

KIRKLAND & ELLIS

Energy Blog

Applying for Royalty Relief from BLM or BSEE

08 June 2020

In response to the economic conditions created by historically low commodity prices and conditions resulting from the COVID-19 pandemic, increased attention has been given to the royalty relief programs offered to oil and gas companies by the U.S. Department of the Interior (“DOI”) through its branches, the Bureau of Land Management (“BLM”), which regulates federal onshore oil and gas leases; and the Bureau of Safety and Environmental Enforcement (“BSEE”) and the Bureau of Ocean Energy Management (“BOEM”), which jointly regulate federal offshore oil and gas leases. To date, while DOI has not implemented a comprehensive royalty relief plan for all lessees of federal oil and gas leases, DOI has committed to continuing to offer royalty relief on an individual basis using existing options available to lessees of federal oil and gas leases. The following describes the royalty relief mechanisms available to federal oil and gas lessees under BLM, BSEE and BOEM administration, respectively, including the application and approval process.

Background

In late March and early April, amid historically low commodity prices, transportation bottlenecks on midstream transportation, and increasingly restrictive conditions created by the spike in COVID-19 respiratory disease in the U.S., Congress was divided on whether DOI should enact a comprehensive royalty relief plan for federal oil and gas leases, and public petitions from members of Congress were sent to DOI both for¹ and against² such a plan. In response, [DOI indicated](#) that royalty relief would be provided for oil and gas companies on an individual basis through existing mechanisms available on federal oil and gas leases through BLM and BSEE. As of May 22, 2020, [BLM indicated](#) that royalty relief had been granted on at least 76 federal leases in Utah, as well as at least 90 federal leases across Wyoming, Nevada

and California, while [BSEE reported](#) that four companies had begun the application process for special case royalty relief for federal offshore leases during the COVID-19 pandemic.

BLM Royalty Relief

Royalty reductions on BLM-administered federal leases are governed by 43 CFR §3103.4-1. Under that regulation, operators of federal leases may submit an application for royalty relief to the applicable BLM State Office containing:

- the serial number of the leases,
- the names of the record title holders, operating rights owners (sublessees), and operators for each lease;
- the description of lands by legal subdivision;
- a description of the relief requested (royalty relief approved during the COVID-19 pandemic [has typically been a reduction to 5%](#) from the usual 12.5%.);
- the number, location and status of each well drilled;
- a tabulated statement for at least each of the six months prior to filing the application of the aggregate amount of oil and gas subject to royalty;
- the number of wells counted as producing each month;
- the average production per well per day;
- a detailed statement of expenses and costs of operating the entire lease;
- the income from the sale of any production;
- relevant facts to show whether the wells can be successfully operated upon the fixed royalty, including information as to whether overriding royalties, payments out of production or similar interests are paid to entities other than the federal government, the amounts so paid and the efforts made to reduce them; and
- agreements of the holders to a reduction of all other royalties or similar payments from the leasehold to an aggregate amount not exceeding half the royalties paid to the federal government.³

In the wake of the COVID-19 pandemic, BLM has added additional application requirements including:

- a self-certification statement with supporting documentation from the operator that the leases would be capable of production in paying quantities if not for the

COVID-19 pandemic;

- an economic analysis table that shows that the leases are uneconomic at the current royalty rate, but would be economic with the royalty rate reduction, identifying the relevant market oil price, the royalty rate, the production capabilities and the operating costs; and
- the requested temporary royalty rate to make the leases economic, noting that reductions [may not drop the royalty rate below 0.5%](#).

BLM notes that trade secrets and other proprietary information should be identified as confidential and proprietary, including operating costs and other financial information as provided for in 43 CFR § 2.26.

Once the application has been completed, an authorized officer of the BLM State Office reviews and evaluates the application and, over the next five business days, verifies the application information. The authorized officer will notify the operator in writing if the application is approved of the effective date of the royalty rate reduction and the sunset date, which is 60 days from the effective date, unless an extension is approved by submitting an additional application. BLM also requires that any approval letter be sent to another division of DOI, the Office of Natural Resources Revenue (“ONRR”), within five business days of approval. The operator and ONRR will also be notified by the authorized officer of the BLM State Office of the termination of the temporary royalty rate, including if the relief timeline is extended.

If BLM does not approve the application, the applicant has the right to appeal the decision. Under 43 CFR § 3165.3(b), an applicant whose application for royalty relief has been rejected may request an administrative review before the State Director within 20 business days of the rejection, with a ruling by the State Director within 10 business days of the submission of the complete request for administrative review or the oral presentation, if one is made.⁴ In the event that the application remains rejected after State Director review, the oil and gas company may further appeal to the Interior Board of Land Appeals pursuant to 43 CFR § 3165.4.

