



## Reforming Offshore Oil and Gas Royalty Procedures

### The Problem

**Oil and gas companies are failing to pay their fair share for fossil fuels extracted from publicly owned lands, and the federal government is letting them off the hook.** The Department of the Interior’s Bureau of Ocean Energy Management (BOEM) periodically holds auctions where companies can bid on leases for tracts on the seafloor and the rights to explore or drill for underlying oil or gas deposits. Because these tracts are owned by the public, the government is required to ensure the taxpayer receives “fair market value” for natural resources extracted by private industry on site.<sup>1</sup> Part of this fair market value is generated by collecting royalties on the sale of oil and gas produced from the leases. The bureau has the discretion to set royalty rates for offshore oil and gas drilling based on market conditions, or alternatively reduce or waive royalties altogether in an effort to increase production. However, the bureau’s archaic processes for determining what these royalty rates should be, as well as the conditions in which a reduction or waiver is necessary, have already cost taxpayers billions in forgone royalties.<sup>2</sup>

Additionally, the bureau has continued to systematically lower its original valuation for tracts in order to accept intentionally lowball bids from the industry, despite evidence that deferring the award to a later date will often result in a higher bid for the same tract.<sup>3</sup> Also, the bureau methodically predicts unreasonable depreciation in tract value over time, which effectively greenlights the bureau to award tracts to substandard bids as long as they are lower than present market value but higher than predicted market value. Both practices line the pockets of oil and gas companies and have together denied taxpayers an estimated \$1.4 billion in potential revenue.<sup>4</sup>

### The Solution

To ensure that taxpayers receive fair market value for private companies’ use of publicly owned lands, Congress needs to impose greater transparency requirements on the bureau and engage in a broader effort to hold the Department of the Interior accountable for its deference to industry priorities over its legal obligations to taxpayers.

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<sup>1</sup> 43 U.S.C. § 1344(a)(4) (2020), <https://www.law.cornell.edu/uscode/text/43/1344>.

<sup>2</sup> Government Accountability Office, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, GAO-19-531 (September 2019), 18, <https://www.gao.gov/assets/710/702062.pdf>.

<sup>3</sup> GAO, *Opportunities Exist to Better Ensure a Fair Return on Federal Resources*, 28 [see note 2].

<sup>4</sup> Letter from POGO Policy Analyst Tim Stretton to the Department of the Interior’s Office of Natural Resources Revenue urging the department to withdraw a rule that would benefit the oil industry over taxpayers, November 25, 2020, <https://www.pogo.org/letter/2020/11/pogo-urges-royalties-agency-to-withdraw-rule-that-would-benefit-oil-industry-over-taxpayers/>.

Congress can achieve this goal by taking the following steps:

- **Require the Bureau of Ocean Energy Management to disclose accepted bids when it has to lower the initial lease value retroactively.** The bureau consistently assigns tracts lower value than companies do, even though these supposedly non-viable tracts consistently go on to produce oil and gas. This means that the federal government is leaving taxpayer money on the table. Congress should scrutinize the bureau's model for evaluating how to assign a tract value.
- **Require an independent assessment into the bureau's internal tract valuation system.** Currently, the bureau is permitted to award offshore leases to oil and gas companies if a bid is lower than current market value but higher than the bureau's estimated predicted market value. Troublingly, the bureau systematically undervalues projected market value, which leads the government to selling leases to oil and gas companies for far less than they're worth. It is unclear how the bureau arrives at these estimates for projected market value. Congress should require an independent third party to analyze whether the current model for calculating long-term value for a lease actually delivers to taxpayers what they are owed in royalties revenue. This report should be made publicly available.
- **Hold targeted, not area-wide, auctions.** The bureau should stop holding area-wide auctions, which open up entire regions of the seafloor for lease as opposed to only a select portion. Area-wide leasing often results in less head-to-head bidding between companies, and therefore ultimately generates less revenue that is returned to the taxpayer. Instead, the bureau should hold targeted auctions, which promote healthy and competitive bidding between companies and are more likely to secure fair market value from a lease.

## Additional Context

[Drilling Down: Big Oil's Bidding](#)

[POGO Calls for Congressional Action to Reform Onshore and Offshore Royalty Systems](#)

[Royalty Relief Procedures Cost Taxpayers Tens of Billions](#)

[POGO Urges Royalties Agency to Withdraw Rule that Would Benefit Oil Industry over Taxpayers](#)

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