Position Paper
Consolidated Land, Energy, and Aquatic Resources Act

Legislation to reorganize and reform federal mineral leasing and energy resource management before the House Natural Resources Committee is based on the criticism that the natural gas and oil industry is not diligently developing the 60 million acres currently leased.

- When Congress and environmental organizations talk about leased acres supposedly sitting idle, they show no understanding of the business risk associated with oil and gas exploration and the fact that the process to approve and permit oil and natural gas projects is cumbersome and extremely time consuming. Much of the leased acreage is not producing currently because operators are engaged at some stage of the process and cannot start producing until jumping through all the required legal and regulatory hoops.

- This is a classic Catch-22 situation…
  - Whereby the government has created a cumbersome permitting and environmental review process that takes years to complete
  - Environmental organizations exploit the process to throw up legal roadblocks
  - And both turn around and blame the industry for not diligently developing energy.

- A natural gas and oil lease is a ***definite maybe*** ….
  - *Maybe* you'll get through all the environmental analyses and regulatory hurdles
  - *Maybe* you'll get permission to drill
  - *Maybe* your project won't be held up by legal challenges from obstructionist groups
  - *Maybe* you'll find oil or natural gas.

But you'll ***definitely*** have to pay, potentially millions of dollars.

- The natural gas and oil industry pays billions of dollars into the U.S. Treasury to obtain leases, $10 billion in 2008. Each lease is an at-risk investment, with no guarantee that energy resources will be found or that it will return any revenue to the leaseholder.

- Companies pay a per-acre rental fee and bonus, and annual rental. No matter how long it takes to get through the permitting process, companies must pay annual rental fees.

- BLM is holding $40.7 million worth of unissued or suspended leases in Utah, $50 million in Wyoming, and about $9 million in Colorado. That's about $100 million of companies' capital being held by the federal government in a non-productive capacity.

- Almost every parcel offered for lease by BLM is protested by environmental groups.

- Now the House Natural Resources Committee is proposing punitive legislation that would make leasing more expensive, increase uncertainty, increase centralized Government control over market mechanisms, and create a new, redundant layer of bureaucracy.

- Taken together these provisions could render leasing on public lands nonviable, thereby putting at risk more than 15% of the nation's natural gas supply. Since the expanded use of natural gas is the most obvious and cost-effective way, immediately and over the long term, to reduce greenhouse gas emissions and increase energy security, this bill has serious implications for America's ability to address climate change.

House Natural Resource Committee provisions affecting natural gas and oil producers in the Consolidated Land, Energy, and Aquatic Resources Act of 2009

Section 2. Definitions: Defines non-renewables as oil and natural gas.

- It's hard to argue that this is a comprehensive energy bill when it leaves out coal, which has the largest potential reserves of any conventional energy source in America.
- The bill also shows no acknowledgement that natural gas is necessary to backup intermittent renewables like wind and solar, and that with its low carbon emissions, more natural gas will be necessary to address climate change.
- The definition of 'ecosystem-based management' implies a shift away from multiple use and sustained yield of natural resources. This is a move away from the productive use of public lands in an environmentally responsible manner, to conservation that trumps the need for energy and other economic uses of pubic lands, which is in opposition to the BLM's multiple-use mandate in the Federal Land Policy and Management Act (FLPMA).

Title 1 Consolidation of Department of Interior (DOI) Energy and Minerals Leasing Programs: Establishes an Office of Federal Energy and Minerals Leasing and shifts BLM's oil and gas program to the new office.

