TAXPAYERS for COMMON SENSE

O&G REPORT

July 2023

Gaming the System II: Oil & Gas Leasing in Nevada is Trouble for Taxpayers

0 of the 2,467 leases, containing 6.2 million acres, leased noncompetitively since 2000 have ever entered production.

67% of acres sold from FY13-FY22 were sold for the minimum bid of $2 per acre, **and** **87%** of acres were sold for under $10 per acre.

95.3% of 626,000 authorized acres sit idle at the end of FY2022.

61% of all acres leased noncompetitively for oil and gas development from FY13-22 were in Nevada.

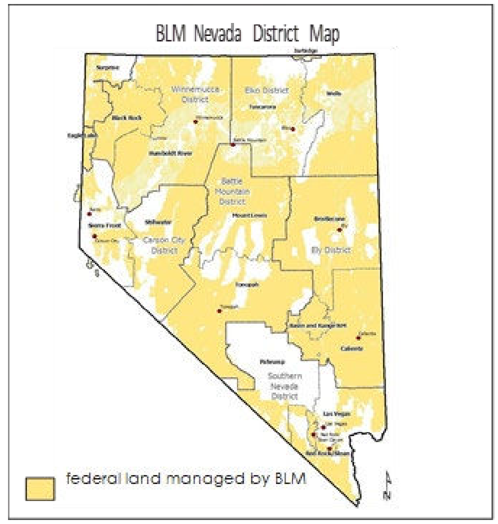
Only **0.3%** of all oil and gas leases issued since 1953 ever entered production.

$34 million in lost revenue from outdated rental rates and royalty for federal leases, FY13-FY22.

The federal government oversees roughly 640 million acres of surface estate and 700 million acres of subsurface mineral estate, which contains valuable, taxpayer-owned resources. Every year, oil and gas developers produce hundreds of millions of barrels of oil and trillions of cubic feet of natural gas on federal lands. The Bureau of Land Management, under the Department of the Interior (DOI), is responsible for managing the development of these resources and is charged with ensuring taxpayers receive a fair return for their development. However, federal policies fail to accomplish this and instead leave taxpayers with billions of dollars in fiscal and environmental liabilities from irresponsible development.

The current system has allowed hundreds of thousands of acres of federal land in Nevada to be locked into non-producing leasing, preventing other potential uses and limiting returns to the public. In Nevada, only 72 oil and gas leases have ever entered production since 1953. Currently, more than 95% of acres leased for oil and gas production remain nonproducing. Additionally, over the last decade, federal taxpayers have lost $34 million from outdated and below-market leasing terms in Nevada. The federal royalty rate, rental rate, and bonding requirements have contributed to substantial taxpayer losses as well as growing taxpayer liabilities from abandoned oil and gas wells.

Federal Oil and Gas Production in Nevada



The federal government manages close to 60 million acres of public lands in the state of Nevada.[1] At the end of Fiscal Year (FY) 2022, 626,000 acres of federal land across the state were leased for oil and gas development. Though little oil and gas production happens in the state, most of the oil and gas produced in Nevada is extracted from federal lands. Between FY2013 and FY2022, 99.4% of oil and 93% of natural gas produced in Nevada was from federal lands.[2] Of the 77 currently active oil and gas wells in Nevada, 75 are located on federal lands.[3]

Oil production on federal lands in Nevada steadily decreased between FY2013 and FY2022 from 336,000 barrels annually to 232,000 barrels annually, a 31% drop. Over this period, Nevada accounted for 0.1% of all oil produced on federal lands.

Natural gas production in Nevada has consistently been negligible.[4] From FY2013-FY2022, operators in Nevada produced just 0.0001% of the natural gas produced on federal lands, making it the 3rd lowest producer of federal onshore gas over the last decade. Natural gas produced on federal lands in Nevada is either used by the operator on site to power production facilities or flared from oil wells. No natural gas from federal lands was brought to market nor was any extracted gas charged a royalty.

