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Big Break for Big Oil, Larger Burden for Taxpayers

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Taxpayers bear brunt of federal failure to collect share of energy revenues from public lands

Even as leaders grapple with the nation's fiscal troubles and urge expanded drilling for natural resources, their failure to remedy decades-old systemic shortcomings at the Interior Department may have allowed billions of dollars in royalties from oil and natural gas companies to slip away, increasing the burden on taxpayers.

By law, energy companies must pay one-sixth to one-eighth of the value of oil and gas obtained on public lands and in federal waters off the nation's coasts. In practice, government auditors and Interior's inspector general believe the industry is paying less than it legally should. Exactly how much less is anybody's guess, but it is believed to be at least hundreds of millions — and possibly tens of billions of dollars.

So flawed and complicated are Interior Department operations and records that even auditors from the Government Accountability Office, the watchdog arm of Congress, have been unable to figure out exactly how much has been lost to taxpayers.

"This is something that is a struggle for us," Franklin Rusco, the director of the GAO's team of natural resources and environment investigators, told iWatch News .

This much is clear, added Rusco: "Interior can't provide reasonable assurance that it is collecting all the royalties that it should."

The government's failures are all the more striking against the backdrop of heightened attention and political showdowns over government spending and taxes. "It's outrageous that even during a fiscal crisis, Interior fails to pursue taxpayers' fair share of royalties," said Mandy Smithberger, an investigator for the Project on Government Oversight , a Washington-based government watchdog group that has examined other issues involving the royalty system.

Despite at least three decades of demands for improvement from Congress and the GAO, the Interior Department repeatedly has failed to heed basic recommendations for fixing the complicated and ill-funded process, which largely relies on companies to volunteer pricing information on which royalty payments are based, according to recent audits and the testimony of Interior Department officials reviewed by iWatch News .

Those reports and interviews show that the federal government is hampered by staffing and technology inadequate to track and confirm what the companies disclose, as well as antiquated royalty collection laws and poor communication within the federal bureaucracy.

One Interior Department agency, for instance, lacks any way of keeping up to date on the activity of wells and the amount of energy produced in the Gulf of Mexico, where the government grants companies the lucrative privilege of exploring and drilling.

Lack of such real-time data is critical because royalties are based in part on current oil and gas prices. Without information on industry revenue, the Interior Department has no way of knowing whether oil and gas companies are paying their fair share. It also can't tell which producers may be underpaying the most, and thus warrant scrutiny.

And only half of the money paid to the government during each of the past three years has been audited by the department for accuracy.

The Obama administration acknowledges some of the failures but says it is working on remedies. Interior spokeswoman Kendra Barkoff said that an "aggressive" reorganization of Interior precipitated by the BP oil spill one year ago already has increased oversight of the gas and oil industry in the past nine months. That includes oversight of royalty collections by the Office of Natural Resources Revenue.

Even so, the government insists significant underpayments are eventually detected due to a "sophisticated accounting and detection system," Barkoff said in a written response to questions from iWatch News. "The department does not believe that material amounts of royalties are ultimately uncollected."

The oil and gas industry, while acknowledging weaknesses in the royalty collection system, says that it is paying its fair share. The American Petroleum Institute, the leading trade association for the oil and gas industry, says in a statement on its website that it is "committed to working with all parties to improve any perceived inadequacies in the system." Industry groups did not respond to multiple iWatch News requests for comment.

Royalty payments from companies that drill on public lands and waters account for the federal government's second-largest source of income; only taxes generate more revenue for Uncle Sam.

In 2009, the energy industry paid an estimated $9 billion in royalties on sales of oil and gas obtained from federal lands and waters. If taxpayers are missing just 3 percent of royalties — a conservative estimate from sources contacted by iWatch News — the missing amount would be into the hundreds of millions of dollars annually.

> "These are publically owned resources and we should be getting a fair value for them," said Autumn Hanna, who analyzes environmental spending for Taxpayers for Common Sense, an independent policy group in Washington. "These are things the federal government owns that we have a right to — and that corporations are making billions of dollars off of."

Oil companies treated 'like royalty'

Politicians in both parties acknowledged concerns about the royalty program's shortcomings in statements to iWatch.

"It is important that the government collect what is fairly owed and that the necessary systems are in place to collect these funds as stipulated by the contractual terms in all federal oil and gas leases," said Thad Cochran of Mississippi, a Republican member of a Senate appropriations subcommittee overseeing the Interior Department. Cochran is among a number of Republicans and Democrats seeking to expand drilling on the nation's public lands and along its coastlines.

Cochran said he is urging colleagues to "embrace policies to maximize royalties paid to the U.S. Treasury, not only by ensuring that royalties due under existing leases are paid in full but also by increasing all domestic energy production consistent with environmental laws."

Massachusetts Democrat Ed Markey, a member of House energy and natural resources committees, argues for a royalty crackdown on oil and gas companies — especially when the nation faces a budget deficit. "We need to reclaim the tens of billions of dollars in royalties from oil companies drilling for free on public land," he said, "and use those funds to reduce the deficit."

