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Report to the Chairman, Subcommittee on Energy and Mineral Resources, Committee on Natural Resources, House of Representatives

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MINERAL RESOURCES

BLM Needs to Improve Controls Over Oil and Gas Lease Acreage Limitation

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GAO

United States
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Resources, Community, and
Economic Development Division

B-259216

December 29, 1994

The Honorable Richard Lehman
Chairman, Subcommittee on Energy and
Mineral Resources
Committee on Natural Resources
House of Representatives

Dear Mr. Chairman:

The Mineral Leasing Act of 1920, as amended, (30 U.S.C. 181 et seq.) regulates the development of oil, gas, and coal on public domain lands.[1] For oil and gas leases, the act limits the acreage that one party may control in any one state to 246,080 acres, reflecting congressional concern about the potential for monopolistic control of federal oil and gas resources.[2] The act authorizes the Secretary of the Interior, through the Bureau of Land Management (BLM), to issue and administer onshore oil and gas leases, as well as coal leases, on federal lands. Currently, BLM administers over 51,000 producing and nonproducing oil and gas leases on about 37 million acres of federal lands. You asked us to determine the adequacy of BLM's controls intended to ensure that federal oil and gas leases are not issued to parties who have exceeded the acreage limitation.

Results in Brief

BLM's internal controls are not adequate to ensure that federal oil and gas leases are issued only to parties who have not exceeded the Mineral Leasing Act's acreage limitation. BLM allows oil and gas lessees to self-certify that they have not exceeded the acreage limitation, and the agency does have procedures for auditing compliance with the requirement. However, since 1993, BLM has not performed these compliance audits because it views this responsibility as having a low priority relative to other work and duties. In addition, when these audits were performed, BLM's strategy for selecting lessees was ineffective because it did not target parties approaching or appearing to exceed the acreage limitation. Instead, BLM used a stratified sampling methodology. Finally, in some cases, BLM has allowed companies that share the same officers, directors, or major stockholders (some of whom are also members of the same family) to be considered separate leaseholders under the acreage limitation.

[1]Public domain lands are, principally, lands owned by the federal government that have never been in private or state ownership.

[2]In Alaska, the aggregate limit is 600,000 acres.

By targeting parties whose lease holdings are approaching or appear to have exceeded the acreage limitation, our review identified a lessee who had exceeded the limitation by over 190,000 acres in Wyoming and by almost 27,000 acres in Nevada. By presuming that companies are affiliated when they share the same officers, directors, or major stockholders, our review identified five companies, including the one above, whose aggregate acreage exceeded the limit by over 800,000 acres in Wyoming, 435,000 acres in New Mexico, and 86,000 acres in Nevada.

Background

The Mineral Leasing Act, as amended, serves to prevent the concentration of control over federal oil and gas resources in a few companies or individuals. Under the act, once a party reaches the statutory acreage limitation, it is prohibited from controlling additional acreage in that state. The Secretary of the Interior has the authority to compel a party whose acreage is in excess of the statutory limitation to divest excess acreage and forfeit the leases on this acreage. Acreage to which a party holds the record of title, has an option for future ownership, or owns the operating rights must be counted against the limit. Certain holdings are excluded from the acreage computation, however, including those in unit agreements or development contracts.[3]

When issuing oil and gas leases, BLM relies primarily on bidders' self-certification; that is, bidders certify that they have met the qualification requirements of the act by signing the lease application form. In signing the form, bidders establish a legal responsibility for the accuracy of the statements made. Knowingly making false statements is a violation of 18 U.S.C. 1001, which provides for up to a $10,000 fine or up to 5 years in prison or both.