- It's not clear that creating a new bureaucracy will do anything to increase American energy supplies, but would certainly create confusion for a significant time period while reorganizing agencies that have been in place for over half a century.
- A mere bureaucratic reorganization will be ineffective and a waste of taxpayer money in the absence of measures to improve the DOI information systems and data necessary to track leasing and ensure diligent development of energy resources.
- Separating the leasing from the overall land stewardship of BLM will result in severed functionality and lack of a holistic approach to land management.
- Charges the new Office of Federal Energy and Minerals Leasing with establishing the fair market value for onshore leases (page 11), but gives no indication of the methodology the government will use to determine the market value.
    - IPAMS believes the free enterprise system should decide the fair market value, rather than government bureaucrats.
    - The bill is silent on how the government would determine fair market value. IPAMS is concerned that this reflects a command and control approach to setting lease prices. Government setting a 'market value' is inherently contradictory.
    - The changes to the leasing system proposed in Title III further erode the ability of the government to maximize revenue from lease sales by letting the free market system set the market value.
- The draft bill states that nothing in this title shall apply with respect to Indian lands. However, since BLM issues permits for oil and gas development on Indian lands, removing that function and putting it in the new Office of Federal Energy and Minerals Leasing will certainly affect permitting on Indian lands. This is another indication that this whole reorganization is not well thought out and will have many unintended consequences.
- The draft bill claims that nothing in this title affects land use planning authorities of BLM under FLPMA (p. 13), yet removing the oil and gas program from BLM would

completely take away one of the main functions BLM analyzes in resource management plans (RMP).
  - Title I starts out saying that BLM's oil and gas program is transferred to the new office, which conflicts with the statement in part (f) that all responsibilities under FLPMA are retained.
  - How would BLM establish and enforce lease stipulations, conditions for surface occupancy and reclamation requirements if it is not responsible for issuing permits?
  - Rather than retaining its authority under FLPMA, Title 1 appears to relegate BLM to a consulting role, which it will be unable to effectively perform if not retaining leasing and permitting authority.
- Requires BLM and the Forest Service to approve land use plans 'in which energy development would not conflict with other land uses.' The management of public lands is inherently a matter of balancing often competing land uses. If energy can proceed only were there are not 'conflicts' with other land uses, it would likely never occur on public lands.

Title II Oil and Gas Royalty Reform:

Section 205 Fines and Penalties: Significantly increases penalties for underpayment or missed royalty payments.
- Since the DOI Inspector General found that DOI suffers from incompatible systems and inaccurate data,[1] IPAMS believes that DOI should fix its systems first before increasing penalties on industry that could be based on faulty data.
- This section does not make adequate provisions for honest mistakes in royalty payments. The fines for underpayments, which usually result from accounting errors not malfeasance, are excessively punitive. There is no justification for changing the current system, which already provides significant deterrent and punishment for violations.
- IPAMS believes there must be accountability on the part of the government too, and that a payer of royalties must have some form of recourse when the government is late, inaccurate, or negligent in its responsibilities and facts.
- Complying with existing law is already extremely complex, as the strict timelines for making payments require companies to make estimations.
- There are significant opportunities for honest mistakes because of the complexities of the law and the rigorous deadlines for making payments.
- Penalties are already enough of a deterrent without doubling them in every case.

Section 206 Interest on Underpayments: Eliminates interest on overpayments of royalties.
- The rigorous deadlines for royalty payments require companies to estimate payments before all information is available on production. Companies make every effort to ensure that they pay their fair royalties, and overpayments reflect an earnest effort to make sure the full royalty payment is made.

[1] *Oil and Gas Production on Federal Leases: No Simple Answer*, U.S. Department of the Interior, Office of Inspector General, Royalty Initiatives Group, February 27, 2009.

- Requiring interest paid for underpayment, but not similar interest on overpayments is inequitable. Companies are not 'gaming' the system by knowingly making overpayments. They currently receive a lower interest rate for overpayments than they pay for underpayments, and as such overpayment interest is not a favorable financial instrument exploited by industry at the expense of the government.

Section 214 Natural Gas Reporting: Mandates guidelines, policies and procedures related to BTU sampling and measurement from production on Federal leases.

