



How Cheap Federal Leases Benefit Oil and Gas Companies

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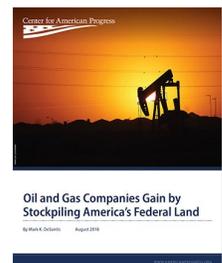
In 2008, the U.S. Securities and Exchange Commission (SEC) made it easier for companies to list what are known as proved undeveloped reserves (PUDs) as assets on their annual reports to investors and shareholders. Proved undeveloped reserves are subsurface oil and gas reserves that have yet to be drilled or brought into production. Historically, they were viewed as high-risk, low-value assets compared with developed reserves, due to the high capital costs required to bring these assets to market.

But the shift in SEC policy—in conjunction with other shifts in industry practices and technology—gave oil and gas companies a cheap and easy opportunity to add subsurface reserves as assets to their balance sheets, immediately improving companies' overall financial health, boosting their attractiveness to shareholders and investors, and even increasing their ability to borrow on favorable terms. Enabled by these changes, oil and gas companies are now stockpiling undeveloped leases on public land, which provides direct financial benefits to companies while delivering unfairly low returns to taxpayers for federally managed oil and gas. The overleasing of public lands also prohibits the U.S. Department of the Interior from managing these parcels for conservation and recreation opportunities.

This fact sheet summarizes findings from a 2018 Center for American Progress-commissioned study of how oil and gas companies use undeveloped—and often highly speculative—federal leases to increase their financial valuations.

Policy and technology developments provide boon for industry

- As of 2017, less than half of the nearly 26 million acres of federal land¹ under lease to oil and gas companies were producing oil or gas.
- Technological advances in the oil and gas industry—particularly the onset of the shale gas revolution that began around 2008—lowered the cost to drill and produce PUDs.
- With this drop in exploration and production (E&P) costs, PUDs became more valuable to companies and their investors.



This document summarizes the 2018 CAP report “Oil and Gas Companies Gain by Stockpiling America’s Federal Land.”

- At the same time as these technological shifts were occurring, the George W. Bush-era SEC promulgated the “Modernization of Oil and Gas Reporting” rule, which loosened regulations on reporting standards for the oil and gas industry.
- These changes gave companies greater leeway in how they reported on these newly high-valued PUDs, allowing predictive models to be used to estimate reserve volumes and expanding the maximum distance from producing wells from which companies could include estimates for “proved” reserves.
- The 2008 SEC rule was intended to help boost oil and gas companies’ stock prices and attract new investors following the 2008 economic collapse. However, the revised rule also appears to have given companies added incentive to engage in speculative bidding on oil and gas leases on public lands.

Undeveloped oil and gas reserves are now at least as valuable as developed reserves

- A CAP-commissioned study of more than 60 publicly traded oil and gas companies that hold federal leases found that both proved developed producing (PDP) and PUD reserve estimates are reliable predictors of a company’s market valuation and theoretical takeover price. Although PUD estimates have traditionally been seen as a less reliable indicator of a company’s value than traditionally lower-risk PDP reserve estimates, this new study indicates that PUD levels can sometimes serve as a slightly stronger indicator than PDP reserves of a company’s overall value, particularly during unfavorable market conditions in which low demand or commodity prices reduce the value of developed reserves.
- PUD estimates for the 60-plus companies studied nearly doubled within five years of the enactment of the new SEC regulations in 2008.
- This study also saw an increase in the correlation between a company’s reported PUD volumes and its total market value over the course of five years following the 2008 regulations.

Companies appear to be hoarding undeveloped reserves to boost takeover prices

- The study also examined acquisitions of publicly traded oil and gas companies since 2008. Newly acquired companies appear to have a higher percentage of undeveloped acreage than the average E&P company, regardless of size.

- On average, these newly acquired companies increased their rate of undeveloped acreage in the years immediately preceding buy-out, suggesting that companies are acquiring undeveloped acreage to boost PUD levels and potentially increase their takeover price—all without having to invest in costly drilling or exploration activities.
- According to a 2017 study conducted by Ernst & Young of the 50 largest U.S. companies, the oil and gas industry spent more on unproved property acquisition than on proved property acquisition in four of the past five years.
- This same study showed that unproved property acquisition expenditures increased by 119 percent from 2015 to 2016, while exploration and development costs dropped 35 percent and 52 percent, respectively, during the same time period.

Why does this matter?

- The more that financial markets value undeveloped reserves, the more incentive there is for oil and gas companies to cheaply stockpile leases on federal public lands.
- Since bid prices for federal leases are typically offered below market value as compared with those on private, state, or tribal lands, U.S. federal lands are a prime target for companies looking to add to their PUD reserves.
- While companies continue to benefit from amassing undeveloped reserves on federal leases, the U.S. taxpayer loses out on revenue from producing wells that the leased land is meant to generate.
- These undeveloped leases tie up land that would otherwise be managed for conservation, recreation, or other beneficial uses as required under the Bureau of Land Management's multiple use mandate.

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¹ "Federal land" refers to all land and interests in land owned by the United States that are subject to the mineral leasing laws managed and administered by the Bureau of Land Management. This does not include federal lands not managed by BLM, tribal lands, private land leases, or offshore leases administered by the Bureau of Ocean Energy Management. For a definition of "United States," see Legal Information Institute, "United States," available at https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=30-USC-2032517217-29248279&term_occur=3&term_src=title:30:chapter:29:section:1702 (last accessed June 2018). For a definition of "mineral leasing laws," which are administered by the secretary of the interior, see Legal Information Institute, "mineral leasing law," available at https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=30-USC-2071023005-832227489&term_occur=2&term_src=title:30:chapter:29:section:1702 (last accessed June 2018).