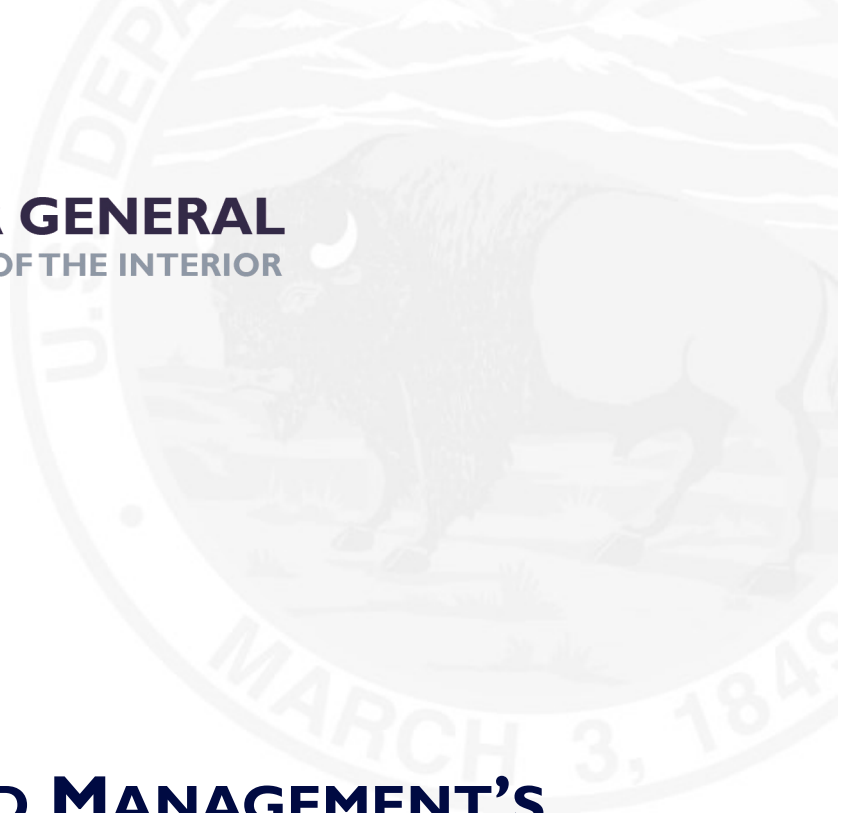




OFFICE OF
INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR



BUREAU OF LAND MANAGEMENT'S MANAGEMENT OF PRIVATE ACQUIRED LEASES




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INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR

DEC 11 2015

Memorandum

To: Neil Kornze
Director, Bureau of Land Management

From: Mary L. Kendall 
Deputy Inspector General

Subject: Inspection Report – Bureau of Land Management’s Management of Private Acquired Leases
Report No. 2015-EAU-057

The Office of Inspector General reviewed the Bureau of Land Management’s (BLM) oversight of private acquired leases (PAQs) to determine if BLM has appropriate regulations and staffing structure to manage current oil and gas production from PAQs. PAQs are private oil and gas leases acquired by Federal surface management agencies that are transferred to BLM for management. We also assessed whether BLM has considered the impact on PAQs of anticipated oil and gas production growth in the Marcellus and Utica shale formations in the Northeastern United States where most PAQs are located. We focused our inspection on the BLM Northeastern States District Office (NSDO), which manages the vast majority (92 percent) of all PAQs (see Attachment for our Scope and Methodology). We identified several areas that BLM could address to improve oversight, mitigate risks, and prepare for additional PAQs and increased oil and gas production.

The broad authorities BLM has to manage PAQs differ significantly from those it has to manage federally-issued leases. Because PAQs are not subject to the laws and regulations governing federally-issued leases, they present BLM with a unique management task, which requires additional policies and procedures to address their specific challenges. We found that BLM does not have updated formal policies or procedures for managing PAQs. Further, BLM has no role in PAQ acquisitions. Finally, NSDO is unable to keep up with the associated administrative workload, which is expected to increase with future oil and gas development. Though PAQs comprise only a small number of BLM-managed leases, they present a unique responsibility, and potential safety and environmental liabilities.