- A mandate is unnecessary. Industry and the MMS and BLM continue to have discussions on BTU sampling and measurement issues. There is no need to mandate establishment of guidelines or procedures or impose a timeline on the resolution of those issues.
- It is unclear whether this provision is mandating a rulemaking or an internal agency process which will not include industry participation. BLM and MMS plan to have rules addressing BTU sampling and measurement issues developed for industry comment within the next year and half.
- BLM and MMS are working with industry to use existing American Petroleum Institute (API) industry standards as a basis for any new regulatory requirements. The Gas Processors Association (GPA) also publishes industry standards. It is appropriate that industry have a voice in the development of any standards in this complex field.
- The timeline proposed by the bill is extremely short and will not provide an adequate opportunity to assess the costs and benefits of proposed guidelines and procedures or whether they will truly increase accuracy of royalty calculation and payment.

Section 215 Incorrect Reporting of Data: Establishes civil penalties for late or incorrect reporting of data.

- These penalties should only apply to intentional incorrect reporting.
- The reporting requirements already are very complex and subject to interpretation. Punitive measures for clerical errors are burdensome to companies who are honestly trying to comply with the law and fairly pay royalties.
- Further penalizing minor mistakes opens the door for frivolous legal challenges.
- IPAMS believes there must be accountability on the part of the government too, and that a payer of royalties must have some form of recourse when the government is late, inaccurate, or negligent in its responsibilities and facts.

Section 216 Required Recordkeeping: Mandates rulemaking to set a records retention requirement for natural gas measurement data, which is also applicable to persons other than the lessee.

- To the extent MMS and BLM have jurisdiction beyond the actions of the lessee, there are existing rules which require record retention. To the extent these provisions seek to expand that jurisdiction, it should be narrowly tailored to include only those documents which are necessary and should not extend beyond the period in which adjustments can be made.
- The bill includes a definition of marketing affiliate. (Title II, Sec. 201)
- The term 'marketing affiliate' is not used in the bill's provisions nor is it used in the Federal Oil and Gas Royalty Management Act, the law to which the proposed amendment is addressed. The definition should be struck.

Section 217 Limitation on Royalty In-Kind Program: Eliminates the Royalty-In-Kind (RIK) program

- In the summary of the bill, the Majority Staff justify the elimination on the grounds of ethical improprieties, rather than simply reforming the ethical problems.
- RIK allows companies to pay royalties directly with quantities of natural gas or oil, providing a straightforward method for handling royalty payments. Prices of natural gas and oil vary by date, by marketer, by grade of product sold (gravity of oil, BTU content of gas, quality of natural gas liquids, etc.) and other factors. The payment of royalties through the RIK program simplifies this complexity, and eliminates the need for hundreds of auditors. Under the RIK program, the only determination is the quantity of natural gas or oil delivered to the government.
- According to government reports, the RIK program raises millions of dollars in additional revenues to the government than would normally be received if the royalty were taken in cash value.

Title III – Oil and Gas Leasing Reforms

Section 301 Diligent Development: Requires DOI to define due diligence and benchmarks that companies must meet.

- This section displays a lack of understanding of the business of exploration and production of natural gas and oil. Finding and developing energy is not a simple process that one-size-fits-all benchmarks can be applied to. Differences in geology, topography, reservoir characteristics, composition of the resource, environmental considerations, market conditions and economics, and many other factors make each play unique.
- Provides DOI with one year to define diligent development. IPAMS believes that producers are already trying to diligently develop leases where it makes economic sense to do so, but the government and environmental groups throw up roadblocks at every stage of the process. Any definition of diligent development must include recognition of all the activities companies are performing and the impediments to development beyond the operator's control.
- Requires a diligent development plan showing how the lessee will meet the benchmarks. Such a report would add more bureaucratic overhead that will not contribute to development of vital energy resources on public lands. Leaseholders already submit a plan when they initiate project-level analysis under the National Environmental Policy Act (NEPA). It's not clear how these plans interact with NEPA.
- Enables the Interior Secretary to terminate a lease for failure to comply with any requirements of this section. Compliance becomes a subjective determination without clear definition of 'diligent development.' This would seriously call into question the good faith of the government in establishing contracts, and would invalidate property rights at the discretion of the Secretary.
- After obtaining a lease, companies may have to spend several years acquiring other surrounding leases to accrete a sufficiently large acreage block to justify the cost of an exploration well.
- At every step of the process, environmental groups and the government throw up road blocks. Protests of leases in the Rockies have risen from 27% of all leases in 2001 to

