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OIL AND GAS LEASING

Past Work Identifies Numerous Challenges with Interior's Oversight

Statement of Frank Rusco, Director
Natural Resources and Environment



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Highlights of [GAO-11-487T](#), a testimony before the Committee on Natural Resources, House of Representatives

Why GAO Did This Study

The Department of the Interior oversees oil and gas activities on leased federal lands and waters. Revenue generated from federal oil and gas production is one of the largest nontax sources of federal government funds, accounting for about \$9 billion in fiscal year 2009. For onshore leases, Interior's Bureau of Land Management (BLM) has oversight responsibilities. For offshore leases, the newly created Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE), has oversight responsibilities. Prior to BOEMRE, the Minerals Management Service's (MMS) Offshore Energy and Minerals Management Office oversaw offshore oil and gas activities, while MMS's Minerals Revenue Management Office collected revenues from all oil and gas produced on federal leases.

Over the past several years, GAO has issued numerous recommendations to the Secretary of the Interior to improve the agency's management of oil and gas resources. In 2011, GAO identified Interior's management of oil and gas resources as a high risk issue. GAO's work in this area identified challenges in five areas: (1) reorganization, (2) balancing responsibilities, (3) human capital, (4) revenue collection, and (5) development of existing leases.

View [GAO-11-487T](#) or key components. For more information, contact Frank Rusco at (202) 512-3841, or ruscof@gao.gov

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What GAO Found

Reorganization: Interior's reorganization of activities previously overseen by MMS will require time and resources and may pose new challenges. Interior began a reorganization in May 2010 that will divide MMS into three separate bureaus—one focusing on revenue collection, another on leasing and environmental reviews, and yet another on permitting and inspections. While this reorganization may eventually lead to more effective operations, GAO has reported that organizational transformations are not simple endeavors. GAO is concerned with Interior's ability to undertake this reorganization while meeting its revenue collection and oil and gas oversight responsibilities.

Balancing Responsibilities: GAO has reported that Interior has experienced several challenges with meeting its responsibilities for providing for the development of oil and gas resources while managing public lands for other uses, including wildlife habitat. In January 2010, GAO reported that, while BLM requires oil and gas operators to reclaim the land they disturb and post a bond to help ensure they do so, not all operators perform reclamation. For fiscal years 1988 through 2009, BLM spent about \$3.8 million to reclaim 295 so-called "orphaned" wells—because reclamation had not been done, and other resources, including the bond, were insufficient to pay for it.

Human Capital: GAO has reported that BLM and MMS have encountered persistent problems in hiring, training, and retaining sufficient staff to meet their oversight and management responsibilities for oil and gas operations. For example, in March 2010, GAO reported that BLM and MMS experienced high turnover rates in key oil and gas inspection and engineering positions responsible for production verification activities. As a result, Interior faces challenges meeting its responsibilities to oversee oil and gas development on federal leases, potentially placing both the environment and royalties at risk.

Revenue Collection: While federal oil and gas resources generate billions of dollars in annual revenues, past GAO work has found that Interior may not be properly assessing and collecting these revenues. In September 2008, GAO reported that Interior collected lower levels of revenues for oil and gas production in the deep water of the U.S. Gulf of Mexico than all but 11 of 104 oil and gas resource owners whose revenue collection systems were evaluated in a comprehensive industry study. Nonetheless, Interior has not completed a comprehensive assessment of its revenue collection policies and processes in over 25 years. Additionally, in March 2010, GAO reported that Interior was not consistently completing inspections to verify volumes of oil and gas produced from federal leases.

Development of Existing Leases: In October 2008, GAO reported that Interior could do more to encourage the development of existing oil and gas leases. Federal leases contain one provision—increasing rental rates over time for offshore 5-year leases and onshore leases—to encourage development. In addition to escalating rental rates, states undertake additional efforts to encourage lessees to develop oil and gas leases more quickly, including shorter lease terms and graduated royalty rates.