At the end of FY2022, the Bureau of Land Management reported that oil and gas operators had leased 626,000 acres of federal land in the state of Nevada, and only 4.7% of which – 29,000 acres – are currently producing.[5] The percentage of producing acreage in Nevada is far below the national average of 52%. Of states with active federal oil and gas production, Nevada had the highest percentage of nonproducing acres on federal land in the Lower 48.[6] However, 4.7% is the highest percentage of producing acreage Nevada has recorded over the last decade, with

[1] Nevada Petroleum and Geothermal Society, "Summary of Oil, Geothermal, and Dissolved Minerals Activity 2021-2022," March 2022. https://minerals.nv.gov/uploadedFiles/mineralsnvgov/content/home/features/RP/RP_NPGS_2021_Fluid_Minerals%20in%20Nevada%20Review.pdf

[2] Nevada Division of Minerals Open Data Site, "Oil-Gas Production Data," https://data-ndom.opendata.arcgis.com/pages/c9cc6482a2d741ed814e099120990a80

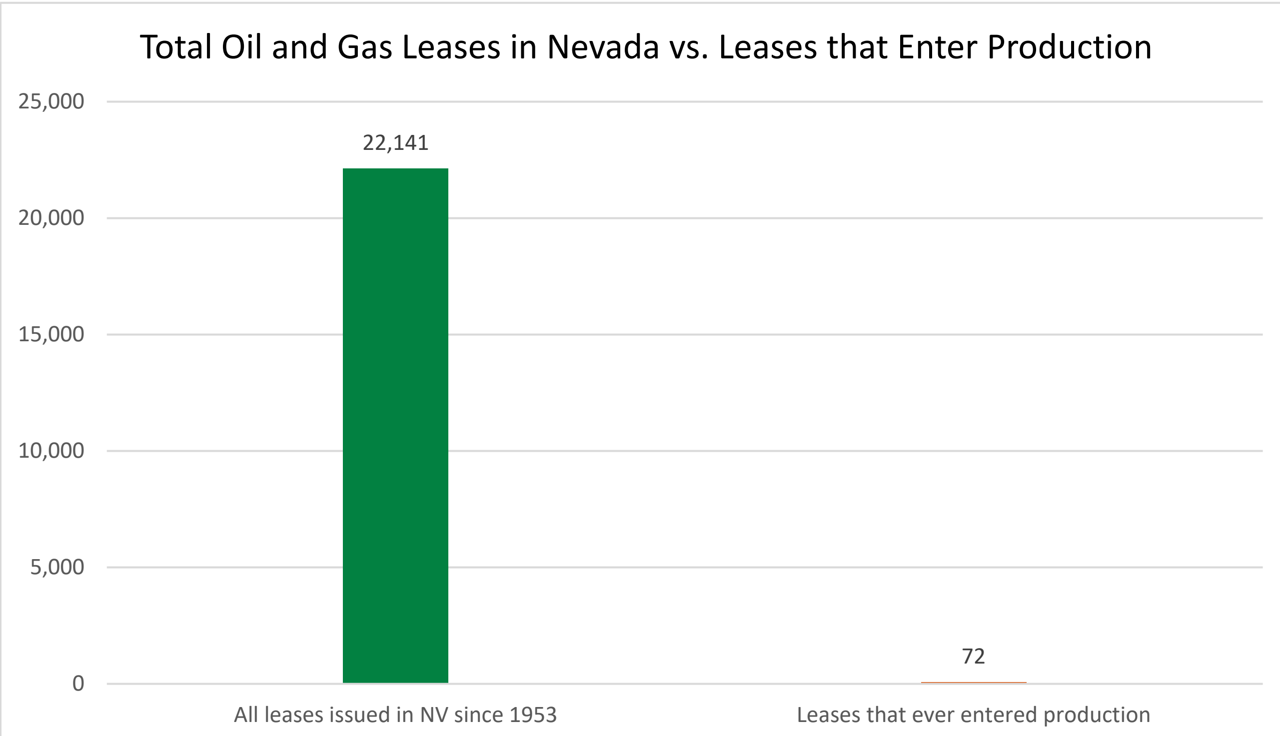
[3] Nevada Division of Minerals Open Data Site, "Oil-Gas Production Data," https://data-ndom.opendata.arcgis.com/pages/c9cc6482a2d741ed814e099120990a80

[4] Office of Natural Resource Revenue, "U.S. Department of the Interior Natural Resources Revenue Data," https://revenuedata.doi.gov/

[5] Bureau of Land Management, "Oil and Gas Statistics," October 2022. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics

[6] Arizona, Maryland, and Oregon reported no oil and gas production on federally leased land FY2013 through FY2022.

a low of 0.6% recorded in FY2013 and FY2014. Nevada's track record of low production extends beyond just the past decade—only 72 out of the 22,141 leases issued since 1953 ever entered production. Despite the high percentage of nonproducing leases, Nevada has continued to offer and issue new leases for oil and gas development over the past decade. Between FY2013 and FY2022, the Bureau of Land Management leased around 1.5 million acres of federal land in Nevada.[7]



The Federal Oil and Gas Program

The federal government has the opportunity to capture fair market value for taxpayers throughout the leasing process. First, DOI sells leases to the highest bidder in a live auction, with the resulting revenue referred to as "bonus bid" revenue. Next, the federal government charges leaseholders rent for holding the land. Finally, leaseholders are charged a set percentage of the resources' value, known as a royalty, when oil and gas is produced and sold. Under the current leasing system, taxpayers lose valuable revenue through outdated and below-market rates at every step of the process.

