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Energy Blog

Proposed Build Back Better Legislation Includes Important Changes for Oil and Gas

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On October 28, 2021, the House Rules Committee released the text of H.R. 5376, the "Build Back Better Act." Although final passage in Congress remains uncertain, the proposed legislation includes important changes to federal regulations and policies governing oil and gas development and leasing on federal lands and waters. Below we highlight several proposed policies and actions in the context of (1) federal leasing program changes, (2) a focus on methane emissions and (3) fees and bonding changes for operators that would impact the oil and gas sector if enacted as proposed in the House bill. We are continuing to monitor ongoing developments and will publish future posts as relevant.

Federal Leasing Program Changes

- Increased Royalty on New Leases. The proposed legislation would increase the royalties payable on production from federally owned onshore lands from 12.5% to 18.75% on newly issued leases. The existing royalty rate of 12.5% or "one-eighth" has not been increased on federal lands since the Mineral Leasing Act was signed into law by President Woodrow Wilson in 1920. Before a terminated or canceled oil and gas lease may be reinstated, the proposed legislation also requires that "back" royalties are paid, and future royalties become payable at a rate of 25%. Further, new leases granted on the Outer Continental Shelf would be issued at a rate of "not less than 14 percent."
- Reduced Lease Term. The proposed legislation provides for a primary term under new oil and gas leases of five years, rather than 10 years under existing federal regulations. The 10-year lease term was originally considered a key incentive to attract operators to develop oil and gas reserves on federal lands; however, most

modern oil and gas leases on private lands already provide for a primary term of three to five years.

- Minimum Bid Rates; Elimination of Non-Competitive Leasing. Under existing regulations, leases are awarded to the highest bidder offering at least a minimum per acre price. The current minimum bid is $2 per acre, which has been in place for decades. The proposed legislation would increase the minimum bid rate to $10 per acre and provide for additional adjustments based on inflation every four years. Under the existing regulations, if a federal tract of land available for lease does not receive a minimum bid, then it may be leased on a non-competitive basis. The proposed legislation would eliminate non-competitive leasing altogether, and leases that fail to receive competitive bids may no longer be leased.
- Increased Rental Rates. Federal leases, unlike many modern "paid up" private oil and gas leases, require annual rental payments during the primary term. Currently, these rates are set at $1.50 per acre for the first five years and increase to $2 per acre each year thereafter. The proposed legislation would increase rental rates to $3 per acre for the first two years and $5 per acre each year thereafter. Additionally, terminated leases would not be eligible for reinstatement unless the operator agrees to increase future lease rentals to $20 per acre each year.
- Elimination of Arctic, Pacifi c Region, Atlantic Region and Eastern Gulf of Mexico Planning Areas. The proposed legislation would repeal section 20001 of the 2017 Tax Act (P.L. 115-97), which established the Arctic National Wildlife Refuge oil and gas leasing program. This repeal would cancel the Arctic leases sold in January 2021 and return all payments related to the leases to the lessees within 30 days of enactment of the House bill. The proposed legislation would also effectively ban new offshore oil and gas leasing along the Atlantic and Pacific coasts and in the Eastern Gulf of Mexico by prohibiting the Secretary of the Interior from issuing a lease or any other authorization for the exploration, development or production of oil or natural gas in any of the planning areas on the Outer Continental Shelf in the Pacific Region Planning Areas, in the Atlantic Region Planning Areas or in the Eastern Gulf of Mexico Planning Area identified on the map entitled "Outer Continental Shelf Lower 48 Planning areas" and dated October 18, 2021.[1]
- Elimination of Royalty Relief Program. Many operators on federal oil and gas lands and waters learned about the federal government's royalty relief programs for onshore and offshore production during the height of the economic disruption caused by the COVID-19 pandemic. Under these programs, the Secretary of the Interior has the power to suspend, reduce or even waive royalties on federal leases. This program is rarely used, and many of the applications sought during COVID-19 were denied. Under the proposed legislation, the relief programs would be eliminated for both onshore and offshore leases.

