

SHORELINES – April 2018

As presented to the *Island Review* magazine

OCS Oil & Gas Leasing Program – Status Summary And A Royalty & Revenue Sharing Primer

Status Summary

Last year (2017), the Bureau of Ocean Energy Management (BOEM) announced the Administration was going to re-script the current 5-Year Outer Continental Shelf (OCS) Oil & Gas Leasing Program. BOEM is an agency under the Department of Interior (DOI) and per Section 18 of the OCS Lands Act, the Secretary of the DOI/BOEM prepares and maintains a schedule of proposed oil & gas lease sales in federal waters, indicating the size, timing, and location of auctions that would best meet national energy needs. This is done on a five-year basis per law. The current plan is for 2017-2022 and logically superseded the older 2012-2017 plan.

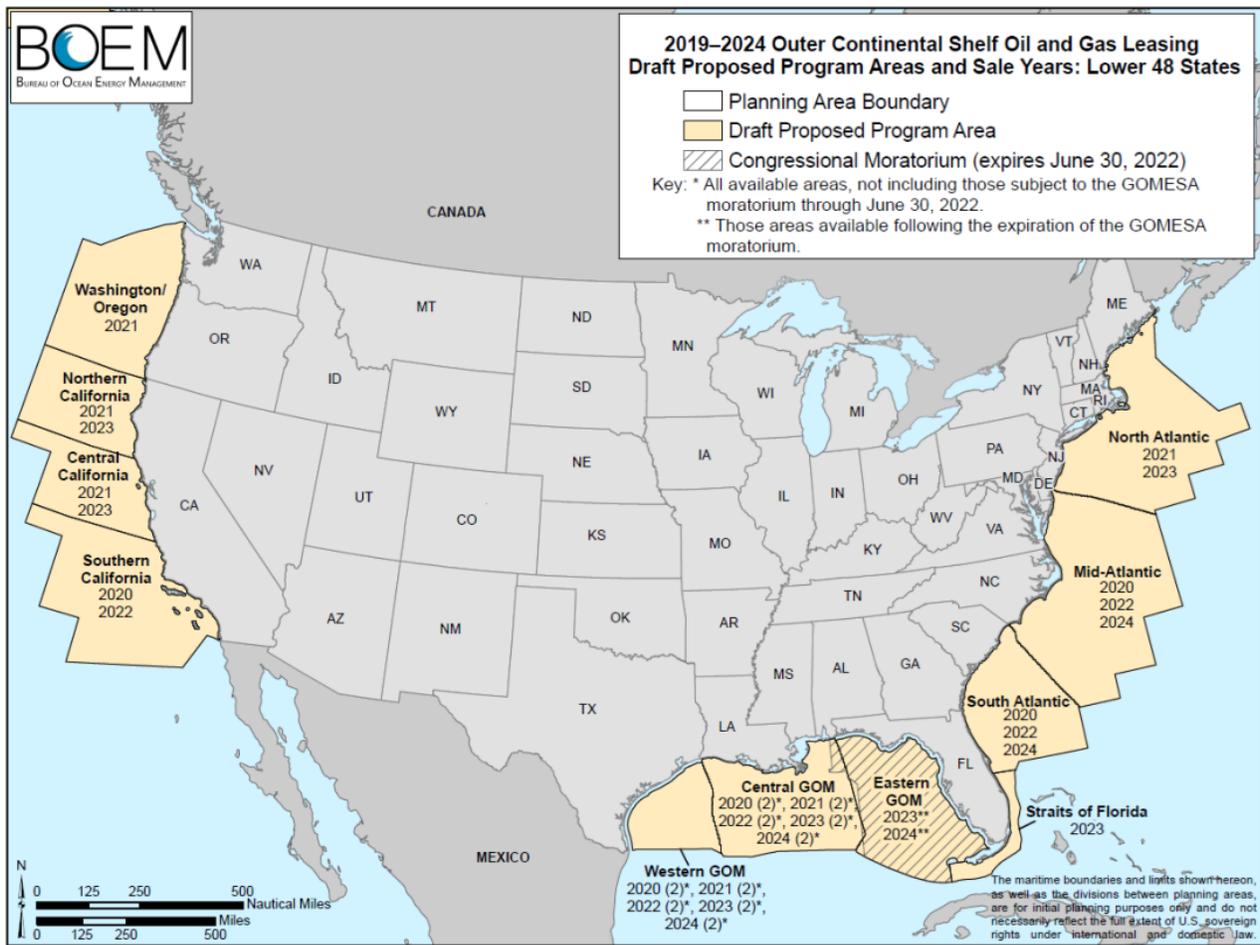


Fig. 1 - Map of BOEM’s 2019-2024 Draft Proposed Oil & Gas Leasing Program released on January 4, 2018 depicting the geographic extent and dates of lease sales, including the entire breadth of the North, Middle, and South Atlantic Planning Areas. These areas could be reduced, possibly significantly, once the Draft Lease Program is finalized.

However as introduced above, the new Administration (Trump) decided not to wait for the next 5-year cycle (2022-2027) but rather proposed to replace the existing 2017-2022 plan with a modified 2019-2024 plan. Coupled with this announcement in 2017, the new Administration via the National Marine Fisheries Service, proposed to issue five permits allowing seismic surveys in the Atlantic from the New Jersey/Delaware border to central Florida. With these foreshadows it did not take much to conclude that when the rescripted 2019-2024 Oil & Gas Leasing Program was to be released; it would most certainly include large swaths of the Atlantic OCS, particularly the North, Middle, and South Atlantic Planning Areas. And true to form, DOI/BOEM released the 2019-2024 **Draft** Proposed OCS Oil & Gas Leasing Program on January 4, 2018 including the entire breadth of the Atlantic Planning Areas (Figure 1) with lease sales currently proposed in 2020, 2022, and 2024. Public comment was due on March 9th and it will be several months or next year before the Leasing Plan is finalized. In the interim, there are a couple of notes to keep in mind

