

*The 1998-1999 Oil and Gas Leases and the
Geological and Geophysical Amortization
Schedule: An Etude in G Minor*



Thinking Points, Vol. 1, No. 7

**Prepared by the Republican House Policy Committee
United States Representative Thaddeus G. McCotter, Chair
110th Congress**



Oilverture



*Now the oil's gone
And the money's gone
And the jobs are gone
Still we're hangin' on....*

**“Dry Country”
Bon Jovi**

(Musical Selection Courtesy of Hon. Todd Tiahart)



America's Challenge



During the latter 1990's, deepwater lease agreements between the federal government and American oil and gas companies contained a royalty incentive designed to encourage oil and gas exploration in areas where such costs ordinarily precluded profitability. The incentive allowed companies to extract a designated volume of oil and natural gas before paying royalties which, because they were tied to the extracted volume and not market prices, would increase in the event the market prices of oil and gas exceeded an established limit. Granted as additional incentives due to historically low crude oil and natural gas prices, such leases issued under the Clinton administration in 1998 and 1999 omitted this price limitation under the terms of these leases; consequently, these oil and gas company lease owners are not required to pay royalties until all of the incentive volume was produced, even though market prices for oil and gas have escalated past the limit established in other lease agreements.

In June 2006, the House passed "The Deep Ocean Energy Resources (DOER) Act" (HR 4761). A key provision in this bill sought to renegotiate the 1998-1999 Clinton administration's omission. Every oil and gas company holding a 1998-1999 lease had to agree to renegotiate new terms or be assessed a "conservation fee." This fee would approximately equal the amount of royalty payments the companies would have owed the federal government if leases had contained the market price threshold provision of prior

agreements (approximately \$11.4 billion). This language was not included as part of the Senate outer Continental Shelf bill (S. 3711), which was ultimately adopted by the House as part of the “Tax Relief and Health Care Act” (H.R. 6111) on December 7, 2006.

Nevertheless, on the Interior, Environment and related Agencies Appropriations bill (H.R. 5386) the House pressed its renegeing position by approving an amendment to practically prohibit oil and gas companies from pursuing new leases in the Gulf of Mexico unless and until they renegotiated their 1998-1999 lease terms. Not surprisingly, on December 14, 2006, the Interior Department renegotiated five of the twenty-five 1998-1999 deepwater leases. The renegotiated contracts contain a provision to collect royalty payments by applying the market price limitation for production occurring on or after October 1, 2006, when the 1998-1999 leases began to yield the companies something more than scant oil and gas production. Presently held by both integrated and independent energy companies, the twenty outstanding deepwater leases are the targets for new legislation.

Entwined with the 1998-1999 deepwater lease controversy is the Energy Policy Act of 2005’s (H.R. 6) amortization schedule, which allows oil and gas companies to amortize their geological and geophysical expenditures. These geological and geophysical expenditures allow scientists to discern potential oil and gas zones thousands of feet below the earth’s surface; thus, these activities constitute the energy industry’s equivalent of research and development. As a result, the Energy Policy Act of 2005 permitted

companies to amortize over two years all geological and geophysical expenditures incurred in connection with domestic oil and gas exploration.

Effective for geological and geophysical costs paid or incurred in taxable years beginning after the date of the legislation's enactment (August 8, 2005), this amortization provision could allow American companies to invest an additional \$974 billion for American companies' investment in domestic oil and gas production. Importantly, this provision was tailored to facilitate smaller energy companies' explorations for domestic oil and gas; and, to sharpen the point, the Tax Increase Prevention and Reconciliation Act of 2005 specifically disallowed this geological and geophysical amortization schedule for the large oil and gas companies, including Exxon, Mobil, Shell, BP, and Chevron.

Republican Principles



To promote our economy and protect our national security, America must become energy independent.



In this comprehensive strategic transition to energy independence, America must simultaneously increase domestic production; conservation; and the development of alternative fuels.



Americans have the right to just compensation for the private use of public property; and such compensation must be negotiated in good faith by willing participants.



We must expand our economy by reducing taxes on Americans to expand the private sector, not by raising taxes on Americans to expand the public sector.