Focus on Methane

- Incentives to Reduce Methane Emissions. The proposed legislation amends the federal Clean Air Act and provides the U.S. Environmental Protection Agency ("EPA") with $775 million for: (i) grants, rebates, contracts and loans to provide financial and technical assistance to owners and operators of facilities that prepare and submit greenhouse gas reports; (ii) grants, rebates, contracts and loans for methane emissions monitoring; and (iii) grants, rebates, contracts and loans to provide financial and technical assistance to reduce methane and other greenhouse gas emissions from petroleum and natural gas systems, to mitigate legacy air pollution from petroleum and natural gas systems and to provide support for communities. This funding is intended to cover efforts to improve climate resiliency of communities and petroleum and natural gas systems, improve and deploy processes that reduce methane and other greenhouse gas emissions and waste, support innovation in methane and other greenhouse gas emissions and waste, mitigate health effects from greenhouse gas emissions and waste and legacy air pollution from petroleum and natural gas systems in low-income and disadvantaged communities, and support environmental restoration.
- Fees for Methane Emissions. The EPA Administrator is also required to establish waste emissions thresholds for petroleum and natural gas facilities required to report methane emissions as defined under subpart W of part 98 of title 40 of the Code of Federal Regulations, and to impose and collect a charge on waste emissions that exceed those thresholds. The proposed legislation imposes fees of $900 per ton of excess methane in 2023, increasing to $1,200 per ton of excess methane in 2024 and $1,500 per ton of excess methane in 2025. The proposed legislation directs EPA to impose this charge on the reported tons of methane emissions from production facilities that exceed (i) 0.20% of the natural gas sent to sale from the facility or (ii) 10 metric tons of methane per million barrels of oil sent to sale from such facility if the facility did not send any natural gas to sale. The EPA must impose the charge on the reported tons of methane emissions from non-production facilities that exceed 0.05% of the natural gas sent to sale from the facility, and on transmission facilities for reported tons of methane emissions that exceed 0.11% of the natural gas sent to sale from the facility. The charge would not be imposed with respect to emissions caused by an unreasonable delay in environmental permitting of gathering infrastructure, and a facility's liability for payment of this charge is not affected by emissions standards, permit fees, penalties or other legal requirements.
- More Sources to be Subject to Greenhouse Gas Emissions Reporting. Under the proposed legislation, after two years of enactment, and as needed thereafter, the

EPA must revise the requirements under subpart W of part 98 of title 40 of the Code of Federal Regulations to reduce the facility emission threshold to 10,000 metric tons of carbon dioxide of greenhouse gases emitted per year (down from the existing threshold of 25,000 metric tons) and to ensure the reporting and calculation of charges are based on empirical data and accurately reflect methane and waste emissions from facilities. This change would increase the number of oil and gas facilities that are subject to federal annual greenhouse gas emissions reporting.

- Royalty on Extracted Methane. The proposed legislation imposes a royalty on methane gas extracted from federal lands during the course of operations, including methane gas used or consumed for the benefit of the lease and volumes that are flared or vented (unless such flaring or venting occurs as the result of an emergency). While the proposed legislation does not specify the size of the new royalty, under most existing federal oil and gas lease forms the "Lessor reserves the right . . . to establish reasonable minimum values on products after giving the lessee notice and an opportunity to be heard." The proposed legislation also eliminates the royalty waiver for natural gas produced from federal lands and on the Outer Continental Shelf, and requires royalties to be paid on all gas vented, flared or lost through leakage. The only exception in the proposed legislation is for gas vented or flared for no more than 48 hours in an acute emergency situation that poses a danger to human health.