Background

PAQs come from Federal surface management agency acquisitions of surface and mineral estates that include existing private oil and gas leases. The U.S. Army Corps of Engineers and the U.S. Forest Service (USFS) are the surface management agencies that have acquired the most PAQs in the course of managing flood control projects, and adding to national forest lands. Other surface management agencies include the U.S. Fish and Wildlife Service and the U.S. Department of Labor. PAQs, some of which date to the 1880s, expire when lease

conditions have been satisfied, which is generally when wells cease oil and gas production. Most PAQs are located in the Eastern United States because much of the land acquired for Federal use has traditionally been privately owned. For example, in 1935, USFS established the Wayne National Forest in Ohio, and it has been acquiring private lands since that time to continue consolidating the remaining forest. Some of the purchases contained PAQs.

Currently, there are 347 PAQs, which represent less than 1 percent of the approximately 46,000 oil and gas leases BLM manages. For fiscal year 2014, PAQ royalty revenues of \$2.1 million were less than 1/10th of 1 percent of total Federal onshore oil and gas revenues of \$3.1 billion.

NSDO manages 92 percent of all PAQs. NSDO has jurisdiction over 20 States, and PAQs are located in 4 of those States—Pennsylvania, Ohio, West Virginia, and New York. Much of the Marcellus and Utica shale formations, also known as shale plays, are in these States. The Marcellus formation produces the highest amount of natural gas in the Nation, and is second in the world. Since 2007, production has increased approximately 700 percent to about 16 billion cubic feet of natural gas per day. Utica’s natural gas production is about 2.5 billion cubic feet per day, and has the potential to exceed the Marcellus’ production.

Findings

We found that PAQs present unique management challenges to BLM, which has not updated its policies and procedures to manage PAQs appropriately. In addition, NSDO staff members are unable to keep up with the associated administrative workload, which is expected to increase with future oil and gas development.

BLM Has Significant Responsibilities and Liabilities but Minimal Authority

Although BLM is the managing agency for PAQs, its management authorities are subject to individual lease terms and State laws rather than the Federal statutes, regulations, and rules that are applicable to federally-issued leases. For example, BLM personnel managing the vast majority of PAQs rely on a 1983 Office of the Solicitor’s opinion, which states that PAQs in the Wayne National Forest must be administered according to the rights and limitations provided in the lease terms, or by the common-law rights created by the lessor-lessee relationship. Similarly, a 2014 BLM State director's decision vacated three actions that a BLM office had taken in connection with a PAQ, holding that the Federal regulations did not apply. As the State director found, the fact that the PAQs were acquired by the Government did not make them subject to Federal regulations.

In contrast, for onshore Federal oil and gas leases issued on public lands, Federal regulation 43 C.F.R. 3160 designates BLM as the administering agency. This authority comes from legislation including the Mineral Leasing Act of 1920 (30 U.S.C. § 181), the Federal Land Policy and Management Act of 1976 (Pub. L. 94–579), the Federal Oil and Gas Royalty Management Act (FOGRMA) (Pub. L. 97-451), and the Energy Policy Act of 2005 (Pub. L. 109-58).

BLM has no formal agreements with surface management agencies regarding PAQs. BLM and USFS signed a memorandum of understanding (MOU) in 2006 regarding coordination of oil and gas activities such as processing lease applications and surface use plans, but the MOU was developed in response to a requirement in the Energy Policy Act of 2005 and does not specifically address PAQs. NSDO staff members do not consider the MOU relevant to PAQs.

Surface management agencies do not include BLM in PAQ acquisitions and may not consider the implications that they present to BLM. An NSDO employee said that the surface management agencies want the land, and seem to pay little attention to the other aspects of what is being acquired. Acquisition terms are negotiable, and a BLM employee speculated that surface management agencies feel that they gain more control by acquiring both the surface rights and mineral estates.

