TAXPAYERS for COMMON SENSE

O&G REPORT

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No Deal (for Taxpayers) in North Dakota:

How Federal Oil and Gas Leasing Fails Taxpayers

$1.2 billion in revenue loss under the 12.5% federal royalty rate, FY13-FY22.

$4.2 million in lost rental revenue from outdated rental rates for federal leases, FY13-FY22.

$433 million in potential reclamation liability for currently producible wells on federal lands in North Dakota.

$313 million worth of gas vented and flared by operators on federal lands, FY12-FY21.

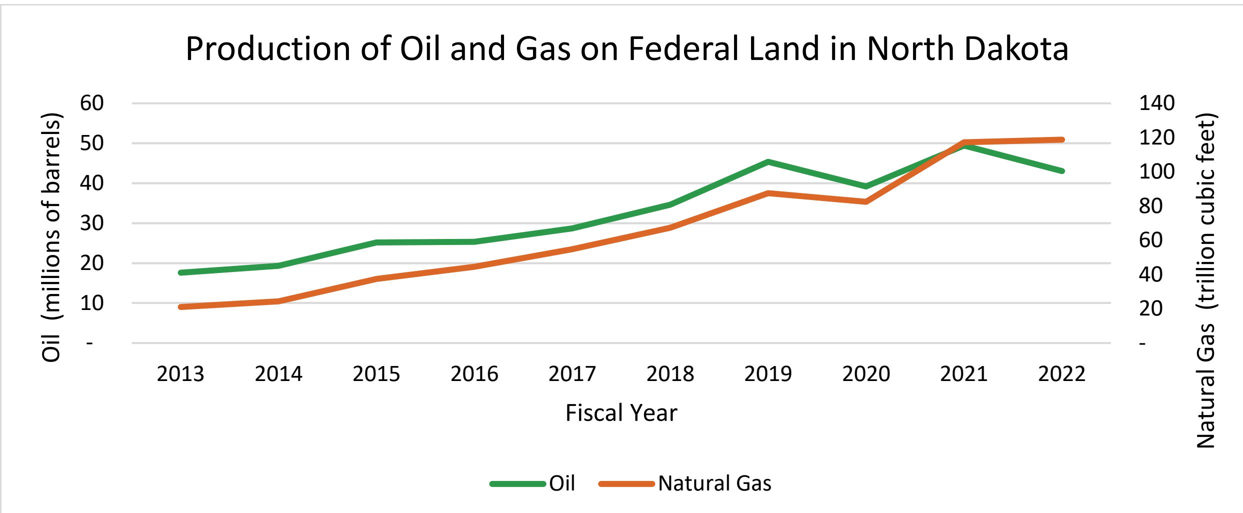
$51.2 million in lost royalty revenues from vented and flared gas on federal lands.

Federal taxpayers own mineral resources across the United States, including a 700-million-acre onshore subsurface mineral estate. The Bureau of Land Management (BLM), within the Department of the Interior (DOI), oversees the subsurface mineral estate and is charged with managing the development of those resources. Yet, despite the massive value of taxpayer-owned resources extracted from federal lands by oil and gas developers every year, taxpayers continue to receive pennies on the dollar due to outdated and below-market federal onshore leasing terms.

Issues within the onshore federal oil and gas leasing system have been long recognized – including by DOI itself – and are long in need of reform. Outdated leasing fees, including below market rental and royalty rates, have cost taxpayers billions of dollars over the last decade. Bonding policies meant to ensure industry is responsible for restoring federal lands after drilling ends have instead burdened taxpayers with the long-term fiscal and environmental liabilities of orphaned oil and gas wells. In North Dakota, these policies have cost taxpayers $1.3 billion over the past decade and left taxpayers with as much as $433 million in potential future reclamation costs from abandoned oil and gas wells.

Oil and Gas Production in North Dakota

At the end of Fiscal Year (FY) 2022, 653,000 acres of federal land in North Dakota were leased for oil and gas development.[1] North Dakota is the third-largest producer of federal oil, behind New Mexico and Wyoming, accounting for 13% of all oil produced on federal lands from FY2013 to FY2022.[2] Production of oil on federal lands in North Dakota has increased by nearly 1.5 times between FY2013 and FY2022. North Dakota is also the fifth-largest producer of federal gas, accounting for nearly 2% of all the natural gas produced on federal lands over the last decade. The production of natural gas on federal lands in North Dakota has dramatically increased over the last decade, more than quadrupling from FY2013 to FY2022.