Chairman Hastings, Ranking Member Markey, and Members of the Committee:

We appreciate the opportunity to participate in this hearing to discuss domestic oil and gas production in light of rising gas prices and the country's continued employment challenges. American families, communities, and businesses all depend on reliable and affordable energy for their health, safety, and livelihoods. Energy—including oil and gas—is crucial to many aspects of peoples' daily lives, including transportation, communication, food production, medical services, and heating and air-conditioning. Since December 2010, oil prices have been increasing, topping \$100 per barrel in recent weeks. The most recent spike in oil prices has been attributed to political unrest in the Middle East—a major exporter of oil. In part because the United States currently imports approximately 51 percent of its oil each year for domestic consumption, many have called for increasing domestic production of oil and gas, including from resources located on leased federal lands and waters. Currently, oil produced from federal offshore leases accounts for approximately 30 percent of all domestic production, while oil produced from federal onshore leases accounts for approximately 6 percent. Oil and gas produced from federal leases is also an important source of revenue for the federal government. In fiscal year 2009, the federal government collected more than \$9 billion in revenues from oil and gas produced from federal lands and waters, purchase bids for new oil and gas leases, and annual rents on existing leases. This makes revenues from federal oil and gas one of the largest nontax sources of federal government funds.

The U.S. Department of the Interior plays an important role in managing and providing oversight of federal oil and gas resources. The explosion onboard the Deepwater Horizon drilling rig and subsequent fire and catastrophic oil spill in the Gulf of Mexico in April 2010 further emphasized the importance of Interior's management of permitting and inspection processes to ensure operational and environmental safety. Under its current organizational structure, Interior's bureaus are responsible for regulating the processes that oil and gas companies must follow when leasing, drilling, and producing oil and gas from federal leases. The bureaus are also responsible for ensuring that companies comply with all applicable requirements. Specifically, Interior's Bureau of Land Management (BLM) oversees onshore federal oil and gas activities; the Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE)—created in May 2010—oversees offshore oil and gas activities; and the newly established Office of Natural Resources Revenue (ONRR) is responsible for collecting royalties on oil and gas produced

from both onshore and offshore federal leases. Prior to the creation of BOEMRE, the now-abolished Minerals Management Service's (MMS) was charged with administering offshore federal leases and managing the collection of royalties for onshore and offshore leases; MMS's Offshore Energy and Minerals Management (OEMM) oversaw offshore oil and gas activities, while its Minerals Revenue Management (MRM) was responsible for royalty collections from both onshore and offshore federal leases.

Interior's management of federal oil and gas activities is critically important and has been a focus of a large body of our work that has found numerous weaknesses and challenges that need to be addressed. In response to our recommendations, Interior has taken steps to address material weaknesses and modify its practices for managing oil and gas resources, but as of December 2010, many recommendations remained unimplemented. Accordingly, we designated Interior's management of federal oil and gas resources as a high risk issue in February 2011.¹

In this context, my testimony today discusses findings from our past work on five broad areas: (1) the ongoing reorganization of Interior's bureaus dealing with oil and gas functions, (2) the challenges Interior faces balancing timely and efficient oil and gas development with environmental stewardship responsibilities, (3) Interior's management of human capital, (4) Interior's collection of oil and gas revenues, and (5) Interior's role in the development of existing leases. This statement is based on our extensive body of work on Interior's oil and gas leasing and royalty collection programs issued from September 2008 through February 2011. We conducted the performance audit work that supports this statement in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to produce a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our statement today. Additional information on our scope and methodology is available in each issued product.

¹GAO, *High-Risk Series: An Update*, [GAO-11-278](#) (Washington, D.C.: February 2011).

Potential Challenges with Reorganization of Oil and Gas Functions

Interior's ongoing reorganization of bureaus with oil and gas functions will require time and resources, and undertaking such an endeavor while continuing to meet ongoing responsibilities may pose new challenges. Historically, BLM managed onshore federal oil and gas activities, while MMS managed offshore activities and collected royalties for all leases. In May 2010, the Secretary of the Interior announced plans to reorganize MMS into three separate bureaus. The Secretary stated that dividing MMS's responsibilities among separate bureaus would help ensure that each of the three newly established bureaus have a distinct and independent mission. Interior recently began implementing this restructuring effort, transferring offshore oversight responsibilities to the newly created BOEMRE and revenue collection to ONRR. Interior plans to continue restructuring BOEMRE to establish two additional separate bureaus—the Bureau of Ocean and Energy Management, which will focus on leasing and environmental reviews, and the Bureau of Safety and Environmental Enforcement, which will focus on permitting and inspection functions.