NSDO periodically discovers wells on lands purchased by surface management agencies that are not part of PAQs, and according to NSDO, do not have clear, responsible parties. NSDO considers them “orphaned wells,” and they present environmental and safety issues, and plugging expenses. NSDO reported 184 of these wells, but added that more will inevitably be discovered because the lands have not been fully analyzed. Finding these wells is difficult because they can be in remote areas and hidden by dense vegetation (see Figure 1).



Figure 1. Wells, such as this one in the Wayne National Forest, are often difficult to locate. Source: OIG.

The age of the wells and their possible state of underground deterioration can result in fluid leakage and contamination of underground water. Surface water contamination from surface fluid discharge is also a risk. NSDO is not aware of any wells that currently threaten water supplies. A BLM petroleum engineering technician showed us a well venting gas next to a

hiking trail in the Wayne National Forest and noted that a hiker could possibly ignite the gas and cause an explosion. NSDO does not know how many other wells are also venting gas.

According to NSDO staff members, surface management agencies do not believe that plugging wells is the agencies' responsibility. NSDO requested BLM funds for plugging in recent years, but no fund requests have been approved. Some wells in Ohio have been plugged using ad hoc funding arrangements between USFS and the State, with NSDO helping to coordinate the effort. Plugging costs for these wells can be expensive because many are inaccessible by roads, and moving equipment on site is challenging. In addition, many wells are old and deteriorated, which can contribute to plugging difficulties and costs.

We also found that PAQ oil and gas operators could be underpaying royalties. Because PAQ leases do not require oil and gas production reporting, the Office of Natural Resources Revenue (ONRR) accepts PAQ royalty payments without verifying how much should be paid. In contrast, for Federal leases, ONRR reconciles royalty payments to required production reports in order to verify the appropriate royalty amount. Neither NSDO nor ONRR have calculated estimated underpaid royalty amounts. ONRR has also declined to pursue possible underpayments because amounts are below established cost-effectiveness thresholds.

In 2013, NSDO began efforts to collect unpaid PAQ royalties using oil and gas production information from States. PAQs that are producing oil and gas according to State data, but are not paying Federal royalties, are the targets. The initial work is to compare information from online State production databases to PAQ royalty payment data provided by ONRR to identify the PAQs in question. NSDO then initiates communication with the operators to verify production and reach an agreement to pay the unpaid royalties. In Fiscal Year 2013, NSDO collected approximately \$140,000 in additional Federal royalties. BLM has not analyzed this process for cost-effectiveness, to determine if the work required to collect the royalties costs more in time and effort than the actual recovered royalties.

BLM Does not Have Policies or Procedures for Managing PAQs

BLM has no established management practices or strategy to guide its efforts in managing PAQs. BLM had one policy and two instruction memorandums dated from the 1980s regarding PAQs, but NSDO staff said they are no longer considered valid and, therefore, are not followed. NSDO has received guidance from the aforementioned Solicitor's opinion and BLM State director review. As a result, NSDO staff attempt to manage PAQs in a manner consistent with federally-issued leases but are hindered by the unique nature of these PAQs.

NSDO Is Unable to Manage PAQ Duties

PAQ management is a complex and time-consuming task for NSDO. One reason is labor-intensive document handling. While Federal lease terms are generally standardized, PAQ lease terms are not standardized. Each PAQ lease must be read individually to determine specific terms. Terms and conditions could have been modified several times over many years; however, the document trail must be followed in order to determine specific lease terms. These documents, some of which date back to the 1880s, can be difficult to analyze because they are hand-written

or of such poor quality that they are unreadable. One NSDO employee stated that she uses three different magnifying glasses to read lease documents.

NSDO has a 1-year backlog of lease documents to process because it has received and continues to receive new PAQ acquisition documents from the surface management agencies without advanced notice. In addition, surface management agencies do not always provide all critical lease documents, such as modifications that change key lease terms. In these cases, NSDO must contact the surface management agencies to request the missing documents. When these efforts fail, NSDO requests the documents from lessees and operators, or they visit courthouses to seek needed records.

