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

Re: H.R. 7377, the Royalty Resiliency Act

March 6, 2024

Introduction:

Chairman Stauber, Ranking Member Ocasio-Cortez, and members of the subcommittee:

Thank you for the opportunity to testify in support of H.R. 7377, the Royalty Resiliency Act, which is a positive piece of legislation that benefits industry, the government, and tribes. I commend the Committee on Natural Resources for taking up this important piece of legislation and hope that it will move forward.

My name is Steve Dudgeon, and I am a principal at Ryan, LLC. Ryan is the largest firm in the world focused on providing tax consulting services. With headquarters in Dallas, Texas, we perform tax services in every state and in nearly 70 countries. From the calculation of property taxes at the local level to assisting taxpayers obtain historic tax credits, Ryan provides a wide array of tax services and interacts with various taxing authorities daily. We seek to provide fair answers faster to both the taxpayer and the taxing authority to ensure payments to the government are accurate.

As for me, I am in the severance tax and royalty practice, which is based in Houston. Our practice solely focuses on the calculation of taxes or royalties owed to government for the production of oil and gas. From the Bakken to the deepest waters of the gulf—we have a wide array of clientele—indeed, we estimate Ryan's oil and gas clients account for the majority of production throughout the United States. This provides us with a unique perspective on the state of the industry and on identifying the best practices for the collection of taxes and royalties. It has also provided us firsthand experience with the issues this Act will resolve.

It is with this perspective that I approach my testimony on the Royalty Resiliency Act. I want to thank Representative Hunt for introducing this legislation, which will address a decades-old issue and result in a win-win for the government and the royalty payors.

Communitization Agreements and Current Law:

Under the Mineral Leasing Act, the Secretary of the Department of Interior ("Department") is authorized to approve communitization agreements ("CAs"). CAs allow operators, with the

agreement of the owners of the resources, to pool together Federal, Indian, State, or private oil and gas resources that could not otherwise be independently developed or would have required multiple wells to be drilled. This permits the acreage to be developed in conformity with established well-spacing and development programs in an efficient manner. CAs define both how the oil and gas production will be allocated among the operators and how revenue will be shared between the operators and the various mineral owners. Once a CA is approved, the Office of Natural Resources Revenue ("ONRR") will use the production allocation information from the Bureau of Land Management ("BLM") to distribute royalties to the parties of the CA, including the Federal government, tribal nations and individual Indian oil and gas resource owners.[1] Without an approved CA, however, ONRR is unable to distribute royalties.[2]

In order to approve a CA, the BLM needs the following information:

> (a) The location of the separate tracts comprising the drilling or spacing unit;
> (b) How [the operators] will prorate production or royalties to each separate tract based on total acres involved;
> (c) The name of each tract operator; and
> (d) Provisions for protecting the interests of all parties, including the United States.[3]

This information is easily discernable by the submitting parties of the CA; however, approval of CAs has proven to be a struggle for the Department with instances of these CAs taking well over seven (7) years to be approved. There are currently hundreds of CAs that are pending approval by the BLM.

In 1996, Congress passed the Royalty Simplification and Fairness Act ("RSFA"). One of the goals of that legislation was to address the pending "approval of allocation schedules for participating areas and communitization agreements" as the delayed "approval of [such] request[s] delay[ed] determination of royalty value and result[ed] in costly retroactive adjustments."[4] Accordingly, RSFA required the Secretary to "approve such requests expeditiously"; failure to do so required the Secretary to "waive interest on the obligation from the date the request was received until the request is approved."[5] Specifically, RSFA imposed a 120-day timeframe for the Secretary to approve CAs.

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[1] Updated BLM Policy for Communitization Agreements Will Aid Timely Distribution of Oil and Gas Royalties | Bureau of Land Management, Bureau of Land Management, Press Release (August 19, 2015), https://www.blm.gov/press-release/updated-blm-policy-communitization-agreements-will-aid-timely-distribution-oil-and-gas.
[2] H. Rept. 104-667, at 20.
[3] 43 C.F.R. § 3105.2.
[4] H. Rept. 104-667, at 20.
[5] *Id*.

Despite the intent and direction of RSFA, expeditious approval of CAs has remained elusive. Indeed, in 2014, the U.S. Government Accountability Office ("GAO") found that the Bureau of Land Management's ("BLM") management and oversight of federal and Indian oil and gas resources was hindered, in part, by "BLM delays reviewing communitization agreements."[6] In reviewing data for 61 Indian and federal wells, the GAO noted that the average approval time was 229 days for Indian CAs and 126 days for federal CAs.[7] The GAO continued: "the delay to process communitization agreements . . . resulted in a delay of royalty payments. This is a concern because . . . individual Indian oil and gas resource owners may rely on revenue from oil and gas development to pay for daily expenses such as food, shelter, health, and education."[8] Moreover, these findings echoed a "2006 Royalty Policy Committee report that recommended BLM review annually the status of communitization agreements awaiting field office approval and communitization agreement approval timelines to identify any prioritization, resource allocation, and/or training needs."[9] In response to the GAO report, the BLM issued a "re-engineered communitization agreement approval process" that sought to establish a streamlined process for adjudication and approval of CAs.[10] Unfortunately, even with the re-engineered process, the delays in approving CAs have persisted.