This production of oil and gas should have generated sizeable revenues for federal and North Dakota taxpayers alike, since revenue from royalties and other leasing terms are shared with the state. However, outdated and below-market leasing terms have not only limited much-needed revenue for taxpayers, but have also allowed oil and gas operators to skirt the responsibilities of reclaiming (cleaning up) well sites after operations cease, leaving taxpayers to cover the costs.

The Federal Oil and Gas Program

The federal government possesses the opportunity to capture fair market value for taxpayers throughout the leasing process. Initially, DOI auctions leases to the highest bidder in a live auction, with the resulting revenue termed as “bonus bid” revenue. Following this, the federal government imposes rent on leaseholders for holding the land before production commences.

[1] Fiscal Year 2022 Oil and Gas Statistics, Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics

[2] “Natural Resources Revenue Data.” U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.

Once leases begin to produce oil and gas, leaseholders are charged a fixed percentage of the production's value, known as a royalty. Under the previous leasing system, which has only recently been updated, taxpayers lost valuable revenue at each stage of the process.

For decades, the federal government employed 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 set by Congress as the legal minimum over 100 years ago, remaining unchanged until last year. This rate was significantly less than what is charged in federal waters (18.75%) or on many state lands (up to 25% in Texas and 18.75% in North Dakota). The previous rental rate for holding land not currently under development – $1.50/acre per year for years 1-5 of the lease and $2/acre per year after – and minimum bid – $2/acre – had remained unchanged for decades before being updated last year.

Low rates and the practice of noncompetitive leasing had enabled 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. 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.[3] 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.

After production ends, oil and natural gas producers operating on federal land are required to plug their wells and clean up the surrounding sites. To guarantee that the cleanup of these potentially hazardous and environmentally harmful sites is paid for, producers must post a bond before they start drilling. If a company abandons its wells on a federal lease or goes bankrupt, the bond is intended to cover the reclamation expenses. However, for leases on federal land, the required bond amounts have not changed in over 60 years and do not cover the full cost of cleanup. Consequently, taxpayers are left paying millions of dollars to reclaim thousands of abandoned wells scattered across federal lands.

Recent Reforms

Recent legislation addressed many of these outdated and below-market fiscal terms, heralding a new era of financial returns for taxpayers. The FY2022 budget reconciliation bill, signed into law in August 2022, included several critical updates to oil and gas leasing rates for the next decade.

[3] "BLM Oil and Gas Statistics." Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics.

Under the new reforms, until August 2032, the federal onshore royalty rate will be 16.67%; rental rates are raised to $3/acre for the first two years, $5/acre for years three to eight, and then no less than $15/acre for years nine and ten; and the minimum bid has been raised to $10/acre. After August 2032, these rates will become the statutory minimum. The bill also eliminated the practice of noncompetitive leasing and created a new expression of interest fee for entities nominating federal land for competitive lease sales, two important measures for helping to limit speculative leasing.

While these changes represent a significant step toward fair returns for federal oil and gas resources, current system shortcomings persist, as seen in the below-market royalty rate and policies that permit producers to waste taxpayer-owned natural gas without adequate compensation. Moreover, the existing bonding requirements expose taxpayers to vast reclamation expenses.

DOI's current plans include additional updates to rules and policies to further secure fair returns. In late July, DOI released a proposed rule that would codify reforms made by Congress in the FY2022 budget reconciliation bill, as well as other recommendations from the Department of the Interior's Report on the Federal Oil and Gas Leasing Program. [4] In tandem with fiscal revisions, the proposed rule would increase the minimum lease bond amount to $150,000 and the minimum statewide bond to $500,000, and eliminate nationwide and unit bonds. The rule would also direct oil and gas leasing away from sensitive areas. These continued efforts aim to enhance taxpayer returns, protect taxpayers from shouldering the oil and gas industry's liabilities, and potentially further reduce speculative leasing.

In the proposed rule, DOI outlines the minimum royalty rate past the 10-year window at 16.67% even though DOI has previously set higher rates. In June 2022, DOI held an oil and gas lease sale that included a royalty rate of 18.75% specific to those leases. After August 16, 2032, DOI could elevate the royalty rate, thereby better capturing fair returns on federal lands.

Additional agency rulemakings on the horizon will contribute to assuring taxpayers a fair return on valuable oil and gas resources, such as improving the capture and royalty collection of vented and flared methane from federal wells.