NSDO work also includes communicating and coordinating with various State government entities regarding PAQ safety issues. NSDO identifies safety issues for PAQs, as it does for Federal leases, but because BLM has no enforcement authority for PAQ operator compliance, NSDO works with the States to help them apply State enforcement actions. NSDO time is also spent keeping abreast of applicable, and changing, State laws and regulations. NSDO previously issued enforcement orders to PAQ operators in these cases, as it does for Federal leases, but was ordered to cease doing so by a BLM State director because Federal requirements did not apply. For Federal leases, BLM has an inspection and enforcement program, per FOGRMA requirements, and enforces FOGRMA-established penalties for operators' noncompliance. FOGRMA, however, does not apply to PAQs, as stated in the 1983 Solicitor's opinion.

Regarding a safety issue, a BLM petroleum engineering technician showed us pumping machinery on a PAQ near a USFS hiking trail that had exposed motor belts (see Figure 2). The technician said that a hiker could lose an arm if he got too close to the belt. If this was a Federal lease, the technician said an enforcement order to correct the safety hazard would have been issued to the operator. NSDO plans to seek State enforcement action for this unsafe condition.



Figure 2. This pump jack is located near a hiking trail in the Wayne National Forest. Source: OIG.

NSDO staff stated that BLM does not consider the PAQ workload when making NSDO staffing and resource allocation decisions. Further, the PAQ workload may increase because surface management agencies will continue to acquire PAQs. For example, representatives of the Wayne National Forest stated that the forest is 29 percent of the desired size, and that as funding allows, additional private parcels will be purchased. They estimate that one-third of these purchases will include PAQs. The workload may also grow as PAQ oil and gas production in the Marcellus and Utica formations increases. NSDO staff indicated that 90 percent of current PAQs are located within the two formations, and while oil and gas production from the formations is currently minimal, it will likely increase.

Recommendations

We recommend that BLM:

1. Formalize working relationships with surface management agencies for managing PAQs through MOUs that would include BLM involvement in acquiring PAQs, and educate surface management agencies on the burden that PAQ acquisitions present to BLM;
2. Develop, update, and implement policies, procedures, and strategy to help standardize PAQ management;
3. Work with the Solicitor's Office to clarify the legal and regulatory environment for PAQs, and BLM's oversight authority, if necessary;

4. Develop and implement a timeline and work plan to address the current backlog of new PAQs;
5. Develop and implement a standard procedure for collecting unpaid royalties; and
6. Evaluate the workload and workforce needed to manage properly PAQs when making NSDO staffing decisions.

Please provide us with your written response to this report within 30 days. The response should provide information on actions taken or planned to address the recommendations, as well as target dates and title(s) of the official(s) responsible for implementation. Please send your response to:

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The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, inspection, and evaluation reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented.

If you have any questions regarding this report, please contact me at 202-208-5745.

Scope and Methodology

The scope of our inspection included policies and procedures associated with the Bureau of Land Management's (BLM) management of private acquired leases (PAQ) and with the Office of Natural Resources Revenue's (ONRR) royalty revenue processing. We primarily focused on the PAQs managed by BLM's Northeastern States District Office (NSDO). To accomplish our objective we—

- reviewed laws, regulations, and policies pertaining to PAQ management;
- reviewed lease documents and royalty reports related to PAQs;
- visited NSDO in Milwaukee, WI, and interviewed staff regarding PAQ management;
- visited BLM's field office in Marietta, OH, and interviewed staff regarding PAQ management;
- visited the U.S. Forest Service' Wayne National Forest in Marietta, OH, and interviewed staff regarding PAQ acquisitions; and
- visited ONRR in Lakewood, CO, and interviewed staff regarding PAQ royalty payment processing.

We conducted our inspection in accordance with the Quality Standards for Inspection and Evaluation as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

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