Only a principled, imperative reason allows the sanctity of fair contracts freely agreed upon between a private party and the public sector to be governmentally abrogated by government.

Republican Policies



Congress must promote American energy independence, which will strengthen our economic vitality and national security; consequently, Congress must act to end our reliance on foreign oil, which costs American jobs and transfers our wealth to overseas regimes, many of which possess financial links to terrorist organizations.



Barring some major development in the area of cold fusion or other astonishing breakthrough, for decades to come petroleum and natural gas will be vital and irreplaceable sources of America's energy, especially in the areas of transportation and home heating. If Congress removes the incentives to discover and produce more domestic oil and gas, the law of supply and demand dictates the price of gasoline, heating oil, natural gas, and other associated energy sources will continue to precipitously rise and proportionately ravage our economy, especially in the already decimated manufacturing sector.



Congress must continue to ensure all future deepwater lease agreements, whether newly entered into or newly renegotiated, contains a provision whereby appropriate royalties are collected by the government. This will guarantee Americans just compensation for the private use of public property.



Congress must dedicate any new revenues derived from such leases to the critical components of a comprehensive strategic transition to American energy independence. Such critical components include the development of alternative fuels; an increase in domestic energy production and conservation; a decrease in foreign oil reliance; and the reduction of the federal deficit and/or debt.



While lengthening the incentive's time frame from five to seven years for major oil companies, Congress should retain the geological and geophysical expenditures. Eliminating the provision will impair domestic energy exploration by small independent oil and gas competitors, and decrease competition for the larger oil companies. Further, the loss of this exploration incentive will lead many domestic companies to engage in energy exploration overseas, which will out-source American energy jobs; place their operations and capital at risk on foreign soil; further expand our trade deficit; and impair our nation's transition to energy independence.



The federal government must provide a principled rationale for the coerced renegotiation of the 1998-1999 deepwater leases and the (prospective) termination of the geological and geophysical amortization schedule. While by no means universally accepted, American energy independence and its concomitantly strengthened economic and national security constitute a principled, imperative reason for the federal government to abrogate its 1998-1999 deepwater leases. (Contrarily, American energy independence constitutes a reason for not terminating the geological and geophysical amortization incentive.) If no principled rationale is put forward for the abrogation of the 1998-1999 deepwater leases, American energy companies

may conclude our government is unfavorable toward oil and gas exploration, and will focus their resources and efforts in foreign lands. This accords with how our domestic energy company's measure their risks abroad, which is primarily predicated upon the host government's stability, consistency, taxation schedule, regulatory construct and reputation for keeping their word. Indeed, these considerations are nearly always of greater import than the prospective remuneration from the project under consideration. Clearly, the federal government's leasing practices and commitment to honoring honestly negotiated leases will have a dramatic impact upon domestic petroleum exploration and production. Bluntly, if the government capriciously vitiates these leases and the amortization schedule, domestic energy will precipitously drop as companies continue to rudely recognize the federal government employs a vicious double standard: When you make a mistake, you owe the government; and when the government makes a mistake, you still owe the government (because, as any bureaucrat will try to convince you, the government never makes mistakes).

Advancing American Exceptionalism



America remains the leading economy of the world. Presently, however, our economic vitality and national security faces grave challenges, nowhere in the economic sector more direly than in the area of energy. It is, therefore, imperative for Congress to embark upon a comprehensive strategic plan for our national transition to energy independence. This plan must increase domestic energy production and conservation, and facilitate the rapid development and deployment of alternative energy sources. By so doing, America will lead the world to emulate our transition from a petroleum dependent economy; and, most importantly, we will further secure our God-given rights and humble hopes for our children and each succeeding generation of our free people.



Contributing Republican House Policy Committee Members



Hon. Mike Burgess (TX)

Hon. Mike Conaway (TX)



Hon. Trent Franks (AZ)

Hon. Thaddeus McCotter (MI)



Hon. Chip Pickering (MS)

Hon. John Sullivan (OK)



Hon. Lee Terry (NE)

Hon. Todd Tiahrt (KS)



Hon. Zach Wamp (TN)