Added Markey: "Our government should be extracting all the royalties rightfully owed to the American people, not expressing fealty to the oil companies and treating them like they are royalty."

Some lay blame for the persistent shortcomings in royalty collections on the influence of the energy industry.

In 2010 alone, the oil and gas industry reported spending more than $146 million to lobby the federal government. During the 2009-2010 election cycle, it donated close to $28 million to federal campaigns, data compiled by the Center for Responsive Politics show. While the money has gone mostly to Republicans, cash has also flowed to the Democratic party of President Barack Obama, whose administration backs a limited expansion of drilling in the Gulf of Mexico.

Dave Alberswerth, a former senior advisor at the Interior Department during the Clinton administration, said the industry has a key role in maintaining a broken system. He calls the influence of the oil and gas industry "enormous." "They have so much influence it's just scandalous," said Alberswerth, now a policy advisor at the Wilderness Society, an environmental advocacy organization. "It's impossible to dislodge them."

Both Albersworth and the GAO's Rusco cite a lack of staffing as a major issue with the royalties system. "Part of the reality is that [Interior] simply does not have enough people going around to do enforcement and inspections" said Albersworth, whose organization supports a proposal in the department's fiscal 2012 budget request that would impose a small fee on oil and gas companies to pay for more inspectors.

A history of problems

Interior Department Inspector General Mary Kendall warnedin an April 2010 report to Congress that the government has "failed to carry out effective oversight and management to ensure all royalty income is collected." And in February 2011, the GAO identified the troubles as serious enough to put it on the watchdog's bi-annual "High Risk" report; it warned that the department's royalty collection shortcomings placed it among programs at a "high risk for waste, fraud, abuse mismanagement or in need of broad reform."

Like many breakdowns in government, this one has been brewing for years.

In January 1982, a federal commission investigating alleged royalties fraud and theft of oil from public lands criticized the government for not "fulfilling a public trust." The study, "Fiscal Accountability of the Nation's Energy Resources" — commonly known as the Linowes report for its economist-chairman, David F. Linowes — began pointedly: "Management of royalties for the Nation's energy resources has been a failure for more than 20 years."

The report went on to cite "disarray" in recordkeeping and "serious inadequacies" in how the government managed the royalty program. "The Nation can no longer afford mismanagement of royalties for its energy resources," it warned. "The stakes are too high."

Even then it was unclear how much was being lost. The 1982 report estimated "about one hundred million to several hundred million dollars a year," but acknowledged that was only a guess. "The exact amount of money the Federal government, the States and the [Indian tribes] lose each year is unknown."

More recently, the government decided to shut down a program that allowed oil and gas companies to make "in-kind" royalty payments. Companies had been allowed to pay in oil or gas, which the government could resell or stash away in the federal Strategic Petroleum Reserve. But in 2008 the Interior Department's inspector general documented a "culture of ethical failure" that described how government staff running the in-kind program socialized with oil and gas industry employees, routinely accepting gifts from them and even engaging in drug use and sexual relations with them.

A spokesman for the in-kind program told iWatch News that Interior Department employees are still tying up loose ends, such as unresolved royalty imbalances.

Vietnam, New Guinea have better collection systems

A series of GAO reports over the past decade detail the Interior Department's struggles with royalty collection, including one in 2008 where the GAO reported that a study of 104 royalty collection systems globally found that the U.S. federal royalty program brought in less revenue than all but 11. Among countries with more effective systems: Papua New Guinea, Vietnam and Norway.

The problems have their roots in the process itself. Each company is responsible for keeping track of the amount produced each month from federal lands or waters, then reporting that production to Interior, along with a total for how much the company owes in royalties. The assessment is based on the total value of that month's production, including the price — a number that fluctuates daily, making it hard to lock down a figure.

Interior auditors check the information but only a fraction of reports are subjected to a rigorous audit in which the company's production and revenue reports are compared against information from other sources. There is no blanket oversight of production facilities, and surprise inspections are rare.

While testifying on the department's fiscal 2012 budget request before a House appropriations subcommittee on March 17, officials from Interior acknowledged GAO's concerns. The department's requested budget addresses them by calling for, among other items, more staff and technology, said Greg Gould, director of the natural resources revenue office.

The planned enhancements — additional "production meter" inspectors and a feasibility study on the use of automated production metering systems — could go a long way in detecting underpayments, the GAO's Rusco told iWatch News.

At the appropriations hearing, Gould was repeatedly asked how much the government is losing in royalty revenues. He never answered the question. But he did acknowledge that the government has identified at least some of the money it was owed.

"Over the last 5 years our audit and compliance program has detected and collected more than half a billion dollars in companies' initial underpayments" Gould testified.

He also indicated that when it comes to collecting oil revenues, a little addition to the federal budget can go a long way.

For every dollar spent on audits, he said, four came back to the government.

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