100% of all lease sales in 2008. This means that many acres may sit idle while a company works to overcome these lease protests and acquire sufficient acreage in a particular area to commence development.
- Rather than institute government-mandated benchmarks, DOI should improve its data systems to track all the activities that are already occurring on leases. Doing so would show the myriad activities companies are conducting to diligently develop leases.
- The DOI IG found that because of severe data integrity and information systems problems, they cannot say with any certainty how many leases are producing. The oft-repeated statistic that 60% of leases are not producing is not backed by credible data.

Section 302 Reporting Requirements
- Requires biannual* reports from each non-producing lease to show the actions the lessee is taking to diligently develop the lease.
- Although reporting would give visibility to all the actions that companies are taking to diligently develop their leases and would highlight the obstacles created by the government and environmental groups that are preventing timely development of America's energy supplies, it could add considerable overhead to developing on public lands.
- This section gives no indication of how complex these reports would be.

Section 303 Notice Requirements
- Requires DOI to notify all surface land owners 'in the area of the lands are being offered' 45 days prior to a lease sale.
- Legally determining who the rightful surface land owner of title can be a difficult task. This will require a significant increase in federal resources to comply.
- The definition of 'area of the lands are being offered' needs to be established.
- Since it is often difficult to determine contact information for all landowners in a vaguely defined area, and some may inadvertently be left off the notification list, this creates grounds for additional legal challenges to lease sales, 100% of which are already protested.
- The existing Mineral Leasing Act language requires DOI to post the notices publicly, which is more reasonable, rather than to particular landowners.
- Requires 30 day notice before APD approval to all surface land owners 'in the area of lands being offered for lease.' Again posting the APD notices to specific landowners rather than generally posting a notice would add additional delays. Currently the processing time for APDs is often much longer than the 30 day approval time period required by the Energy Policy Act of 2005.

Section 304 Natural Gas and Oil Leasing System
- Adds language to the Mineral Leasing Act 'to assure receipt of fair market value for the lands and resources leased and the rights conveyed…' However, the proposed changes in this section would have the effect of instituting a command and control approach to leasing that does not enable the market to determine a fair market price.

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* 'Biannual' is synonymous with both 'semiannual' which is twice a year, and 'biennial' which is every two years. This section should include a less ambiguous word.

- Changes lease sales to sealed bid only.
  - The current live-auction system was developed under the Federal Onshore Oil and Gas Leasing Reform Act of 1987 that was sponsored by Senator Dale Bumpers (D-AR) to specifically make federal onshore leasing more competitive and transparent.
  - Under the current live auction system, the market sets the price of a lease. Under the previous Known Geologic Structure (KGS) sealed-bid leasing system, government bureaucrats made the determination of where the resource was and what the fair market value should be.
  - A sealed bid system does exist for off-shore leasing, but there are many differences in the types and size of reserves, and the amount of seismic surveying available offshore compared to onshore. Onshore leases carry a much higher risk than offshore leases.
  - In order to assess the value of leases by government mandate rather than the market, the Government would have to hire many geologists and auditors to assess the resource and arrive at a value. IPAMS believes that's a job more efficiently and effectively done by private industry working through the market.
  - With today's unconventional resources and industry's ability to apply new technology and develop reserves that even five years ago were not possible, a government bureaucracy mandating where to develop and at what price is especially out-dated and command driven.
  - A sealed bid system, along with other aspects of the bill, indicate that DOI would take a greater role in trying to determine the value of leases, rather than letting the market decide the price.
- Completely destroys the integrity of the bidding system.
  - Rather than a winning bid fairly translating into an issued lease, the bill leaves it to the discretion of the Secretary whether to accept a bid within 90 days after the auction.
  - This would codify the arbitrary decision making displayed by Interior Secretary Ken Salazar regarding the Utah December 2008 lease sale, when he rejected 77 legitimate bids made at auction.
  - Currently the Mineral Leasing Act requires DOI to issue leases within 60 days so that a fair market system is followed. Current law provides certainty that if a company spends time and money pursuing leases, they will receive the leases that they have legitimately won and paid for.
  - No other bidding system, from eBay to a livestock or art auction, allows a seller to withdraw goods from a sale after someone has fairly won the bidding process.
  - This provision would introduce subjectivity into the lease issuance process, and open the door for cronyism, as the Secretary would have the discretion on whose leases would be issued.
- Reduces the number of lease sales from at least four to not more than three. This would further constrain natural gas and oil leasing.
- Increases the cost to explore for and develop natural gas and oil, thereby resulting in less capital available to find and produce American energy.
  - Increases the minimum bonus bid to $2.50.
  - Increases rental fees from $1.50 to $2.50 per acre for the first five years and not less than $3 per acre for each year thereafter.

