James Schroeder
President and CEO,
Mesa Energy Partners
President, Western Energy Alliance (formerly IPAMS)

Before the
House Natural Resources Committee,
Subcommittee on Energy and Mineral Resources

Testimony on the "Effect of the President's FY2012 Budget and Legislative Proposals for the Bureau of Land Management (BLM) and the U.S. Forest Service's Energy and Minerals Program on Private Sector Job Creation, Domestic Energy and Minerals Production and Deficit Reduction"

April 5, 2011

Mr. Chairman and Members of the Committee—thank you for the opportunity to appear before you. The BLM and Forest Service budgets set the tone for how federal land managers implement their multiple-use mandates and whether they enable the productive use of federal lands, or whether they discourage production of energy that all American citizens own. The fees proposed in the budget on the oil and gas industry would have significant, negative impacts on energy production, jobs and economic development in communities across the West.

Mesa Energy Partners, LLC is a privately held oil and natural gas development and production partnership of seven employees. Mesa is currently developing a six well project on a 74,000 acre government unit on BLM land in the Piceance Basin of Colorado. Independent producers such as Mesa are small businesses, averaging twenty employees, yet this community of companies drills 90% of the wells and produce 82% of America's natural gas.

I have been operating on federal lands, both BLM and National Forests, for 20 plus years, and have conscientiously worked closely with BLM field offices, local forest district offices, regional foresters, state BLM offices and the Washington offices of both agencies. The ever increasing and often over-reaching bureaucratic procedures on public lands have resulted in expensive and inefficient operations when compared to operations on state or private lands. These prolonged procedures ultimately mean that federal lands cannot be developed in a timely manner and as such are not as productive as they might be. These inefficiencies have a negative effect on the federal budget deficit and result in less energy for the American people, fewer jobs, and less economic activity in communities across the West.

Producers provide an extraordinary return on investment to the American taxpayer; in FY 2010, oil and gas companies returned $40.12 for every dollar spent by the government. Over the last two years, policy changes at Interior have added additional layers of analysis and rework of prior decisions that are causing public land energy development to be less efficient and return less revenue to the federal government. Just two years ago, BLM's onshore program returned $46.07 for every dollar spent administering the program. The balance has been tipped too far towards constraining oil and gas development, at the expense of government revenue, jobs and the economy. The justification we often hear that new fees are necessary because industry needs to pay it's fair share rings hollow, when we are already doing so 40 times over.

In order to effectively evaluate budget requirements, it is necessary for any business to perform a "look back" and determine where expenditures and budget allocations have been made in order to effectively allocate capital in the future. I would like to reflect on the fact that the BLM has been put in a position to spend an inordinate amount of its budget dealing with or trying to avoid litigation. We have heard that the BLM may spend nearly half of its resources on litigation and legal reviews.

BLM is constantly harassed by lawsuits from special interest groups with an agenda of preventing any oil and gas development on public lands. DOI's approach to alleviate the situation has been to further slow oil and gas development in order to remove the controversy, but the source of the problem remains – the ease with which financially unaccountable groups can sue. Litigation threatens to reduce the productive use of federal lands and the corresponding jobs and economic growth. Last year alone new regulations and bureaucratic delays prevented $3.9 billion in investment by oil and gas companies and a corresponding 16,200 jobs in the West, according to Western Energy Alliance.

The allocation of funds for litigation needs to be brought under control and managed in a fashion that allows the BLM to make decisions in the best interests of the American people. Congress should pass legislation that prevents the federal government from using tax payer dollars to reimburse special interest groups who abuse the Equal Access to Justice Act to fund their litigation programs, and to hold these groups financially responsible for frivolous lawsuits that prevent this country from delivering economic growth.

Budget Details

<u>Royalty Rate Increase</u>
The budget contains the line "The Administration believes that American taxpayers should get a fair return on the development of energy resources on their public lands" and states that Interior will undertake rulemaking to adjust onshore royalty rates. Yet industry already returns $40.12 for every dollar spent administering the onshore oil and gas program. Interior Secretary Salazar has indicated publicly that Interior is considering applying the 18.75% offshore rate. Currently set at 12.5%, the onshore rate provides an excellent return to taxpayers. Paradoxically, although the offshore rate is higher, it returned just $30.08 for each dollar spent by the government in 2010.

Comparison of the onshore rate to the offshore royalty rate is misleading. The reserves found on onshore federal lands are significantly different from the conventional reserves offshore, such as in the Gulf of Mexico. Unconventional reserves on public lands in the West are less productive and more expensive to develop, and the 12.5% onshore 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.

Administration officials often compare the federal onshore 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 encourages production. For example, permitting is done within an average of nineteen days in Texas, versus 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, could become prohibitively expensive with a higher royalty rate.

Fees

All fees are unnecessary, as industry returns over $40 for each dollar spent administering the entire onshore program, including all permitting, inspection, enforcement, leasing, and environmental costs.

Inspection Fees: The inspection fees seem to be another way for the government to decrease efficiency while removing more capital from the actual production of domestic energy. The inspection fees proposed in BLM's budget would create a huge administrative burden for BLM, which would have to determine which leases meet one of four categories depending on surface disturbance and number of wells, track the data, and invoice operators accordingly. Despite the additional administrative burden, BLM's budget projects a return of $38 million to the federal government. BLM is already trying to do too much with too few people, and coupled with all the other new requirements this Administration has placed on them, would further constrain the onshore oil and gas program. In the end, it is feasible to suggest that the fee would return a lot less than anticipated, even before taking into account the production and economic activity that would be lost capital is shifted away from production and into increased fees.

Non-producing Acreage Fee: The budget proposes a $4 annual non-producing acreage fee. The fee 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 regulatory activities necessary before a well is drilled. Besides being inequitable to charge companies a non-producing fee when, in many cases, the government is the entity holding up production on federal leases, the fee would significantly increase the cost of developing on federal lands, making less capital available for producing American energy and creating jobs. A DOI IG report, *Oil and Gas Production on Federal Leases: No Simple Answer* already addressed how punitive fees on non-producing acreage would de-incentivize industry (*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). That same report found that Interior's systems were so bad, that they could not tell with any certainty whether leases are producing. The IG recommended that those data problems be fixed before the Department could adequately determine ways to encourage diligent development.

APD Fee: The Application for Permit to Drill (APD) fee continues to create problems for my company. We are required to pay a fee for each APD submitted, whether that APD is approved or not. Besides the fact that this is akin to charging taxpayers to file their income taxes, the fee has been particularly inefficient since its enactment in 2008 at $4,000, now at $6,500 and proposed to become permanent in the FY 2012 budget. Since the fee was first enacted, BLM has consistently delivered less service and permitting times have increased significantly, from a few hundred days to over 500 days in many cases. In addition, the permitting process has become more ad hoc, resulting in more Conditions of Approval, surveys and other requirements, many of which are not supported by law and regulations.

James Schroder, President and CEO
Mesa Energy Partners, LLC