For decades, the federal government used the same, below-market royalty rate, rental rate, and minimum bid for onshore oil and gas leases. The 12.5% royalty rate on federal lands was first set

[7] Ibid.

by Congress as the legal minimum more than 100 years ago and it remained unchanged until last year. The rate of 12.5% is far less than what is charged in federal waters (18.75%) or on many state lands (up to 25% in states like Texas). The rental rate for holding land not currently under development – which was last changed in 1987 to $1.50 per acre per year for years 1-5 of the lease and to $2 per acre per year after – was only updated again last year. The minimum bid had also remained $2/acre for over three decades before finally getting raised last year.

As is the case in Nevada, low rates enable lease holders to retain federal land without engaging in development activities. Moreover, the federal government has taken limited action to dissuade companies from holding federal leases without utilizing the oil and gas resources associated with them, choosing to allow for the vast majority of Nevada's public lands—close to 90% —to be open for leasing despite those lands largely having little to no development potential.[8] By the end of FY2022, approximately 11.3 million acres of federal land, constituting nearly half of all leased land designated for oil and gas development, remained non-producing. A portion of this land is leased by private entities that have little or no intention of extracting oil or gas. Instead, they aim to retain the land for alternative purposes or seek to generate profit by selling their leasing rights to production companies. This situation not only diminishes potential royalty-based revenue for taxpayers, but also restricts the utilization of valuable land for other purposes.

Noncompetitive Leasing and Low Bids

Prior to the fiscal reforms implemented last year, the practice of noncompetitive leasing, coupled with low bids and no expression of interest fee, resulted in private entities or speculators acquiring leases on federal lands with the intent of profiting from the resale of leasing rights to production companies. Oil and gas companies, either through direct acquisition or by partnering with speculators, sometimes obtain parcels of land without any intention of developing them. This strategy allows them to artificially inflate their reported numbers of undeveloped acreage, thereby enhancing their perceived production prospects. Even though these leased lands may hold minimal to no potential for actual development, this approach provides a cost-effective means for companies to amplify their growth prospects. Public lands leased speculatively almost never enter production.

For decades, vast acres of land were leased noncompetitively in Nevada – entities leasing the land did not even have to pay the $2 per acre minimum bid to hold public land for a primary term of 10 years. Out of the 2,467 leases encompassing 6.2 million acres that were obtained through noncompetitive means in Nevada since 2000, none of them have ever entered

[8] The Wilderness Society, Open for Business (and Not Much Else): How Public Lands Management Favors the Oil and Gas Industry. https://www.wilderness.org/sites/default/files/media/file/Report-Open%20for%20Business.pdf

production.[9] These 6.2 million acres that have remained untapped and inactive represent over 60% of all federal lands leased in Nevada since 2000.

Even with there being hardly any oil or gas resources to be developed, close to 4 million acres of federal lands in Nevada were offered for leasing from FY2013 to FY2022. Of all acres leased at auction in Nevada during that time, 67% of acres were sold for the minimum bid of $2 per acres and 83% were sold for less than $10 per acre.[10] Leasing noncompetitively or for less than $10 per acre, amongst other factors like being leased by entities that are not exploration and production companies, are some of the characteristics of federal oil and gas leases that indicate they might be unreasonably speculative, given the high likelihood these leases will be terminated without ever reaching production.[11] This speculative practice ran rampant in Nevada in particular due to the amount of public land in the state that has been opened to leasing despite having little to no drilling potential.

Noncompetitive leases and leases sold for minimum bid shortchange taxpayers both by lowering the amount of revenue taxpayers receive from bonus bids and by keeping valuable federal land from other, productive uses. In an analysis of federal oil and gas leases that started in FY2003 through FY2009, the Government Accountability Office (GAO) found that noncompetitive leases comprised about 38% of all acreage leased but only generated 11% of the revenue.[12] From FY2003 to FY2019, competitive leases generated $14.3 billion while noncompetitive leases generated only $1.8 billion. Furthermore, only 1.2% of noncompetitive leases and 1.9% of leases sold for the minimum bid of $2 per acre issued during the analysis timeframe ever entered production.[13]

Leases that have not been utilized for oil and gas production hold the potential for various valuable uses that can benefit taxpayers. These unused leases could be employed for purposes such as conservation efforts, recreational activities, or even alternative energy development, among other possibilities. Instead, outdated and ineffective federal leasing policies allow companies to lock up federal land and provide little return for taxpayers.