Current Payment Procedures While a CA is Pending:

As the GAO, BLM and ONRR have all recognized, the inability of the BLM to timely process CAs results in untimely royalty distributions to the federal government, tribes, and individual Indian owners; but there is another element: the failure to expeditiously approve CAs results in *overpayments* and *underpayments* in certain circumstances by the operators. In other words, the current system of delays does not benefit anyone.

Functionally though and under existing law, what are operators required to pay? Through Ryan's communications with the BLM on behalf of our clients, we were told to apply the following general rule:

> For a well that is producing federal or Indian minerals (i.e., a federal application for permit to drill was required for the well), 100 percent of the royalty will need to be paid to the first federal or Indian lease penetrated, until such time as the pending CA or participating area (PA) has been approved by an authorized officer.

[6] U.S. Gov't Accountability Off., GAO-14-238, *Oversight of Federal and Indian Resources* 27 (2014).
[7] *Id*. at 36.
[8] *Id*. at 37.
[9] *Id*. at 37 n. 68.
[10] Re-engineered Communitization Agreement Approval Process, Bureau of Land Management, IM 2015-14 (July 17, 2015), https://www.blm.gov/policy/im-2015-124.

> For a well drilled through all fee or state minerals (i.e. no federal application for permit to drill was submitted to the BLM), then 0 percent of the royalty will be paid to the Federal government until such time as the pending CA or PA has been approved by an authorized officer.[11]

In other words, the only determining factor is whether the wellbore physically passes through federal or Indian minerals even though it may or may not be producing federal or Indian minerals. Even if the well is producing 1% federal minerals, the operator of a wellbore that intersects federal minerals must pay royalties to the federal government as if the communitized area was producing 100% federal minerals until the CA is approved; however, if the communitized area is 99% federal ownership, but the wellbore does not intersect with federal minerals, the operator would pay **no** royalties to the federal government until the CA is approved.

Upon approval of the CA, the operator has until the month following the BLM approval date and confirmation in the ONRR's system to submit all necessary amended royalty returns in order to avoid being assessed interest. This means that if a CA was pending for several years and whether the CA is approved on January 1st or January 31st, they must resubmit all royalty returns by February 28th. This results in a rushed process that frequently requires the assistance from outside consultants and 3rd parties.

Because of this structure—and the delay—companies are paying tens of millions more to the federal government than would otherwise be owed and then awaiting months or years for the ability to accurately report. Meanwhile, the federal government is under-collecting for months or years in other areas where the wellbore does not intersect federal or Indian lands. Moreover, these under- and over-payments are all interest free, meaning when it is corrected months or years later, the government, tribes, and companies do not get compensated.

Accordingly, the current law (and its associated delays) benefits no one and instead ties up capital, results in frequent administrative issues, and results in the government not receiving the funds owed for years.

The Effect of the Royalty Resiliency Act:

Given the belabored history of CAs, this legislation allows for up-front payments. No longer will the needless over- and underpayment collections occur.

Specifically, what does this legislation do?

It allows operators who submit a CA to the BLM to pay in accordance with that CA until approved or modified. If the CA is approved as submitted to the BLM, no changes to payments will be

[11] Email on file.

needed. But if modified, the royalty payors will adjust accordingly, using a similar adjustment process to what they do on **all** CAs under current law.

In other words, this legislation removes the all-or-nothing approach that currently exists, ensuring that operators are—at the very least—paying closer to what they owe, while the government actually collects something.

Importantly, existing law will prohibit abuse of this legislation. Current law provides that any person who knowingly or willfully submits inaccurate information will be subject to a penalty of up to $25,000 per violation for each day such violation occurs.[12] Furthermore, severe abuse may be punished with imprisonment and additional fines.[13]

At Ryan, we have found that producers want to make accurate and timely payments to the government. The Royalty Resiliency Act, coupled with existing safeguards, achieves this.

Conclusion:

The Royalty Resiliency Act addresses a decades' long problem that has plagued the Department, and provides certainty of payment to the government, while limiting over payments by the producer.

Ryan commends the introduction of this legislation and supports its full passage.

[12] 30 U.S.C. § 1719.
[13] 30 U.S.C. § 1720.