[4] Department of the Interior, Report on the Federal Oil and Gas Leasing Program. November 2021. https://www.doi.gov/sites/doi.gov/files/report-on-the-federal-oil-and-gas-leasing-program-doi-eo-14008.pdf

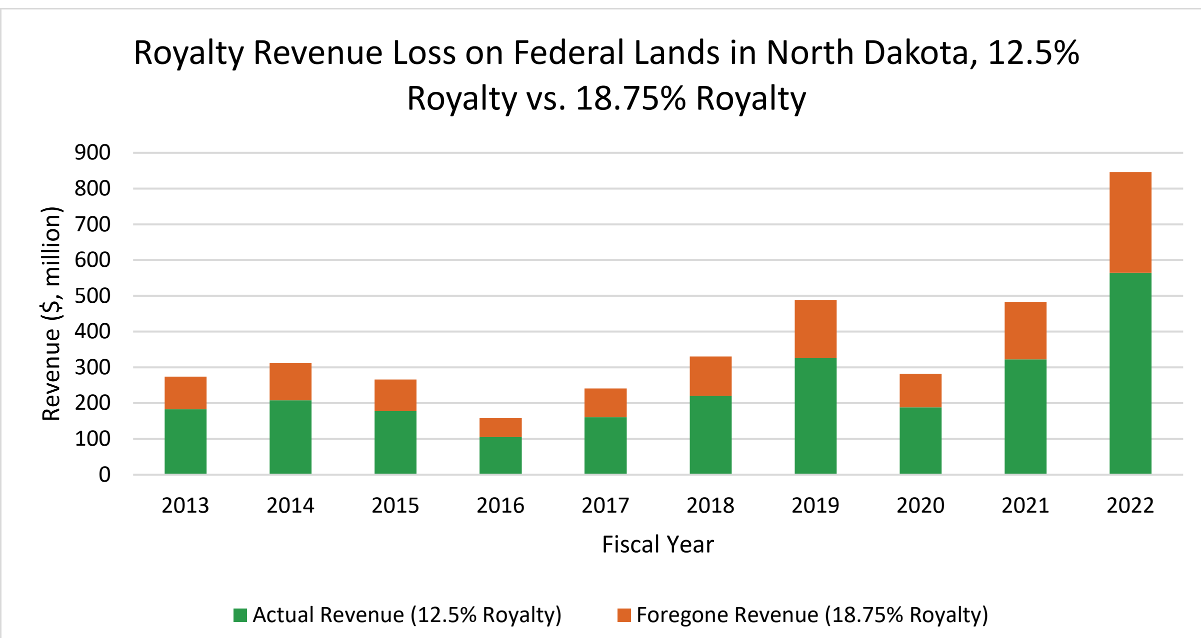
Revenue Losses from Onshore Leasing Terms

While recent actions have helped bring the federal onshore oil and gas leasing system into the 21st century, the system is still inadequate at protecting taxpayers and ensuring a fair return from the sale of taxpayer-owned resources. Taxpayers have lost millions of dollars and, without permanent reform, may continue to lose millions more from outdated and below-market royalty rates and rental rates. Current federal policies on lost gas and bonding benefit the oil and gas industry at the expense of taxpayers, burdening the nation with growing long-term liabilities.

Royalty Rate

Over the last decade, FY2013-2022, the Office of Natural Resource Revenue (ONRR) collected $2.5 billion in royalties on oil and gas produced on federal lands in North Dakota, 88% of which came from the production of oil.[5]

If the current royalty rate of 16.7% had been applied to production in North Dakota over the last decade, federal and North Dakota taxpayers would have received an additional $819 million in revenue.[6] If a royalty rate of 18.75% had been applied – which is more in line with what is charged in federal waters – taxpayers would have received an additional $1.2 billion in revenue.



[5] Office of Natural Resource Revenue, U.S. Department of the Interior Natural Resource Revenue Data, n.d. https://revenuedata.doi.gov/

[6] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.

Rental Rate

Taxpayers also get shortchanged by an outdated rental rate applied to federal lands, including those in North Dakota. Over the last decade, lease holders that were not actively producing oil or gas on federal leases were charged $1.50/acre for the first 5 years of the lease and $2/acre for the second half of the lease term. Those rates had not been adjusted since 1987. The ONRR reported collecting $3.9 million in rental revenue over the last 10 years in North Dakota.[7] Had the rental rates been adjusted annually for inflation, taxpayers would have received $8.1 million, more than double what was actually collected.[8] A new proposed rule at DOI would require that base rental rates be updated annually for inflation.

Federal Bonding Requirements

In North Dakota, oil and gas operators are required to post bonds to ensure wells are properly cleaned up after production ceases when operating on federal land. However, current federal bonding requirements are insufficient to cover the high costs of reclamation, which leaves taxpayers to shoulder the costs of reclamation.

