

Position Paper
Interior's Proposed Fee and Royalty Rate Increases
February 2010



At a time when the Obama administration should be embracing policies to increase employment, stimulate the economy, and increase production of American clean energy, the Department of the Interior (DOI) continues to propose policies that increase uncertainty and put at risk jobs and economic development tied to the production of natural gas and oil in the West. In addition, the President's FY 2011 budget includes new fees on the natural gas and oil industry, along with royalty rate increases. Coupled with \$36.5 billion in additional taxes on industry, these new fees will disproportionately impact the small businesses that produce 82% of America's natural gas and 68% of the oil. The increased costs will remove capital from the development and production of American energy and result in further job losses.

- Industry already more than pays for the administration of the federal onshore natural gas and oil program by returning \$46 for every dollar spent. When income and other taxes are factored in, companies return \$123 for every dollar spent administering the program. **Few other government programs garner such a high direct return.** Industry already more than pays for the leasing, permitting, inspections, environmental enforcement, and all other aspects of the onshore program.
- Despite the fact that the natural gas and oil industry is the second largest source of revenue for the US Treasury after the federal income tax, the Obama Administration is proposing further punitive tax increases, and an increased royalty rate.
- Operating on federal lands is already much more time-consuming and costly compared to operating on private lands. The sum total of all the negative proposals from DOI and the increases in fees and taxes will be a decrease in production on federal lands, a reduction of jobs that result from the productive use of public lands, and a decrease in the production of energy owned by all Americans.
- 27% of America's natural gas is produced in the Intermountain West, more than half of which comes from federal lands. The APD fee and other policies that discourage natural gas and oil development on federal lands block production of American energy owned by all citizens, and threaten American jobs, government revenue, and economic development.
- Short-sighted efforts to increase costs could actually result in less revenue from the onshore program as operators are further discouraged from developing American energy on public lands. The case study of Alberta is illustrative. In 2008, the province increased the maximum royalty rate for natural gas production from 35% to 50%.
 - Operators now pay \$165 in royalties before they show \$100 in profit.¹
 - Alberta experienced a 42% drop in rig count and an 8% reduction in gas production between 2008 and 2009
 - Alberta is now experiencing its first budget deficit in 15 years and recent reports show a net loss of oil and gas royalties totaling \$2 billion since 2008.

¹ Energy Navigator Study, Boyd Russell,
http://www.energynavigator.com/index.php?mact=News.cntnt01_detail,0&cntnt01articleid=49&cntnt01origid=15&cntnt01detailtemplate=news&cntnt01returnid=24

Inspection Fees

- The President's budget directs the Bureau of Land Management (BLM) to collect inspection fees:
 - \$150 for each lease with no wells but with surface use, disturbance or reclamation
 - \$300 for each lease with one to ten active or inactive wells
 - \$750 for each lease with eleven to fifty active or inactive wells
 - \$1,500 for each lease with more than fifty active or inactive wells
- The administration of this fee would be extremely cumbersome for BLM. The DOI Inspector General (IG) found that BLM already has data and systems difficulties, which would hinder the efficiency of these fees.²
- Operators already more than pay for inspections by paying royalties, rents, and bonuses for leases.

Non-Producing Acreage Fee

- The President's budget includes a proposal to assess a \$4 fee on non-producing federal acreage on federal lands.
- Such a fee would de-incentivize industry, and does not take into account all the preparatory work done on a lease before it goes into production, such as geophysical exploration, environmental analyses, permitting, wildlife and cultural resource surveying, and numerous other activities necessary before a well is drilled. All the regulations and analysis that the government requires on federal leases often take more than five years to complete. In addition, the government routinely holds up projects for bureaucratic reasons, and legal challenges from environmental groups further delay projects.
- It is inequitable to charge companies a non-producing fee when, in many cases, the government is the entity holding up diligent development of federal leases. The fee will significantly increase the cost of developing on federal lands, making less capital available for producing American energy and creating jobs. The situation has become even worse with the additional delays imposed on companies by Interior under Secretary Salazar.
- The DOI IG report, which resulted from a Government Accountability Office October 2008 study recommending that DOI conduct further analysis, already addressed why punitive fees on non-producing acreage will do nothing to enhance production.
 - The report 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, 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 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.

² *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.

Royalty Rate Increase

- The President's budget calls for rule making to increase the onshore royalty rate for natural gas and oil. Currently set at 12.5%, the rate provides an excellent return to taxpayers.
- Administration officials often compare the federal rate to states such as Texas which have a higher royalty rate in some instances. The comparison does not take into account the fact that these states have a regulatory and permitting environment that otherwise encourages production. For example, permitting is done within an average of nineteen days in Texas, versus several months, and in some cases over a year for federal permits. Environmental analyses that take several years and cost hundreds of thousands if not millions of dollars on federal lands are not required by these states. Increasing the royalty rate for federal lands, which are already extremely expensive to develop because of the regulatory burden, would become prohibitively expensive with a higher royalty rate.
- Comparison of the onshore rate to offshore royalty rates is also misleading. The reserves found on onshore federal lands are significantly different from the conventional reserves found offshore, such as in the Gulf of Mexico. Unconventional reserves found on public lands in the Intermountain West are less productive and more expensive to develop, and the onshore 12.5% royalty rate reflects that difference. Producers assume 100% of the risk and expense for developing these unconventional resources with no guarantee of any return on investment whatsoever, while providing a huge rate of return to the taxpayer.

Application for Permit to Drill (APD) Fees

- The APD fee was first enacted just two years ago during a closed-door attempt to plug holes in the last administration's budget. Until then, it was understood that industry already more than paid for permits.
- Congress increased the APD fee for FY2010 from \$4,000 to \$6,500 in order to offset a lower funding appropriation for the BLM Natural Gas and Oil Management Program. This 62% tax increase was arbitrary, given that companies already more than pay for the administrative processing of APDs, as well as more than 46 times the cost of the entire onshore program.
- BLM collects the APD fee regardless of whether or not the permit is issued. The money goes into the general treasury, and is not applied to more efficient processing or to on-the-ground environmental protection at the field office where it is collected.
- BLM collecting an APD fee is akin to the IRS charging individual taxpayers a large fee for filing their income tax returns.
- The fee is especially egregious given BLM's slow APD processing times. While obtaining an approved APD on a federal lease has always been a long, time-consuming and expensive process, recent additional bureaucratic delays have resulted in particularly slow permitting times. Many permits take over a year to process, despite a specific 30 day deadline mandated by Congress in the Energy Policy Act of 2005. The long delays in obtaining permits, combined with the fee, further increase the expense of developing American energy on public lands.