In addition to self-certification, BLM has developed internal controls to help ensure that federal oil and gas leases are not issued to parties who have already exceeded the acreage limitation. Specifically, it has developed an audit strategy to verify compliance. For states with more than 500,000 acres of lands under lease, BLM first stratifies lessees by the number of acres leased. The first group includes (1) about 400 lessees with more than 50,000 acres of lands under lease that may be counted against the acreage limitation and (2) parties who BLM personnel or others suspect may exceed

[3]Unit agreements combine separate lease interests into a single operating entity to develop a geographical area in the most efficient and economic manner, without regard to separate ownership rights. Development contracts are intended to allow oil and gas lease operators and pipeline companies to contract with a sufficient number of lessees to economically justify large-scale drilling operations for the production and transportation of oil and gas.

the limit; from this group, BLM randomly selects 51 lessees for audit. The second group includes about 11,000 lessees controlling 50,000 acres or less, and from this group BLM randomly selects another 33 for audit. From the 51 lessees selected from the first group, those controlling more than 200,000 acres are required to submit to BLM an accounting of all acreage that may be counted against the acreage limitation. Those with fewer than 200,000 but more than 50,000 acres are audited only if BLM identifies, through publications that identify corporate affiliations, related companies whose aggregate acreage exceeds 200,000 acres.

If a selected lessee appears to have exceeded the acreage limitation, the information is sent to the appropriate BLM state office for a more thorough audit. The responsible state office reconciles the lease holdings reported by the lessee with BLM's records, which include the records of title, options for future ownership, and ownership of the operating rights.

BLM's Internal Controls Do Not Identify Unqualified Bidders

BLM's internal controls are not adequate to ensure that federal oil and gas leases are not issued to parties who have exceeded the acreage limitation. As a result, companies have been able to compete for and obtain lease acreage beyond the acreage limitation, and other parties who wish to participate in developing federal oil and gas resources may be precluded from obtaining such leases.

Although self-certification establishes bidders' legal responsibility for the accuracy of the statements made on the lease application form, it does not ensure that the bidders have actually complied with the acreage limitation. To provide additional assurance, BLM established procedures for auditing selected lessees' acreage holdings. However, because of limited resources, BLM stopped performing these audits after 1992.

Compliance Audits Were Not Performed After 1992

Since 1993, BLM has not verified compliance with the acreage limitation because it views this responsibility as having a lower priority than other work and duties. For fiscal years 1990 through 1992, BLM's Central Audit Office, located in Cheyenne, Wyoming, performed the audits required under BLM's audit strategy. However, after requesting that BLM headquarters assign the audit responsibility to another state office with a lighter workload and receiving no response, the Central Audit Office stopped performing the audits. According to a Central Audit Office official, as of October 1994, BLM headquarters still had not responded to the request or to the Office's failure to perform the required audits.

BLM's Audit Strategy Is Ineffective

Through 1992, when it did attempt to verify compliance with the acreage limitation, BLM employed an audit strategy that proved ineffective. Specifically, under BLM's strategy, a sample of, rather than all, lessees with 200,000 acres or more was audited. In our review, we identified all parties with acreage holdings in excess of 200,000 acres and found that one company exceeded the acreage limitation by over 190,000 acres in Wyoming and by almost 27,000 acres in Nevada. Under BLM's method, the company that we identified as exceeding the acreage limitation in both Wyoming and Nevada stood about 1 chance in 8 of being selected for audit. On the basis of our review, BLM has initiated an acreage audit of the company we identified as exceeding the limit.

The probability that this company would have been selected would have increased significantly if BLM had audited all lessees whose lease holdings were approaching or appeared to have exceeded the acreage limitation. One alternative would be to reduce the universe from which BLM selects parties for audit to include only lessees with more than 200,000 acres of federal lands under lease that may be counted against the acreage limitation rather than the current threshold of 50,000 acres. BLM's data that we reviewed showed that, in Wyoming, five lessees had more than 200,000 acres under lease. BLM could audit this small number of lessees instead of randomly selecting from a larger universe, thereby auditing all lessees that are approaching the limit. BLM could then randomly select for audit other lessees from the universe of those controlling 200,000 acres or less to ensure audit coverage.

