Although the bureau has since held auctions about every six months, its predicted decline in value has grown to a median of about 27%.<sup>14</sup> Because the frequency of auctions has doubled, it’s surprising that the bureau’s predicated cost of delay has increased and not decreased. As the GAO noted, with oil prices generally forecasted to rise, the value of oil and gas resources would be expected to increase over time, not decrease.

The GAO found that the bureau’s “unreasonably large forecasts of depreciation have increasingly been the deciding factor in decisions to accept bids.” By lowering a tract’s predicted

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<sup>10</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 39 [see note 2].

<sup>11</sup> David S. Hilzenrath, “Report: Interior Gives Oil Companies Discounts on Drilling Rights,” Project On Government Oversight, November 4, 2019. <https://www.pogo.org/analysis/2019/11/report-interior-gives-oil-companies-discounts-on-drilling-rights/>

<sup>12</sup> Note: For fiscal year 2020, the Trump administration requested \$193.4 million for BOEM, an increase of 8% from fiscal year 2019. Laura B. Comay, Congressional Research Service, *Offshore Energy Agency Appropriations, FY2020*, IF11405 (January 10, 2020), 1. <https://crsreports.congress.gov/product/pdf/IF/IF11405>

<sup>13</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 32 [see note 2].

<sup>14</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 31 [see note 2].

future value, the government is unnecessarily passing up hundreds of millions of dollars in potential revenue. According to the GAO, had the bureau rejected 205 bids that it accepted on the basis of delayed values, “it might have subsequently collected more than \$873 million in additional bid revenue for these tracts.”<sup>15</sup>

The GAO’s analysis tracks with the findings of POGO’s 2018 report *Drilling Down: Big Oil’s Bidding*. POGO reported:

When the Bureau considered bids placed in the August 2017 auction, it determined that the [present value] for one tract was \$17 million and that the delayed value of the tract was \$6.9 million. In other words, BOEM estimated that, over several months, an unusually valuable tract would lose more than half its value. On that basis, the BOEM accepted a bid of \$12.1 million, much less than it said the drilling rights were worth at that time.

... In fact, by the government’s own account, rejecting bids and offering the tracts again later “has consistently resulted in higher average returns in subsequent lease sales for the same tracts, even when those tracts not receiving subsequent bids were included in the calculation of the average returns.”

In the Gulf of Mexico from 1984 through 2017, BOEM has stated, the Bureau “rejected total high bids of \$638 million, but when the blocks were reoffered, they drew subsequent high bids of \$1.8 billion, for a total net gain of \$1.2 billion, or an increase of 187 percent.”<sup>16</sup>

### **Conclusion and Recommendations**

In its response to the GAO’s report, the Interior Department stated that it did “not concur with how its bid valuation process is characterized.” Nor did it agree with the recommendation of having “an independent third party” examine whether its use of delayed valuations delivers fair market value and whether it should stop using those lower valuations.<sup>17</sup> POGO believes such an independent examination would bring greater accountability to the bid valuation process. We recommend that this subcommittee require that no funds be spent on approving a delayed-value lease that was not evaluated by a third party.

POGO has prepared report language to provide more accountability and transparency for oil and gas royalty policy at the bureau, which we are happy to provide to the subcommittee. As mentioned above, the language would require the bureau to disclose accepted bids when it retroactively lowers the initial valuation, and would require that a third party examine the bureau’s delayed valuation system.

Thank you for the opportunity to submit testimony. I am happy to answer any questions.

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<sup>15</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 32 [see note 2].

<sup>16</sup> David S. Hilzenrath, “Drilling Down: Big Oil’s Bidding,” Project On Government Oversight, February 22, 2018. <https://www.pogo.org/investigation/2018/02/drilling-down-big-oils-bidding/>

<sup>17</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 66 [see note 2].