While this reorganization may eventually lead to more effective operations, we have reported that organizational transformations are not simple endeavors and require the concentrated efforts of both leaders and employees to realize intended synergies and accomplish new organizational goals.² In that report, we stated that for effective organizational transformation, top leaders must balance continued delivery of services with transformational activities. Given that, as of December 2010, Interior had not implemented many recommendations we made to address numerous weaknesses and challenges, we are concerned about Interior's ability to undertake this reorganization while (1) providing reasonable assurance that billions of dollars of revenues owed to the public are being properly assessed and collected and (2) maintaining focus on its oil and gas oversight responsibilities.

²GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington, D.C.: July 2, 2003).

Challenges of Balancing Oil and Gas Development with Environmental Stewardship

We have reported that Interior has experienced several challenges in meeting its obligations to make federal oil and gas resources available for leasing and development while simultaneously meeting its responsibilities for managing public lands for other uses, including wildlife habitat, recreation, and wilderness. In January 2010, we reported that while BLM requires oil and gas operators to reclaim the land they disturb and post a bond to help ensure they do so, not all operators perform such reclamation.³ In general, the goal is to plug the well and reclaim the site so that it matches the surrounding natural environment to the extent possible, allowing the land to be used for purposes other than oil and gas production, such as wildlife habitat. If the bond is not sufficient to cover well plugging and surface reclamation, and there are no responsible or liable parties, the well is considered “orphaned,” and BLM uses federal dollars to fund reclamation. For fiscal years 1988 through 2009, BLM spent about \$3.8 million to reclaim 295 orphaned wells, and BLM has identified another 144 wells yet to be reclaimed.

In addition, in a July 2010 report on federal oil and gas lease sale decisions in the Mountain West, we found that the extent to which BLM tracked and made available to the public information related to protests filed during the leasing process varied by state and was generally limited in scope.⁴ We also found that stakeholders—including environmental and hunting interests, and state and local governments protesting BLM lease offerings—wanted additional time to participate in the leasing process and more information from BLM about its leasing decisions. Moreover, we found that BLM had been unable to manage an increased workload associated with public protests and had missed deadlines for issuing leases. In May 2010, the Secretary of the Interior announced several departmentwide leasing reforms that are to take place at BLM that may address these concerns, such as providing additional public review and comment opportunity during the leasing process.

Further, in March 2010, we found that Interior faced challenges in ensuring consistent implementation of environmental requirements, both within and across MMS’s regional offices, leaving it vulnerable with regard to

³GAO, *Oil and Gas Bonds: Bonding Requirements and BLM Expenditures to Reclaim Orphaned Wells*, [GAO-10-245](#) (Washington, D.C.: Jan. 27, 2010).

⁴GAO, *Onshore Oil and Gas: BLM’s Management of Public Protests to Its Lease Sales Needs Improvement*, [GAO-10-670](#) (Washington, D.C.: July 30, 2010).

litigation and allegations of scientific misconduct.⁵ We recommended that Interior develop comprehensive environmental guidance materials for MMS staff. Interior concurred with this recommendation and is currently developing such guidance.

Finally, in September 2009, we reported that BLM's use of categorical exclusions under Section 390 of the Energy Policy Act of 2005—which authorized BLM, for certain oil and gas activities, to approve projects without preparing new environmental analyses that would normally be required in accordance with the National Environmental Policy Act—was frequently out of compliance with the law and BLM's internal guidance.⁶ As a result, we recommended that BLM take steps to improve the implementation of Section 390 categorical exclusions through clarification of its guidance, standardizing decision documents, and increasing oversight.

