Institute for Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

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Comments to Royalty Policy Committee, Department of the Interior

The Institute for Policy Integrity at New York University School of Law[1] respectfully submits these comments to the Department of the Interior's Royalty Policy Committee (RPC). Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

The Department of the Interior is required to earn "fair market value" for the use and development of federal natural resources. How royalties are set and assessed is critical to ensuring receipt of fair market value for the public. We write to make the following comments:

- Interior should not lower the offshore royalty rate, which was raised during the George W. Bush administration and is necessary to ensure fair market value for the public's resources;
- Interior should end area-wide leasing, which has led to record-low bids and little to no competition for offshore tracts, breaking with fair market value and competitive leasing requirements;
- Interior should increase federal fossil fuel royalty rates, as multiple studies show that higher royalty rates will increase total revenue for the public;
- Interior should adjust royalty rates upward for coal, oil, and natural gas leases to recoup some of the environmental and social costs of production; and
- Interior must recognize that fossil fuel development is only one statutory purpose of our public lands that must be balanced with other, equally important uses, including preservation, recreation, and renewable energy development.

Each of these recommendations and comments are discussed in turn.

[1] No part of this document purports to present New York University School of Law's views, if any.

I. Interior should not lower the offshore royalty rate, which was raised during the George W. Bush administration and is necessary to ensure fair market value for the public's resources.

The Committee's meeting materials indicates that it is considering lowering the current 18.75 percent royalty rate for deepwater offshore oil and gas leases to 12.5 percent. This would be an irresponsible change that would deliver an unjustified windfall to private industry at the expense of the public, in violation of the Outer Continental Shelf Lands Act (OCSLA)'s fair market value requirement.

The deepwater offshore royalty rate was raised from 12.5 percent to 18.75 percent during the George W. Bush administration.[2] At the time, Interior estimated that the rate increase would raise revenue by $8.8 billion over the next 30 years.[3] Interior increased the rate in response to technological improvements that made exploration and production more efficient, increased oil and gas prices, and strong interest in offshore leases. A former Secretary of the Interior stated that increasing the offshore rate was necessary to ensure that "the American taxpayer is getting a fair return for the oil and gas that the American people own."[4]

This is a bipartisan issue. Interior has a duty to ensure a fair return to the public for its public lands and resources, and to balance fossil fuel production with conservation, pursuant to OCSLA.[5] Interior has stated that "fair market value" is not only the market value of the oil or gas eventually discovered or produced, but the value of the right to explore and, if there is a discovery, to develop and produce the energy resource.[6] OCSLA itself states that "Leasing activities shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government."[7]

The Committee does not have any rational basis for lowering the royalty rate for offshore leases. Indeed, all available evidence points to the opposite conclusion: lowering the

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[2] *See* CONG. RES. SERV., OUTER CONTINENTAL SHELF: DEBATE OVER OIL AND GAS LEASING AND REVENUE SHARING at CRS-2 (2008), http://www.au.af.mil/au/awc/awcgate/crs/rl33493.pdf; U.S. Bureau of Ocean and Energy Mgmt., Proposed Final Outer Continental Shelf Oil & Gas Leasing Program 2012-2017 96 (2012), https://perma.cc/NTZ6-HRBQ.
[3] Government Accountability Office, OIL AND GAS ROYALTIES: THE FEDERAL SYSTEM FOR COLLECTING OIL AND GAS REVENUES NEEDS COMPREHENSIVE REASSESSMENT 17 (Sept. 2008), https://www.gao.gov/assets/280/279991.pdf.
[4] Hon. Ken Salazar, Secretary of the Interior, "Interior, Environment, and Related Agencies Appropriations for 2013," Testimony before the House Committee on Appropriations, Subcommittee on Interior, Environment, and Related Agencies (Feb. 16, 2012), pp. 46–47, http://www.gpo.gov/fdsys/pkg/CHRG-112hhrg74739/pdf/CHRG-112hhrg74739.pdf ("The underlying principle is we are mandated by statute, mandated by fairness to make sure the American taxpayer is getting a fair return for the assets the American people own.").
[5] 43 U.S.C. § 1344(a)(3)-(4).
[6] Government Accountability Office, OIL AND GAS ROYALTIES, *supra* note 3.
[7] 43 U.S.C. § 1344(a)(4).

royalty rate would lead to less total revenue for the public's natural resources, while *raising* it would *increase* total revenue.[8]

Interior should also eliminate royalty rate reductions and royalty relief that hinders receipt of fair market value. Interior should not be in the business of subsidizing uneconomical drilling or mining. Public resources belong to all taxpayers, not to private developers.