BLM Has Allowed Affiliated Companies to Exceed the Acreage Limitation

In addition to not targeting lessees near the acreage limitation, BLM's audits did not identify five companies that, in our opinion, are affiliated and whose aggregate acreage exceeded the acreage limitation in three states. We identified these companies as affiliates because they share officers, directors, and major stockholders (some of whom are also members of the same family). BLM's regulations and the lease application form state that lessees are accountable for all acreage that they control directly and indirectly. However, BLM bases its decisions on whether leased acreage will count against the acreage limitation strictly on the relationships that appear in publications identifying corporate affiliates.[4] The companies we identified as affiliates did not appear in these publications, and because BLM does not define the circumstances under which companies are

[4]BLM's manual identifies the National Register Publishing Company's Directory of Corporate Affiliations, Who Owns Whom and the Standard and Poor's Corporation's Standard and Poor's Corporation Records as the publications the agency uses to identify corporate affiliates.

considered affiliates, the agency allowed them to account for their acreage holdings separately.

In contrast, Interior's Minerals Management Service and Office of Surface Mining Reclamation and Enforcement[5] both presume that companies are under common control when they share the same directors, have family ties, or share stockholders who own 50 percent or more of the stock. The latter office also considers that being an officer of an entity constitutes control. When the presumption of control exists, both offices place the burden of proof on the companies to show that they are not related.

By presuming that companies are affiliated when they share officers, directors, or major stockholders, our review of September 1994 data identified five companies whose aggregate acreage exceeded the limitation by over 800,000 acres in Wyoming, 435,000 acres in New Mexico, and 86,000 acres in Nevada. On the basis of the results of our review, BLM has agreed to review its policies on the aggregate acreage of companies that appear to be under common control.

Conclusions

BLM's controls are not adequate to ensure that federal oil and gas leases are issued only to parties who have not exceeded the Mineral Leasing Act's acreage limitation. In addition, we believe that BLM's policies do not adequately define circumstances under which companies are considered to be under common control.

We are aware that federal land management agencies' staff are being asked to assume increasing responsibilities and to perform more duties and that trade-offs are being made among important yet competing work priorities.[6] However, if BLM does not verify compliance with the acreage limitation in the Mineral Leasing Act, it cannot ensure that lessees will not obtain monopolistic control over federal oil and gas resources. In addition, other eligible parties may be precluded from obtaining such leases.

[5]The Minerals Management Service is responsible for collecting, accounting for, auditing, and distributing revenues from federal and most Indian mineral leases. The Office of Surface Mining Reclamation and Enforcement oversees surface coal mining and the reclamation of mined lands.

[6]See, for example, Natural Resources Management Issues (GAO/OCG-93-17TR, Dec. 1992), Natural Resources Management: Issues to Be Considered by the Congress and the Administration (GAO/T-RCED-93-5, Feb. 2, 1993), and Forest Service Management: Issues to Be Considered in Developing a New Stewardship Strategy (GAO/T-RCED-94-116, Feb. 1, 1994).

Recommendations

To ensure that oil and gas lessees do not exceed the acreage limitation, we recommend that the Secretary of the Interior direct the Director of BLM to

- revise BLM's audit strategy to better target parties whose lease holdings are approaching or exceeding the acreage limitation;
- adopt a policy similar to the policies of the Minerals Management Service and the Office of Surface Mining and Reclamation Enforcement on the affiliations between parties when determining whether companies are under common control; and
- perform audits of lessees' compliance with the acreage limitation.

Agency Comments

Although we did not obtain written agency comments on a draft of this report, we discussed the results of our work with the Fluid Minerals Division Chief and the Leasing Qualifications Program Lead at BLM headquarters in Washington, D.C.; with the Acting Chief, Fluid Minerals Branch of the Mineral Resources Division, and the Supervisory Land Law Examiner in the Central Audit Office in Cheyenne, Wyoming; and with a representative of the Department of the Interior's Solicitor's Office in Washington, D.C. These officials generally agreed with the findings, conclusions, and recommendations in this report.