- (1) The maps are deceiving in a sense because it appears the entire vast Mid-Atlantic Planning Area off the North Carolina coast itself is up for sale. That's not how BOEM operates. Ultimately, 5-year leasing programs need to be approved (i.e., finalized) and each lease sale will go through a prelease evaluation and decision process considering reasonable alternative lease sale configurations, reductions, and/or restrictions within that area. Leases are traditionally offered in blocks that are 9-square miles (3 miles on a side), so the final sales have a checkerboard type of appearance in map view representing the number of individual 9-square mile leasing blocks. For instance the "2020" sale could include 1, 3, 8, etc., individual 9-square mile blocks.
- (2) There was a lot of news concerning the DOI Secretary's (Ryan Zinke's) oral and tweet announcements days after the draft release disclosing the Florida OCS was removed from the Leasing Program entirely. That could very well be the Secretary's intent, but until the Plan is vetted appropriately by BOEM and the Final Leasing Program is released in hard copy; the OCS of Florida is very much still part of the Leasing Program.
- (3) There is no revenue-sharing program for any exploration, discovery, or extraction beyond 6 nautical miles offshore. The potential oil/gas reservoirs are well beyond 25 miles, or even 50-miles offshore and therefore the royalties received by the federal government, which is their second highest source of income besides taxes, will not be shared/distributed to the States, Counties, or local governments. While decisions concerning the OCS Oil & Gas Leasing Program are insular to the Administration (i.e., location and sales), revenue-sharing can be proposed and passed by the U.S. Congress. Thus as it stands now, the current Draft Leasing Program and federal revenue-sharing laws for North Carolina and the Atlantic has been termed by many as an "all risk and no reward" proposition and therefore bears a review here.