According to the North Dakota Department of Mineral Resources (DMR) the average cost to plug and reclaim a well in the state is $150,000.[9] This cost estimate is consistent with recent reclamation spending in the state. Between 2018 and 2020, North Dakota reported plugging 285 orphaned wells, at a total cost of $38 million, in addition to spending $29 million to reclaim associated well sites.[10] Federal bonding requirements fail to cover these anticipated costs, leaving taxpayers on the hook for expensive reclamation when oil and gas operators abandon their wells. The Government Accountability Office reported that DOI held an average bond value of $2,122 per well in 2019, less than 2% the documented cost of plugging orphaned wells in North Dakota.[11]

Taxpayers are already on the hook for orphaned oil and gas wells on federal lands in North Dakota. Per a recent Interstate Oil & Gas Commission Compact (IOGCC) report, North Dakota

[7] Office of Natural Resource Revenue, U.S. Department of the Interior Natural Resource Revenue Data, n.d. https://revenuedata.doi.gov/
[8] Lost royalty and rental revenue estimates are calculated by TCS using ONRR data.
[9] North Dakota Department of Mineral Resources, Bakken Restart Task Force, May 28, 2020. https://wdeawebsite.blob.core.windows.net/usrfiles/news/Bakken_Restart_052820.pdf
[10] North Dakota reported spending $29 million restoring 192 sites, 190 of which are well sites. The other 2 sites are on treating plant and one pipeline. Source: "Idle and Orphan Oil and Gas Wells: State and Provincial Regulatory Strategies 2021," Interstate Oil & Gas Compact Commission, 2021. https://iogcc.ok.gov/sites/g/files/gmc836/f/iogcc_idle_and_orphan_wells_2021_final_web.pdf
[11] "Oil and Gas: Bureau of Land Management Should Address Risks from Insufficient Bonds to Reclaim Wells," Government Accountability Office, Sep 18, 2019. https://www.gao.gov/products/gao-19-615

recorded 46 documented orphaned wells on federal or tribal land as of November 30, 2021.[12] Using North Dakota DMR reclamation costs, these orphaned wells will cost around $6.9 million to reclaim. Some of this funding will come from the Infrastructure, Investment, and Jobs Act (IIJA), which appropriated $250 million for reclaiming orphaned wells on federal lands, as well as $150 million for orphaned wells on tribal lands.

The taxpayer costs of orphaned wells in North Dakota extend beyond currently documented orphaned wells. Currently producing oil and gas wells carry the same, inadequate oil and gas bonding requirements that may leave taxpayers on the hook for reclamation liabilities. According to Bureau of Land Management, there were 2,931 producing oil and gas wells on federal lands in North Dakota at the end of FY2022.[13] If we assume DOI still holds an average bond value of $2,122 per well, the federal government has only $6.2 million in financial assurances for wells that may cost nearly $440 million to reclaim, leaving taxpayers with $433 million in potential future liabilities.

Federal taxpayer spending does not end with orphaned oil and gas wells on federal lands; taxpayers also fund state initiatives to remediate wells on state and private land. In August 2022, North Dakota was awarded an initial grant of $25 million to reclaim 120 orphaned wells on state and private land.[14] This money was part of the $4.275 billion appropriated in the IIJA for state orphaned well cleanup programs.

As oil and gas operators continue to shirk their reclamation responsibilities on state and private land in North Dakota, the federal government will likely continue to provide financial support. As of December 2023, the North Dakota Department of Mineral Resources reported 18,753 producing wells in North Dakota – including federal, state, and private land – which may carry a total of $2.8 billion in future reclamation costs.[15] If operators fail to cover these full cleanup costs, federal taxpayers will likely shoulder some of this burden.

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[12] "Idle and Orphan Oil and Gas Wells: State and Provincial Regulatory Strategies 2021," Interstate Oil & Gas Compact Commission, 2021. https://iogcc.ok.gov/sites/g/files/gmc836/f/iogcc_idle_and_orphan_wells_2021_final_web.pdf

[13] Fiscal Year 2022 Oil and Gas Statistics, Bureau of Land Management, n.d. https://www.blm.gov/programs-energy-and-minerals-oil-and-gas-oil-and-gas-statistics

[14] Department of Interior, Through President Biden's Bipartisan Infrastructure Law, 24 States Set to Begin Plugging Over 10,000 Orphaned Wells. August 25, 2022. https://www.doi.gov/pressreleases/through-president-bidens-bipartisan-infrastructure-law-24-states-set-begin-plugging

[15] North Dakota State Industrial Commission, "Oil and Gas Production Report," December 2023 https://www.dmr.nd.gov/oilgas/mpr/2023_12.pdf

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In 2020, the North Dakota Industry Commission requested and received $66.4 million in funding from the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act to plug wells and reclaim sites abandoned by oil and gas companies. At the time, the North Dakota Department of Mineral Resources reported 549 abandoned wells in North Dakota’s oil-producing region.

