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New Interior Department Rule Proposes Increase in Cost to Acquire and Maintain Federal Oil and Gas Leases

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In the spring, the federal government will be issuing a new rule aimed at modernizing federal oil and gas leasing regulations. In July, the Department of Interior, Bureau of Land Management (BLM) proposed a new rule, designed to update the fiscal terms of existing oil and gas leasing regulations to reflect provisions of recently enacted federal legislation, the Inflation Reduction Act and Infrastructure Investment and Jobs Act. See Fluid Mineral Leases and Leasing Process, 88 Fed. Reg. 47,562 (proposed July 24, 2023). These regulations, located at 43 C.F.R. pt. 3000 and 3100 et seq., have not been significantly modified since 1988, and this new rule comes amid increased scrutiny over whether existing regulations are outdated and no longer protective of the federal government's fiscal interests.

Under the Federal Land Policy Management Act, BLM is responsible for managing approximately 245 million acres of federal public land and 700 million acres of subsurface federal minerals. Within this responsibility, BLM administers the federal onshore oil and gas leasing program. The fiscal terms of oil and gas

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Thomas Tyrell, left, and Charles Dennen, right, of Archer & Greiner.

leases are set out in the federal Mineral Leasing Act, which establishes the specific costs for acquiring and maintaining a lease. These costs include application fees, minimum bids, rental and royalty rates, and a minimum bond amount. Minimum bids are used to facilitate competitive lease sales, where lands will be leased to the highest bidder. During each lease, the lessee will pay an annual rent per acre until the land begins producing oil and gas, at which point the lessee will pay a royalty rate of the value of the oil and gas produced. Bonds are put up by a lessee prior to performing work on the land to protect the federal government

in the event the lessee does not reclaim the land after its operations cease. This monetary amount will then be used by the federal government to restore the leased lands. There are currently four types of bonds that exist—individual lease, statewide, nationwide and unit operator.

BLM has been under increased pressure to update the fiscal terms of oil and gas leases for many years. Under the current regulations, minimum bids and rental rates have not increased in 30 years, bond rates have not increased in 50 years, and royalty rates have never increased since the Mineral Leasing Act was passed in 1920. These federal rates are now significantly lower than what states charge for leases on state-owned land. As a result of these fiscal terms remaining static for decades, the federal government has concluded that the oil and gas leasing program no longer provides a fair return and increases the risk of environmental liability falling to the government when a lessee does not perform its required reclamation obligations.

Moreover, current regulations have led to an inefficient use of federal lands, where leased lands have not been developed to maximum capability. Of the 26 million onshore acres under federal leases, nearly 13.9 million (53%) are not producing oil and gas. BLM seeks to fix these issues by significantly increasing the costs associated with acquiring an oil and gas lease and establishing new criteria to determine whether to lease certain land, focused on identifying lands with high production potential.

First, the proposed rule intends to increase the administrative costs of obtaining a lease, while creating a new administrative fee called an "expression of interest" (EOI) fee. An EOI is an informal nomination by the public of specific land to be included in the oil and gas leasing program. The new fee will be a $5 per acre filing fee at the time an EOI is filed.

The rule also plans to increase minimum bids and rental rates for all new leases issued in the next 10 years. The minimum bid amount will increase from $2 per acre to $10 per acre. Rent will increase from $1.50 per acre for the first five years and $2 thereafter to $3 per acre for years one to two; $5 per acre for years three to eight; and $15 per acre thereafter.

Additionally, royalty rates and minimum bond amounts will significantly increase. Royalty rates for new leases will increase from 12.5% to 16.67%. Beginning on Aug. 16, 2032, 16.67% will be the minimum royalty rate from that point forward. The minimum for individual bond amounts will increase from $10,000 to $150,000, while the minimum for statewide bonds will increase from $25,000 to $500,000. Under the rule, nationwide and unit operator bonds will be eliminated altogether.

By increasing the cost of acquiring and maintaining a lease, BLM intends to start receiving a fair return on its leases. The current costs, which have not been adjusted for decades of inflation, arguably do not adequately compensate the federal government for the value of oil and gas leases. It was previously reported that the federal government lost up to $12.4 billion in revenue from oil and gas drilling on federal lands from 2010-2019 merely because royalty rates were too low. The rule seeks to combat this issue through substantial increases in cost.

This increase in costs combined with higher bond amounts is also intended to help shield the federal government from having to use federal funds on reclamation-related costs in the event a lessee can no longer pay to restore the land after its operations cease. Under existing regulations, the money generated from a

lease does not even cover the price of reclaiming a well. The proposed rule will give BLM significantly more money to pay to restore the land from abandoned leases. Additionally, substantially higher bonds have the potential to rid the leasing program of bad actors who choose not to reclaim the land after the work is completed. These parties will now lose 15 to 20 times more bond money. BLM argues that these changes will prevent reclamation-related costs from eventually having to be paid by taxpayers once federal funds eventually run out. However, the recently enacted Bipartisan Infrastructure Law has set aside $4.7 billion to help restore idled wells left on these abandoned leases. Therefore, it would likely take some time before these costs ever fell to the American public.

The petroleum industry has opposed these increases in cost and argued that they will disproportionately harm small lessees. Significant increases in cost combined with new additional costs could lead to existing lessees no longer being able to operate their leases, as well as a decline in potential lessees willing to bid for new federal leases. It is the industry's belief that this will result in a waste of federal resources.

Finally, under the proposed rule, BLM must use new criteria when determining whether to lease land nominated through an EOI. BLM must consider the following factors when making this determination: the proximity to already existing oil and gas development; the presence of important fish and wildlife habitats; the presence of historical and sacred properties; the presence of recreation and other important uses; and the potential for oil and gas development. These new considerations work to encourage leasing on lands with a high potential for production, while steering new leases away from lands previously undeveloped and better suited for different uses.

By making BLM assess the area surrounding the leased lands, as well as the actual production potential of the land, the rule is intended to allow a more efficient use of oil and gas leases, where the vast majority of leases will be producing. Lands with low potential for production can then be used for a more suitable purpose, such as recreation or wildlife preservation. This can then lead to fewer idled wells, which can ultimately result in less harm to the environment and less financial liability to the federal government.

The petroleum industry views the new "preference criteria" differently and believes it has the ability to suppress new domestic oil and gas production. It argues that placing an emphasis on land with existing development will eliminate expansion into newly discovered producing areas and constrain future oil and gas development to areas where it already exists.

The 60-day comment period for the rule ended on Sept. 22, 2023. The BLM is currently analyzing the comments received and is expected to issue a final rule in the coming months.

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