Royalties & Revenue Sharing

Presently the U.S. federal government collects a 12.5% royalty from the industry on all oil and gas extracted from federal lands, Native American lands, and the OCS. Royalty payments are also complimented by; (a) bonus bids (payment to the U.S. government for the right to explore a lease), and (b) annual lease payments to retain the right to develop the resource. Once collected, ~50% of the royalty payments received are provided in various proportions to the States as revenue, the Historic Preservation Fund, the Land & Water Conservation Fund, the Reclamation Fund, and Native American Tribes & Allottees. The remaining 50% is apportioned to the U.S. Treasury. ***However in the OCS environment, 100% of the royalties are directed to the U.S. Treasury unless there is a statutory revenue-sharing program in place with States and/or Coastal Political Subdivisions (CPDs).***

Per section 8(g) of the OCS Lands Act; 27% of bonuses, rent, and royalty revenues obtained within State waters and the first adjacent three nautical miles of federal waters is provided directly to the States hosting production. For North Carolina, State waters extend three nautical miles seaward from the shoreline and therefore when applying the “three adjacent nautical miles” provision, the “8(g) zone” for revenue sharing is six nautical miles. For areas seaward of the “8(g) zone” out to the Exclusive Economic Zone (in most cases 200 nautical miles), there is no revenue-sharing program with the States except for those included in the Gulf of Mexico Energy Security Act (GOMESA). Passed in 2006, GOMESA provides **37.5%** of all qualified OCS revenues; including bonus bids, rentals, and production royalties to Alabama, Louisiana, Mississippi, Texas, and their CPDs to be utilized for coastal conservation, restoration and hurricane protection. An additional 12.5% is applied to the Land & Water Conservation Fund (federal program). Figure 2 is a general schematic illustrating the various zones and their relationship to revenue-sharing applicable (or not applicable) to North Carolina.

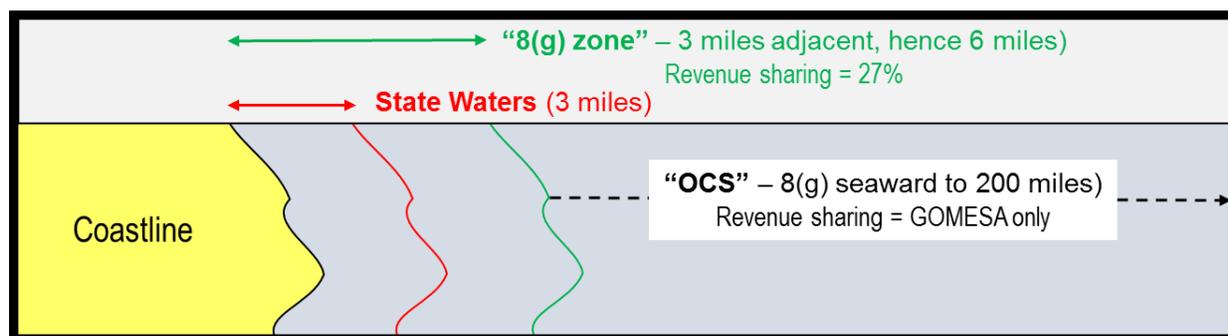


Fig. 2 – Schematic map depicting State jurisdiction and revenue-sharing zones germane to North Carolina.

While on the surface revenue-sharing with States and their CPDs makes intuitive sense based on the environmental risks involved and surge of infrastructure that would be required to support the oil & gas sector; the past two Administrations have been very unwilling to “give up” the royalty income they receive from the industry. In fact, they have been proactive in even stripping away existing revenue-sharing law. The President’s budget proposals both included the wholesale removal of GOMESA in 2015 (Obama) and 2017 (Trump); meaning there would be no revenue-sharing past the “8(g) zone” - anywhere. Of course the U.S. Congress had other ideas and those proposals never became codified in the final budgets for those two fiscal years.

And lastly, there have been some small movements afoot to secure revenue-sharing beyond the “8(g) zone” in the Atlantic; notably, S2011 - the Offshore Production and Energizing National Security Act (2015), S1279 - the Southern Atlantic Energy Security Act (2015), and S3110 - the American Energy and Conservation Act (2016). While these pieces of legislation never went to the full U.S Congress, they did have a similar structure to GOMESA where States and CPDs receive revenue-sharing based on an inverse proportional distance formula - i.e., the closer to the production well offshore, the more that particular State/CPD receives. It would not be surprising to see similar bills proposed this year or next and will be worth paying attention to albeit they will likely not make front page headlines in the broader 2019-2024 OCS Oil & Gas Leasing Program debate.