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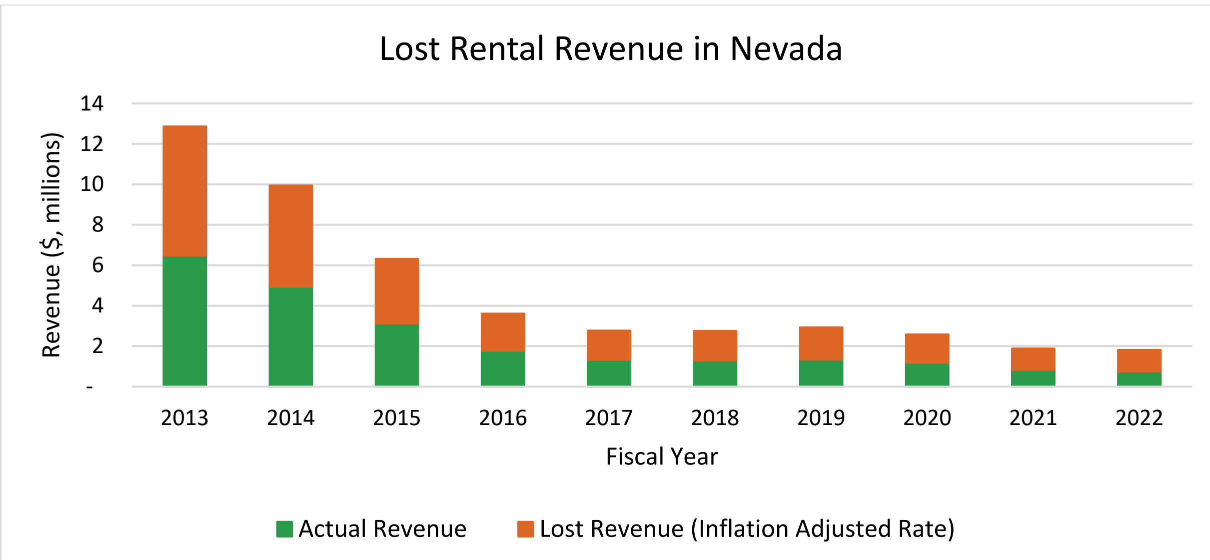
[9] Bureau of Land Management, Land & Mineral Legacy Rehost 2000 System (LR2000).
[10] Ibid.
[11] Taxpayers for Common Sense, "The Cost of Speculation on Oil and Gas Leases on Federal Land", October 2017. https://www.taxpayer.net/wp-content/uploads/ported/images/downloads/LOCKED_OUT_Energy_Report.pdf
[12] Government Accountability Office, "Oil and Gas: Onshore Competitive and Noncompetitive Lease Revenues," November 2020. https://www.gao.gov/products/gao-21-138
[13] Ibid.

Outdated Rental, Royalty, and Insufficient Bonding

Taxpayers have also suffered from inadequate leasing terms on the limited number of active leases in the state. When land is leased but not producing, operators are charged a rental rate which, over the last decade, has been outdated and below market. Between FY2013 and FY2022, the Office of Natural Resource Revenue (ONRR) reported collecting $23 million in rental fees.[14] Had these rental rates been adjusted for inflation (compared to when they were established in FY88), taxpayers would have received $47.5 million in revenue from FY2013-FY2022, more than double what they actually received.[15]



Federal and state taxpayers also receive revenue from the little production in the state in the form of royalties. From FY2013 to FY2022, ONRR collected $19 million in revenue from royalties on oil produced on federal lands in Nevada.[16] If the current royalty rate of 16.7% had been implemented earlier, taxpayers would have received an additional $6.3 million in revenue over the last decade.[17] If a royalty rate of 18.75% had been applied – a rate more in line with what the federal government charges for oil in federal waters and closer to what many states charge on non-federal land (up to 25% in Texas) – taxpayers would have received an additional $9.5 million in revenue from FY2013-FY2022.

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[14] Office of Natural Resource Revenue, "U.S. Department of the Interior Natural Resources Revenue Data," https://revenuedata.doi.gov/
[15] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.
[16] Office of Natural Resource Revenue, "U.S. Department of the Interior Natural Resources Revenue Data," https://revenuedata.doi.gov/
[17] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.