However, most of the wells identified and later plugged were not truly orphaned. Although North Dakota law does not have a legal designation for “orphaned” wells, the terms is generally understood by the industry as wells that have been abandoned with owners that are unknown or have gone bankrupt. The state assumed ownership of 320 wells – 243 of which were owned by companies with other, active wells in the state – and shifted the full costs of reclamation to state taxpayers. One company, Cobra Oil and Gas, had 121 wells confiscated while the company was operating 369 active wells at the time.

According to news reporting, North Dakota had plugged 280 wells as of May 2021, at a total cost of $39.3 million. Less than 10% of this cost, $3.4 million, was recuperated from operator bonds.

Taxpayers are already paying for cleanup when the well owners are solvent and are likely to be exposed to more financial liabilities if well operators go bankrupt. North Dakota taxpayers can be especially vulnerable to this risk as the state allows other unnamed forms of financial assurance that are not cash or surety.

Source: North Dakota Mineral Resources;[16] Inside Climate News;[17] Western Organization of Resource Councils;[18]

Royalty-Free Gas

Federal oil and gas leasing policies allow producers to vent and flare natural gas during production, much of which is done without incurring a royalty. Over the last decade, operators on federal lands reported losing 100.4 billion cubic feet of gas – an amount that can power 1 million homes for a year and is valued at $313 million – during oil and gas development.[19] 81%

[16] North Dakota Mineral Resources, “Bakken Restart Task Force/Cares Act Update”, May 2021. https://www.dmr.nd.gov/oilgas/CARES_Act.Task_Force_Report_7.6.21.pdf
[17] Nicholas Kusnetz, “North Dakota, Using Taxpayer Funds, Bailed Out Oil and Gas Companies by Plugging Abandoned Wells,” *Inside Climate News*. https://insideclimatenews.org/news/23052021/north-dakota-orphaned-abandoned-oil-gas-wells-methane-emissions/
[18] Western Organization of Resource Councils, “Reclaiming Oil and Gas Wells and Addressing Climate Impacts: State Policy Recommendations,” March 2021 https://www.worc.org/media/2021.3-WORC-Reclaiming-Wells-Addressing-Climate-Impacts-v2.pdf
[19] All information regarding methane emissions on federal lands was obtained through the Office of Natural Resources Revenue via a Freedom of Information Act Request by TCS. Gas value calculations used monthly average Henry Hub Natural Gas Spot Prices obtained from the Energy Information Administration. Source: htps://www.eia.gov/dnav/ng/hist/rngwhhdM.htm

of this gas did not incur a royalty, meaning operators were able to waste a valuable federally owned resource without compensating taxpayers. In FY2020 and FY2021, operators in North Dakota reported venting and flaring more gas than those in New Mexico but produced 4 times less oil. Flaring in North Dakota is particularly egregious—99% of gas waste from federal lands in North Dakota was due to flaring as operators have no incentive to capture the gas that comes to the surface along with oil production.

Between FY2012 and FY2021, oil and gas operators on federal lands in North Dakota reported losing gas with an estimated value of $312.9 million, yet ONRR only collected $7.4 million in royalties.[20] If the royalty rate at the time, 12.5%, had been applied to all reported lost gas, taxpayers would have received an additional $31.7 million in revenue. If the current royalty rate, 16.7%, had been applied, taxpayers would have received $44.7 million more in revenue than what ONRR collected. If a royalty rate matching what is charged in federal waters, 18.75%, had been applied, taxpayers would have received an additional $51.2 million in revenue.[21]

Conclusion

The federal government is responsible for ensuring taxpayers – both state and federal – get a fair return for the development of publicly-owned resources. The current onshore oil and gas leasing system fails to accomplish this – and these failures are evident in North Dakota. Residents of North Dakota and federal taxpayers deserve better. Common sense reforms will ensure taxpayers receive fair market value on the natural resources we collectively own.

North Dakota Oil & Gas | Bureau of Land Management

[20] "Natural Resources Revenue Data." U.S. Department of the Interior, n.d. https://revenuedata.doi.gov/query-data/.
[21] "Gas Giveaways II: Methane Waste on Federal Lands is Business as Usual," Taxpayers for Common Sense, August 30, 2022. https://www.taxpayer.net/energy-natural-resources/gas-giveaways-ii-methane-waste-on-federal-lands-is-business-as-usual/