    - The DOI IG has cautioned that mandating production on federal leases or increasing lease fees would not enhance production, but could de-incentivize industry.
    - BLM spent about $90 million in FY2008 to administer the onshore natural gas and oil program in 2008. From that small investment, the federal government gained $4.2 billion in royalties, rents, and bonuses. For every dollar invested, the oil and gas program returned $46.
    - Despite paying for the program, companies must pay a $4,000 fee per Application for Permit to Drill, whether or not the permit is granted. That fee is proposed to increase to $6,500 for Fiscal Year 2010 without any justification for the increase.
    - Overall, the natural gas and oil industry pays about $28 billion annually in local, state, and federal taxes.
    - Industry pays its fair share – increased fees are not warranted, especially at the same time the Administration is pursuing an ill-advised strategy to raise another $36 billion of taxes on industry.
    - Industry assumes all the cost and risk of exploring for and producing natural gas and oil, and pays a fair return to the American taxpayer.
- Eliminates non-competitive leasing.
    - Non-competitive leases are only issued if they fail to receive a bid at a competitive lease sale.
    - The intent is to get lease parcels of little or no value issued so such parcels can still be generating some revenue.
    - Noncompetitive leasing encourages leasing of lands for wildcat development. Areas such as the Pinedale Anticline in Wyoming, Bakken play in North Dakota, and Marcellus shale in Appalachia were once considered wildcat areas, and are now some of the major producing areas for natural gas and oil.

Section 306 Best Management Practices: Requires final regulations within one year of enactment requiring best management practices on federal lands to minimize and mitigate impacts to the environment.

- Top-down BMPs are contrary to good, on-the-ground management of natural resources. Every area is different, and different lands and ecosystems require tailored practices. That job is best left to federal land managers on the ground, not fiat from Washington.
- BMPs should be determined at the field office level, by the petroleum engineers, wildlife biologists, reclamation scientists, and other land use management professionals working with operators who understand the land in their area. Enabling only case-by-case adjustment of BMPs is overly rigid, and a top-down, one-size-fits-all approach is not appropriate to the varied ecosystems and geology of the Intermountain West.
- NEPA already requires environmental analysis or an environmental impact statement to be prepared. In an EA or EIS, federal land managers analyze the impact of a proposed action and determine appropriate mitigation strategies to address specific impacts. On-the-ground land managers are thereby able to customize BMPs, stipulations, reclamation actions, and other measures to the local conditions.

Section 307 Coal Mine Methane Recovery

- IPAMS agrees with the goal of capturing methane from coal mines. However the language should be changed to ensure agreement between coal operators and natural gas owners so that both coal and natural gas resources can be equitably developed.
- The language should be strengthened to ensure that negotiation takes place by striking 'to make a reasonable effort' from page 44, lines 8 and 9. The sentence would then read 'Any coal lease that involves federally owned coal and nonfederally owned gas resources shall require the coal operator to negotiate an arrangement with the gas owner in advance of conducting any mining operations.'