Fees and Bonding Changes for Operators

- New Severance Fee. One of the most meaningful changes in the proposed legislation includes a new severance fee imposed on hydrocarbon production from federal onshore lands and the Outer Continental Shelf. Under the proposed legislation, the Secretary of the Interior must collect a severance fee of $0.50 per barrel of oil equivalent on oil and natural gas produced from federally owned lands. Because most federal oil and gas leases are subject to the regulations imposed by the Secretary, including those promulgated after execution, to the extent such regulations are not inconsistent with the existing lease terms, the proposed severance fee may affect existing oil and gas leases.
- Idled Well Fees. The proposed legislation provides for a series of new annual fees for idled wells on federal lands and waters, which are intended to encourage operators to either resume operations or release the acreage. The proposed fees are staggered in amount based upon the duration the wells have been in idled status. The fees, which would be adjusted every four years based on inflation, would be assessed annually for each idled well as follows:

- $500 for each well idled at least one year, but less than five years;
- $1,500 for each well idled for at least five years, but less 10 years;
- $3,500 for each well idled for at least 10 years, but less than 15 years; and
- $7,500 for each well idled for at least 15 years.

- New Fees for Expressions of Interest. For many years, operators have been able to informally nominate desired lease tracts of federally owned lands for inclusion in a competitive oil and gas lease sale by submitting an expression of interest. If the nominated lands did not receive bids, they could then be leased on a non-competitive basis. Under the proposed legislation, a fee would be required in connection with making such requests, and as noted earlier in this summary, lease tracts would no longer be eligible for non-competitive leasing. The size of the proposed fee is at the discretion of the Secretary but may not be less than $15 per acre and would be adjusted every four years for inflation.
- Pipeline Ownership Fees. Within 180 days of enactment, the proposed legislation would require the Bureau of Safety and Environmental Enforcement to charge owners of existing and new offshore oil and gas pipelines annual fees of $10,000 per mile for pipelines in water depths of 500 feet or greater and $1,000 per mile for pipelines in water depths less than 500 feet. No portion of such fee that is passed on to a lessee may be deducted as part of a lessee's transportation allowance when calculating royalties due to the U.S.
- Increase to Inspection Fees. The proposed legislation would also raise inspection fees for designated operators under each oil and gas lease or unit and communitization on federal land that is subject to inspection and that is in force at the start of the fiscal year 2021. Specifically, each such designated operator would need to pay a nonrefundable annual inspection fee in an amount established by regulation by the Secretary of the Interior sufficient to recover the full costs incurred by the U.S. for inspection and enforcement with respect to such federal oil and gas leases. Until the effective date of such regulations to be set by the Secretary of the Interior, the fee would be $1,000 for each lease, unit or communitization agreement, provided that the Secretary of the Interior may increase the fees based upon actual costs incurred for inspections. For fiscal year 2022, the Secretary of the Interior would assess the fee at $1,000 for each lease, unit or communitization agreement and provide notice of such assessment to each designated operator who is liable for the fee within 60 days of the enactment of the proposed legislation.
- Bonding Changes. The proposed legislation requires the Secretary of the Interior to publish a final rule within 18 months of enactment that requires oil and gas leaseholders on public lands to provide the agency with a bond, surety, or other financial instrument prior to commencement of surface-disturbing activities at an

onshore oil and gas lease. This provision is designed to ensure the complete and timely reclamation of the lease tract and restoration of lands and waters adversely affected by lease operations.

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1. https://www.boem.gov/sites/default/files/oil-and-gas-energy-program/Leasing/Five-Year-Program/2019-2024/DPP/NP-Decision-Map-Lower-48-States.pdf.↩

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Suggested Reading

- 05 November 2021 Energy Blog Biden Administration and Congress Focus on Methane Emissions
- 05 November 2021 Energy Blog Increasing Focus on Biodiversity-Related Financial Risk Presents New Challenges and Opportunities in Energy and Infrastructure
- 07 October 2021 Energy Blog SEC Responds to Investor Demand for Climate Risk, Human Capital Management Disclosures

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