II. Interior should end area-wide leasing, which has ushered in record-low bids and little to no competition for offshore leases, violating its mandates to earn "fair market value" and hold competitive auctions.

Instead of offering more or larger offshore areas open for bidding, which is contemplated in Interior's draft proposed program for 2019-2024 and this Committee's meeting agenda, Interior should offer fewer tracts for lease and end its practice of "area wide leasing," in order to hold competitive auctions and ensure receipt of fair market value, both of which are required by OCSLA.

Interior leaves a staggering sum of money that belongs to the public on the table by holding uncompetitive fossil fuel leasing auctions. As just one example, in Interior's last offshore lease sale, held in August 2017, more than 90 percent of tracts had only one bidder.[9] In one of the rare instances where there were two bidders for a tract, one company bid $3.5 million and the second, winning company bid more than triple that amount—$12.1 million.[10]

Unfortunately for the public, the August 2017 auction was not unique. Interior has held uncompetitive offshore lease sales ever since the agency adopted "area wide leasing" in 1983. Adjusted for inflation, the average price paid per offshore tract since 1983 has declined from $9,068 to $391 per acre in each Gulf of Mexico auction—a decline of 95.7 percent.[11] The Project on Government Oversight's analysis shows the American people have lost tens of billions of dollars in revenue over the last three decades because of area wide leasing and Interior's failure to reject inadequately low bids.[12]

Interior's Bureau of Ocean Energy Management (BOEM), which manages offshore drilling, has even acknowledged that some bidders have received windfalls due to its own methodological shortcomings, stating, "[I]n some cases BOEM issued leases where it

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[8] *See* Part III, *infra*.
[9] https://www.usnews.com/opinion/economic-intelligence/articles/2018-01-10/oil-wins-american-coast-and-people-lose-under-offshore-drilling-expansion.
[10] Bureau of Ocean Energy Management, Oil and Gas Lease Sale 249, Preliminary Bid Recap, Gulfwide Lease Sale (August 16, 2017) at 16, https://www.boem.gov/Sale-249-Preliminary-Bid-Recap-by-Area-and-Block-for-All-Bids/.
[11] Project on Government Oversight, Drilling Down: Big Oil's Bidding (Feb. 22, 2018), http://www.pogo.org/our-work/articles/2018/drilling-down-big-oils-bidding.html.
[12] Project on Government Oversight, Press Release: Offshore Giveaway to Big Oil Cheats Taxpayers out of Billions (Feb. 22, 2018), http://www.pogo.org/about/press-room/releases/2018/press-release-offshore-giveaway-to-big-oil-cheats-taxpayers-out-of-bilions.html.

estimated the block [lease tract] values to be negative, the blocks were issued for near minimum bid, and the lessees made discoveries of substantial size."[13]

Interior's systematic failure to hold competitive auctions violates its statutory mandates to hold competitive auctions[14] and to earn fair market value for the use of public lands and resources[15] Taking actions that will further exacerbate these issues runs counter to legal requirements.

III. Interior should increase federal fossil fuel royalty rates, as multiple studies show that higher royalty rates will increase total revenue for the public.

Several reports by the U.S. Government Accountability Office ("GAO") have concluded that raising federal royalty rates for federal oil, gas, and coal resources would substantially *increase* total federal revenue. Interior must consider policies that will increase the public's fair share, as revenue from leasing supports public schools, community infrastructure, municipal budgets, and environmental protection.