Human Capital Challenges

We have reported that BLM and MMS have encountered persistent problems in hiring, training, and retaining sufficient staff to meet Interior's oversight and management responsibilities for oil and gas operations on federal lands and waters. For example, in March 2010, we reported that BLM and MMS experienced high turnover rates in key oil and gas inspection and engineering positions responsible for production verification activities.⁷ As a result, Interior faces challenges meeting its responsibilities to oversee oil and gas development on federal leases, potentially placing both the environment and royalties at risk. We made a number of recommendations to address these issues. While Interior's reorganization of MMS includes plans to hire additional staff with expertise in oil and gas inspections and engineering, these plans have not been fully implemented, and it remains unclear whether Interior will be fully successful in hiring, training, and retaining these additional staff. Moreover, the human capital issues we identified with BLM's management

⁵GAO, *Offshore Oil and Gas Development: Additional Guidance Would Help Strengthen the Minerals Management Service's Assessment of Environmental Impacts in the North Aleutian Basin*, [GAO-10-276](#) (Washington, D.C.: Mar. 8, 2010).

⁶GAO, *Energy Policy Act of 2005: Greater Clarity Needed to Address Concerns with Categorical Exclusions for Oil and Gas Development under Section 390 of the Act*, [GAO-09-872](#) (Washington, D.C.: Sept. 16, 2009).

⁷GAO, *Oil and Gas Management: Interior's Oil and Gas Production Verification Efforts Do Not Provide Reasonable Assurance of Accurate Measurement of Production Volumes*, [GAO-10-313](#) (Washington, D.C.: Mar. 15, 2010).

of onshore oil and gas continue, and these issues have not yet been addressed in Interior's reorganization plans.

Concerns over Revenue Collection

Federal oil and gas resources generate billions of dollars annually in revenues that are shared among federal, state, and tribal governments; however, we found Interior may not be properly assessing and collecting these revenues. In September 2008, we reported that Interior collected lower levels of revenues for oil and gas production in the deep water of the U.S. Gulf of Mexico than all but 11 of 104 oil and gas resource owners whose revenue collection systems were evaluated in a comprehensive industry study—these resource owners included other countries as well as some states.⁸ However, despite significant changes in the oil and gas industry over the past several decades, we found that Interior had not systematically re-examined how the U.S. government is compensated for extraction of oil and gas for over 25 years. GAO recommended Interior conduct a comprehensive review of the federal oil and gas system using an independent panel. After Interior initially disagreed with our recommendations, we recommended that Congress consider directing the Secretary of the Interior to convene an independent panel to perform a comprehensive review of the federal system for collecting oil and gas revenue. More recently, in response to our report, Interior has commissioned a study that will include such a reassessment, which, according to officials, the department expects will be complete in 2011. The results of the study may reveal the potential for greater revenues to the federal government.

We also reported in March 2010 that Interior was not taking the steps needed to ensure that oil and gas produced from federal lands was accurately measured.⁹ For example, we found that neither BLM nor MMS had consistently met their agency goals for oil and gas production verification inspections. Without such verification, Interior cannot provide reasonable assurance that the public is collecting its share of revenue from oil and gas development on federal lands and waters. As a result of this work, we identified 19 recommendations for specific improvements to

⁸GAO, *Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment*, [GAO-08-691](#) (Washington, D.C.: Sept. 3, 2008).

⁹GAO, *Oil and Gas Management: Interior's Oil and Gas Production Verification Efforts Do Not Provide Reasonable Assurance of Accurate Measurement of Production Volumes*, [GAO-10-313](#) (Washington, D.C.: Mar. 15, 2010).

oversight of production verification activities. Interior generally agreed with our recommendations and has begun implementing some of them.

Additionally, we reported in October 2010 that Interior's data likely underestimated the amount of natural gas produced on federal leases, because some unquantified amount of gas is released directly to the atmosphere (vented) or is burned (flared).¹⁰ This vented and flared gas contributes to greenhouse gases and represents lost royalties. We recommended that Interior improve its data and address limitations in its regulations and guidance to reduce this lost gas. Interior generally agreed with our recommendations and is taking initial steps to implement these recommendations.