Offshore Royalty Relief

BSEE and BOEM have separate and overlapping responsibilities when it comes to royalty relief. Pursuant to 30 CFR § 560, BOEM administers incentive-based relief programs that are codified in lease agreements issued by BOEM, such as royalty

relief for certain royalty-free volumes of production to promote development of deepwater Gulf of Mexico leases and certain shallow-water deep gas production. BSEE administers [discretionary need-based programs](#). Because DOI has determined that royalty relief related to COVID-19 will be solely on a discretionary basis, applicant oil and gas companies must apply to BSEE if they seek royalty relief.

BSEE has a number of discretionary royalty relief programs for certain types of leases, including for deepwater leases issued before November 1995 that are uneconomic under current royalty rates but would become economic with royalty relief, for ultra-deep and deep gas wells in shallow water leases, and for producing leases that are nearing depletion, where halving royalties may result in increased production on the lease. Finally, BSEE allows producers to request [special case royalty relief](#) in circumstances that do not qualify for BSEE's other royalty relief programs.

In order to qualify for special case royalty relief, the lessee must show in a pre-application that the lease or project meets two or more of the following characteristics:

- substantial history of production and evidence that the lessee can recover at least a years' more worth of production than if royalty relief is not approved;
- the existence of valuable facilities such as a platform or pipeline that a successor lessee would be unlikely to use, or that exist off-lease and depend on continued production from the applicable lease;
- a substantial risk that no new lessee will recover the resources;
- major efforts to reduce operating costs that were made too recently to use the formal program for royalty relief, such as a change in operations; and
- circumstances beyond the lessee's control (other than water depth) preclude reliance on one of the existing royalty relief programs.⁵

If BSEE agrees that two or more of the above conditions are met, BSEE will send the applicant a confirmation letter with detailed instructions on how to submit the formal application, tailored to the applicant's specific case. The confirmation letter will also inform the lessee of the amount of the application fee, which is [determined on a case-by-case basis](#) pursuant to 30 CFR § 203.3. Historically, special case royalty relief required the drilling of a well by the applicant, however, in light of current circumstances, BSEE has issued guidance on how applicants may apply for special case royalty relief that does not include the drilling of a well. In such

instance, the applicant will need to provide the following:

- statements and supporting documentation identified in the confirmation letter;
- a signed statement certifying that the lessees are at significant and imminent risk of failure to meet contractual requirements to the federal government and other counterparties;
- a signed statement certifying how the requested royalty relief would increase production; and
- a signed statement attesting to the current uneconomic status of the leases and anticipated economic status of the leases if royalty relief were granted.

If BSEE approves the request, it would issue an approval letter indicating the period of royalty relief. The royalty relief would be capped by the amount necessary to equate the total allowable expenses with the total adjusted revenue, such that if the total adjusted revenue exceeds the allowable expenses for any production month during the period of royalty relief, no royalty relief is to be given during such month.

During the period of royalty relief, operators must:

- submit monthly summaries prepared according to GAAP of revenues, allowable expenses and payor allocations, including certification of accurate preparation; and
- provide a post-production true up report prepared according to GAAP by an independent CPA no later than 120 days after the end of each calendar year quarter.

Finally, royalty relief is conditioned upon BSEE and ONRR reevaluating the propriety of prior royalty relief and making appropriate adjustments, as well as the lessee's acceptance that its submission may be subject to a DOI audit.

1. See Letter to Secretary David Bernhardt from Members of the U.S. Senate, dated March 30, 2020, available at <https://assets.documentcloud.org/documents/6823542/Letter.pdf>.↵

2. See Letter to Secretary David Bernhardt from Members of the Congress of the United States, dated April 6, 2020, available at <https://naturalresources.house.gov/imo/media/doc/Letter%20to%20Bernhardt%20opposing%20oil%20and%20Gas%20Royalty%20Cuts%20April%206%202020.pdf>.↵

3. [43 CFR §3103.4-1.](#)

4. [43 CFR § 3165.3.](#)

5. [See 30 CFR § 203.80.](#)

[Read more insights from Kirkland's Energy & Infrastructure blog](#) or [subscribe to receive future updates.](#)

Authors

Rahul D. Vashi, P.C.

Partner / Houston

Chris Heasley

Partner / Austin / Houston

Justin W. Clune

Associate / Houston

Related Services

Practices

- Transactional
- Energy & Infrastructure

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

This publication may cite to published materials from third parties that have already been placed on the public record. The citation to such previously published material, including by use of "hyperlinks," is not, in any way, an endorsement or adoption of these third-party statements by Kirkland & Ellis LLP.