As recently as July 2017, GAO reported that "state oil and gas rates tend to be higher than federal royalty rates," and that raising federal fossil fuel royalty rates would *increase total revenue* for the federal government and the states with which it shares that revenue.[16]

One of the studies that GAO reviewed estimated that raising the federal royalty rate for onshore oil and gas to 16.67 percent, 18.75 percent, or 22.5 percent could increase net federal revenue by $125 million to $939 million over 25 years. The Congressional Budget Office estimated that if the royalty rate for onshore oil and gas parcels were raised from 12.5 percent to 18.75 percent, net federal revenue would increase by $200 million over the first 10 years, and potentially by much more over the following decade.[17] And for federal coal, GAO found that raising the royalty rate to 17 percent or 29 percent could increase federal revenue by up to $365 million per year after 2025.[18]

In addition, the White House Council for Economic Advisors ("CEA"), found that maximizing federal revenue from federal coal leasing would require royalty rates of 304 percent (equal to approximately a $30 per short ton royalty charge on Powder River Basin

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[13] Bureau of Ocean Energy Management, https://www.boem.gov/2017-2022-OCS-Oil-and-Gas-Leasing-PFP/.
[14] *See* 43 U.S.C § 1337(a)(1).
[15] *See* 43 U.S.C. § 1344(a)(4).
[16] U.S. GOVT. ACCOUNTABILITY OFFICE, GAO-17-540, OIL, GAS, AND COAL ROYALTIES (2017) at 1, 16, https://www.gao.gov/assets/690/685335.pdf.
[17] *Id*. at 22 (citing Congressional Budget Office (CBO), Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands (Washington, D.C.: April 2016), https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51421-oil_and_gas_options-OneCol-3.pdf).
[18] *Id*. at 1.

coal), which would limit some future federal coal production while still increasing total revenue by $2.7 to $3.1 billion when fully phased in by 2025.[19]

Further, analysis by the Institute for Policy Integrity at NYU School of Law found that increasing the federal royalty rate to 18.7% for Powder River Basin coal would have earned up to $1.2 billion in additional royalty revenue over the five years between 2011 and 2015.[20]

Officials from Texas and Colorado interviewed by GAO noted that the history of increasing royalty rates for oil and gas production on state lands suggests that increasing the federal royalty rate would not have a clear impact on production. In particular, officials from Colorado and Texas said that they raised their state royalty rates for oil and gas (to 20 and 25 percent, respectively) without any significant effect on production on state lands.[21] One study that GAO reviewed found that onshore oil and gas production could decrease by less than 2 percent per year if royalty rates increased from their current 12.5 percent to 22.5 percent, based on fiscal year 2016 production data. Another study stated the effect on production could be "negligible" over 10 years if royalty rates increased to 18.75 percent.[22]

The studies cited here show that lowering royalty rates would only take away from the public's fair share. Instead, the Committee should be considering raising royalty rates for fossil fuel resources in order to earn *more revenue* for the federal government, states, and local communities. The Royalty Policy Committee is tasked with ensuring the public's receipt of fair market value for the use and development of public lands and resources.[23] We urge the Committee to follow its own charter which identifies its core objective as: "to ensure the public receives the full value of the natural resources produced from Federal lands."[24]

IV. Interior should adjust royalty rates upward for coal, oil, and natural gas leases to recoup some of the environmental and social costs of production.

Fossil fuel leasing is not all upside. There are real costs—including climate change costs—that should be taken into consideration in managing these programs to earn fair market value and protect environmental values.

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[19] THE WHITE HOUSE, OFFICE OF THE PRESIDENT, THE ECONOMICS OF COAL LEASING ON FEDERAL LANDS: ENSURING A FAIR RETURN TO TAXPAYERS (2016) at 3, 4, 25, https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160622_cea_coal_leasing.pdf%22%22.

[20] *See* Jayni Foley Hein and Peter Howard, *Illuminating the Hidden Costs of Coal*, INSTITUTE FOR POLICY INTEGRITY, NYU School of Law (Dec. 2015), http://policyintegrity.org/files/publications/Hidden_Costs_of_Coal.pdf.

[21] *Id*. at 21-22.

[22] U.S. GOVT. ACCOUNTABILITY OFFICE, GAO-17-540, OIL, GAS, AND COAL ROYALTIES (2017) at 1, 16, https://www.gao.gov/assets/690/685335.pdf.

[23] Of course, the complete absence of any public interest or conversation organization on the Committee itself is highly problematic.

[24] Interior, Royalty Policy Committee Charter, https://www.doi.gov/sites/doi.gov/files/uploads/2017_charter_royalty_policy_committee.pdf.