Furthermore, we reported in July 2009 on numerous problems with Interior's efforts to collect data on oil and gas produced on federal lands, including missing data, errors in company-reported data on oil and gas production, and sales data that did not reflect prevailing market prices for oil and gas.¹¹ As a result of Interior's lack of consistent and reliable data on the production and sale of oil and gas from federal lands, Interior could not provide reasonable assurance that it was assessing and collecting the appropriate amount of royalties on this production. We made a number of recommendations to Interior to improve controls on the accuracy and reliability of royalty data. Interior generally agreed with our recommendations and is working to implement many of them, but these efforts are not complete, and it is uncertain at this time if the efforts will fully address our concerns.

Development of Existing Leases

In October 2008, we reported that Interior could do more to encourage the development of existing oil and gas leases.¹² Our review of Interior oil and gas leasing data from 1987 through 2006 found that the number of leases issued had generally increased toward the end of this period, but that

¹⁰GAO, *Federal Oil and Gas Leases: Opportunities Exist to Capture Vented and Flared Natural Gas, Which Would Increase Royalty Payments and Reduce Greenhouse Gases*, [GAO-11-34](#) (Washington, D.C.: Oct. 29, 2010).

¹¹GAO, *Mineral Revenues: MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties*, [GAO-09-549](#) (Washington, D.C.: July 15, 2009).

¹²GAO, *Oil and Gas Leasing: Interior Could Do More to Encourage Diligent Development*, [GAO-09-74](#) (Washington, D.C.: Oct. 3, 2008).

offshore and onshore leasing had followed different historical patterns. Offshore leases issued peaked in 1988 and in 1997, and generally rose from 1999 through 2006. Onshore leases issued peaked in 1988, then rapidly declined until about 1992, and remained at a consistently low level until about 2003, when they began to increase moderately. We also analyzed 55,000 offshore and onshore leases issued from 1987 through 1996 to determine how development occurred on leases that had expired or been extended beyond their primary terms. Our analysis identified three key findings. First, a majority of leases expired without being drilled or reaching production. Second, shorter leases were generally developed more quickly than longer leases but not necessarily at comparable rates. Third, a substantial percentage of leases were drilled after the initial primary term following a lease extension or suspension.

We also compared Interior's efforts to encourage development of federal oil and gas leases to states' and private landowners' efforts. We found that Interior does less to encourage development of federal leases than some states and private landowners. Federal leases contain one provision—increasing rental rates over time for offshore 5-year leases and onshore leases—to encourage development. In addition to using increasing rental rates, some states undertake additional efforts to encourage lessees to develop oil and gas leases more quickly, including shorter lease terms and graduated royalty rates—royalty rates that rise over the life of the lease. In addition, compared to limited federal efforts, some states do more to structure leases to reflect the likelihood of oil and gas production, which may also encourage faster development. Based on the limited information available on private leases, private landowners also use tools similar to states to encourage development.

In conclusion, as concerns rise over the recent increase in oil prices and as demands are made for additional drilling on federal lands and waters, it is important that Interior meet its current oversight responsibilities. Interior is now in the midst of a major reorganization, which makes balancing delivery of services with transformational activities challenging for an organization. Managing this change in a fiscally constrained environment only exacerbates the challenge. If steps are not taken to improve Interior's oversight of oil and gas leasing, we are concerned about the department's ability to manage the nation's oil and gas resources, ensure the safe operation of onshore and offshore leases, provide adequate environmental protection, and provide reasonable assurance that the U.S. government is collecting the revenue to which it is entitled.

Chairman Hastings, Ranking Member Markey, and Members of the Committee, this concludes our prepared statement. We would be pleased to answer any questions that you or other Members of the Committee may have at this time.

Contact and Staff Acknowledgements

For further information on this statement, please contact Frank Rusco at (202) 512-3841 or ruscof@gao.gov. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement. Other staff that made key contributions to this testimony include, Jeffrey Barron, Glenn C. Fischer, Jon Ludwigson, Alison O'Neil, Kiki Theodoropoulos, and Barbara Timmerman.

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