Section 308 Environmental Review: Eliminates Section 390 Statutory Categorical Exclusions (CX)

- The limited circumstances where Section 390 of the Energy Policy Act of 2005 CXs may be used were designed to enable energy development where the environmental impact is minor, in developed fields, and where drilling was analyzed in a NEPA document as a reasonably foreseeable activity.
- The law was designed to limit redundant environmental analysis, and to limit environmental impact by enabling drilling on existing well sites. CXs enable a balanced approach to developing vital energy resources while still being protective of the environment.
- Contrary to the language in the staff summary of the bill draft that CXs are being abused and that they are an unwarranted end-run around long-standing environmental statutes, CXs merely eliminate redundant NEPA. The only abuse of the system is that BLM consistently does not utilize these Congressionally mandated CXs, even when companies meet all the criteria for their use.
- Redundant NEPA analysis is routinely used to slow the delivery of American energy resources, and elimination of CXs will continue to divert limited government resources to paperwork that does not result in better protection of the environment. CXs enable federal land managers to avoid some red tape so that they can focus on activities like inspections and monitoring that lead to actual, on-the-ground environmental protection.

Title VII Miscellaneous Provisions

Section 702 Production Incentive Fee: Imposes a $4 per acre fee for non-producing leases.

- A recent DOI IG report[2] cautioned that mandating production on federal leases or increasing lease fees would not enhance production, but could de-incentivize industry.
- The DOI IG found that because of severe data integrity problems, DOI cannot say with any certainty how many leases are producing. The oft-repeated statistic that 60% of leases are not producing is not backed by any credible data.
- Inconsistencies between MMS and BLM mean that leases identified by BLM as producing may be reported as non-producing by MMS, and vice versa.
- It is unreasonable to impose a disincentive fee on industry when DOI systems do not enable accurate tracking of producing and non-producing leases, and do not track all

[2] *Ibid.*

the government and legal obstacles that prevent companies from producing on their leases.

- This fee penalizes lessees who are performing environmental analysis and conducting exploratory work to determine the best way to develop resources, and whether it is even worthwhile to develop the leases. Rather than developing intelligently where it makes sense to do so, this disincentive fee could encourage wanton drilling.
- Section 702 specifies that the fee would apply to all leases in effect on the date of enactment of the Act, rather than just on new leases. Such a retroactive measure would violate the terms of valid existing leases and government contracts that were entered into in good faith by lessees under the terms in effect at the time.

Federal Onshore Lease - Exploration & Potential Production Time Line

Cost (millions)	Cumulative Cost (millions)	Activity
$1-5	$1-5	Evaluate existing 2D and 3D seismic for geological, geophysical and engineering data to identify leads/drilling ideas.
N/A	$1-5	Nominate Lands - Time for lands to appear on a Federal sale (6 to 12 months)
N/A	$1-5	Lease sale
$1-20	$2-25	High bid leases awarded (10 year term).
$5-10	$7-35	Acquire and refine 3D and other data to turn ideas into drillable exploratory prospects. (12 to 24 months)
$1	$8-36	Perform environmental analysis and regulatory permitting requirements to obtain Federal approval to drill. (8 to 12 months)
N/A	$8-36	Contract a rig to drill. (4 to 8 months)
$5-10	$13-46	Drill and complete (2 to 6 months) exploration well. (subject to timing stipulations)
N/A	$13-46	Evaluate geologic, production and engineering results. (6 to 12 months)
$5-10	$18-56	If prospect encouraging, drill appraisal/delineation well(s) and step out well(s) to define the field.
$1-3	$19-59	Evaluate well results, formulate plan of development for discovery - Prepare NEPA document (24 to 60 months)
Minimal	$19-59	Prepare and file permits for development, wait for approvals. (8 to 12 months per permit)
$500-3,000	$519-3,059	Build and install facility, drill and complete development wells to achieve production. (time varies based on production volume and receipt of permits)

Lease Year: -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14

Lease Sale

If exploration well unsuccessful, start process over

Discovery

1st Exploration Production

1st Development Production

LEGEND: Pre-leasing evaluation; Lease Term; Exploration Phase; Development Phase

Source: Independent Petroleum Association of Mountain States (IPAMS)