The federal government, states, and tribes bear many of these costs directly, through fighting wildfires on public lands and dealing with the effects of reduced snowpack that threaten water resources. As just one example, climate change has led to fire seasons that are now on average 78 days longer than in 1970, and an increasing portion of the U.S. Forest Service budget is directed to fighting wildfires on public lands.[25]

Current royalty rates are inefficiently low because they do not account for environmental and social impacts. Interior can and should price environmental externality costs into royalty rates using metrics like the Social Cost of Carbon and the Social Cost of Methane.[26] By raising royalty rates to include these externality costs, the Secretary can better fulfill his or her statutory mandate to balance environmental values and development, and ensure fair market value for the lands leased.[27]

V. Interior must recognize that fossil fuel development should be balanced with other, equally important uses of our public lands, including preservation, recreation, and renewable energy development.

Pursuant to both the Federal Land Policy and Management Act ("FLPMA") and OCSLA, fossil fuel development is only one of a suite of possible uses for our public lands. Natural resources fiscal policy—including royalty rates—directly affects how our public lands and resources are developed, including resulting resource consumption, revenue, and environmental effects. Therefore, when providing recommendations on royalties and other fiscal components of our public lands, this Committee must consider the "multiple use" mandate that Congress established.

FLPMA requires agencies to manage public lands in accordance with the "principles of multiple use and sustained yield." The Act defines "multiple use" as:

> [T]he management of the public lands and their various resource values so that they are utilized in the combination that will best meet *the present and future needs of the American people*; . . . the *use of some land for less than all of the resources*; a combination of balanced and diverse resource uses that takes into account the *long-term needs of future generations* for *renewable and nonrenewable resources*, including, but not limited to, recreation, range, timber, minerals, watershed, wildlife and fish, and natural scenic, scientific and historical values.[28]

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[25] U.S. DEP'T OF AGRICULTURE, THE RISING COST OF WILDFIRE OPERATIONS: EFFECTS ON THE FOREST SERVICE'S NON-FIRE WORK (2015), https://www.fs.fed.us/sites/default/files/2015-Fire-Budget-Report.pdf.
[26] Jayni Foley Hein, *Federal Lands and Fossil Fuels: Maximizing Social Welfare in Federal Energy Leasing*, 42 HARV. ENVTL. L. REV. __ (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2919094.
[27] *See id.; see also* Jayni Foley Hein & Caroline Cecot, *Mineral Royalties: Historical Uses and Justifications* (August 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2919094.
[28] 43 U.S.C. § 1702(c) (emphasis added).

"Multiple use" also refers to the "harmonious and coordinated management of the various resources *without permanent impairment of the productivity of the land and the quality of the environment* with consideration being given to the relative values of the resources and *not necessarily to the combination of uses that will give the greatest economic return or the greatest unit output*."[29]

Managing and planning for multiple use and sustained yield means that there must be a significant portion of public lands devoted to conservation in order to sustain public resources—particularly for the "present and future" needs of the American people. Fossil fuel development is only one use of our public lands that must be balanced with other multiple uses and considered on equal footing.

Similarly, Section 18 of OCSLA directs that management of the Outer Continental Shelf be "conducted in a manner which considers economic, social, and environmental values of the renewable and nonrenewable resources contained in the outer continental shelf, and the potential impact of oil and gas exploration on other resource values of the outer continental shelf and the marine, coastal, and human environments."[30] Congress also directed the Secretary of the Interior to "select the timing and location of leasing, to the maximum extent practicable, so as to obtain a proper balance between the potential for environmental damage, the potential for the discovery of oil and gas, and the potential for adverse impact on the coastal zone."[31]

Thus far, this administration appears intent on carrying out a willfully blind "energy dominance" strategy that strongly preferences fossil fuel development over other compelling uses, such as preservation and renewable energy production. This strategy may enrich a small number of fossil fuel industry executives, but it will leave our children and grandchildren with scarred landscapes and a costly, intractable climate change problem. This Committee must consider the multiple use mandate of FLPMA, as well as OCSLA's required balancing as it continues to examine federal fiscal policy for natural resources.

Sincerely,

Jayni Foley Hein

Policy Director
Institute for Policy Integrity
NYU School of Law

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[29] *Id*.
[30] 43 U.S.C. § 1344(a)(1).
[31] 43 U.S.C. § 1344(a)(3).