After production, outdated bonding rates result in ongoing losses for taxpayers. In Nevada, as well as across the nation, oil and gas operators are obligated to provide bonds to ensure the adequate plugging and reclamation of well sites following drilling activities. Unfortunately, the existing federal bonding requirements fall short of covering the substantial reclamation expenses, shifting the financial responsibility onto taxpayers for the cleanup of abandoned wells and well sites. Comprehensive reclamation costs can range from $20,000 to $145,000 per well.

According to GAO, 84 percent of bonds, which cover 99.5 percent of wells, are not enough to cover even the lower estimate of $20,000 per well.[18] As of May 12, 2023, the Nevada Division of Minerals (NDOM) recorded 6 documented orphaned wells – 5 of which are on federally owned surface. While the number of current orphaned wells in Nevada is low, potential cleanup liabilities should never fall on taxpayers. Using GAO's estimated cost of well reclamation, the 119 open wells on federal land in Nevada carry estimated combined reclamation costs of between $2.4 million and $17.3 million. According to a GAO report published in 2019, the average value of bonds held by DOI in 2019 was $2,122 per well.[19] Assuming this is still the average value of bonds held by DOI today in Nevada as the rates were never updated, the bonds can only cover $253,000 of any potential reclamation liability, meaning taxpayers may be on the hook for the shortfall—between $2.1 million and $17 million.

Recent Reforms and Future Actions

While the fiscal terms associated with leasing sat untouched for decades, recent legislation updated many of these terms, and this will increase financial returns for taxpayers. The fiscal year 2022 budget reconciliation bill, which was signed into law in August 2022, contained several important updates to oil and gas leasing rates. The bill raised the onshore oil and gas royalty rate, rental rates, and minimum bid for the next 10 years. Until August 2032, the federal onshore royalty rate is set at 16.67%; rental rates are raised to $3/acre for the first 2 years, $5/acre for years 3-8, and then no less than $15/acre for years 9-10; and the minimum bid is now $10/acre.

The fiscal year 2022 budget reconciliation bill also ended the practice of noncompetitive leasing, which could have significant benefit for states like Nevada where competition for leases is historically low. Generally, federal oil and gas leases are sold competitively through online auctions, with a minimum bid requirement of $2 per acre. However, until this year, if parcels offered at lease sales did not receive a minimum bid, they were available on a first-come, first-serve basis for two years starting on the next business day with no bid. Roughly 1.6 million acres

[18] Government Accountability Office, "Bureau of Land Management Should Address Risks from Insufficient Bonds to Reclaim Wells," September 2019. https://www.gao.gov/assets/gao-19-615.pdf

[19] Government Accountability Office, "Bureau of Land Management Should Address Risks from Insufficient Bonds to Reclaim Wells," September 2019. https://www.gao.gov/assets/gao-19-615.pdf

offered for lease in the last 10 fiscal years were leased noncompetitively.[20] Not only does noncompetitive leasing limit revenue from bonus bids, but federal land leased noncompetitively is also less likely to enter production.

Additionally, the bill implemented a new expression of interest fee of $5/acre, which is charged to nominate federal land for auction. Considering that nominations put administrative burden on the BLM and often do not lead to leases—in one particularly egregious example, it took BLM's Nevada office 5 years to review 28 million nominated acres,[21] most of which did not end up getting leased—this fee will further discourage companies from nominating lands with little potential for oil and gas development which could be purchased at auction for next to nothing.

While these reforms are an important first step in ensuring taxpayers get a fair return for federal oil and gas resources, the current system still fails taxpayers with below market-royalty rate, insufficient bonding protection for reclamation, and allowing entities to nominate parcels and lease land with little value for oil or gas that they have no intention to ever develop. Presently, Congress and the Administration are pursuing a variety of potential actions that could improve taxpayer return from the development of valuable oil and gas resources, including efforts to limit federal land with low production potential from being offered in oil and gas lease sales and rulemakings to make royalty and other fiscal reforms permanent.

Conclusion

Federal taxpayers in Nevada and across the country deserve a fair return from the valuable mineral resources we all own. Unfortunately, the continuation of outdated and inadequate federal onshore oil and gas leasing policies cost taxpayers valuable revenue and allow industry to skirt financial and environmental liabilities. Recent reforms have helped bring fiscal policies in line with market rates, but more must be done to ensure federal oil and gas resources are managed in a way that brings the greatest value to the American taxpayer and protects us all from future liabilities.

[20] Bureau of Land Management, Land & Mineral Legacy Rehost 2000 System (LR2000).
[21] GAO, Oil and Gas Leasing: BLM Should Update Its Guidance and Review Its Fees. November 2021. GAO-22-103968. https://www.gao.gov/assets/gao-22-103968.pdf