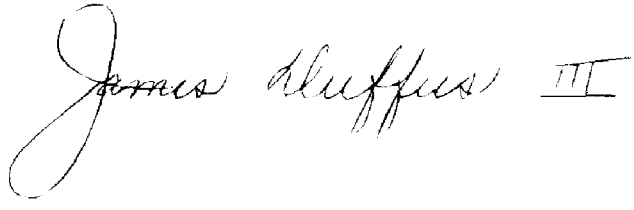
In conducting our review, we examined the relevant laws and regulations governing oil and gas lessees' qualifications, as well as pertinent documents at BLM. We also interviewed BLM officials at all organizational levels who are responsible for managing federal oil and gas leasing; these officials are in the Washington, D.C. office; in state, district, and resource area offices; and in the Denver Service Center. We obtained and analyzed data from BLM on mineral leases. We contacted officials in various states to obtain information on certain companies' corporate structures. We discussed common control with officials from the Minerals Management Service and the Office of Surface Mining Reclamation and Enforcement. Appendix I contains the details of our scope and methodology.

We performed our review between March and November 1994 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of the Interior and the Director, Bureau of Land Management. Copies are available to others upon request.

Please contact me on (202) 512-7756 if you have any questions about this report. Major contributors to this report are listed in appendix II.

Sincerely yours,



James Duffus III
Director, Natural Resources
Management Issues

Scope and Methodology

In April 1993, the Chairman, Subcommittee on Energy and Mineral Resources, House Committee on Natural Resources, asked us to assess the adequacy of the Bureau of Land Management's (BLM) controls intended to ensure that oil and gas leases are not issued to parties who have exceeded the acreage limitation.

We interviewed BLM officials responsible for managing federal oil and gas lessees' qualifications, including officials in Washington, D.C., and in six of BLM's state offices—Colorado, Nevada, New Mexico, Montana, Wyoming, and Utah. We selected these states because they have the greatest number of leased acres under BLM's management; all have more than 1 million acres of federal onshore leases.

We examined the relevant laws and regulations governing oil and gas lessees' qualifications. We also reviewed BLM documents, including pertinent acreage-audit and other case files in the agency's Central Audit Office located in Cheyenne, Wyoming, to (1) identify audit procedures and results and (2) confirm the information on acreage for certain leases. We obtained and reviewed BLM's relevant instructional memorandums, manuals, and reports. We also attended the August 1994 lease sale in Cheyenne, Wyoming, to identify BLM's procedures for such sales. We selected the Wyoming office because it handles the most leasing and because it continued to lease acreage to a lessee we identified as holding acreage in excess of the legal limit.

We obtained data from several sources. From BLM's Service Center in Denver, Colorado, we obtained acreage data for all existing federal oil and gas leases in each of the six states, as of September 1994. We also obtained data on the actions taken on these leases since their inception.

We identified and calculated the acreage chargeable to each lessee in each of the six states and summarized the data to identify which lessees had exceeded or were approaching the acreage limit in any state. We calculated the amount of chargeable acreage by multiplying each lessee's percentage of interest in a lease by the total acreage leased. We excluded some holdings that do not apply toward the limit. For example, if a lease was in a unit agreement or development contract, we did not count the affected acreage because it is not chargeable against the limit.

We then sorted the data by lessees' name and address to identify potentially related entities that have, for example, different names but the same address. Also, because BLM does not assign a unique identifier to

each lessee, variations in names occur within the data; we combined entities' holdings in such instances. On the basis of this initial identification of possibly linked corporations, we contacted state officials in Wyoming, Montana, Utah, New Mexico, Colorado, and Texas to obtain information on the identity of corporate officers and directors. We also interviewed officials at the Minerals Management Service and at the Office of Surface Mining Reclamation and Enforcement to determine how these offices' regulations and policies address common control over companies.

We discussed the contents of the draft report with responsible BLM officials, and they generally agreed with the contents of the report.

Major Contributors to This Report

Natural Resources Management Issues

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