

# Program Evaluation

## Minerals Management

Trust Land Management Division, DNRC



**ENVIRONMENTAL QUALITY COUNCIL**

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## Introduction

The Environmental Quality Council is required to evaluate programs within the Department of Natural Resources and Conservation pursuant to 75-1-324, MCA. That law requires the EQC to “review and appraise the various programs and activities of the state agencies, in the light of the policy set forth in 75-1-103, for the purpose of determining the extent to which the programs and activities are contributing to the achievement of the policy and make recommendations to the governor and the legislature with respect to the policy.”

The policy reads as follows:

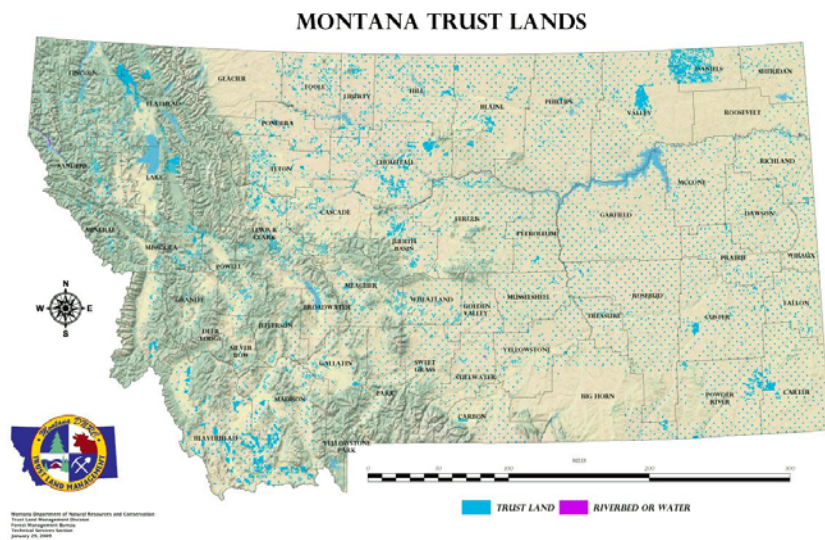
The legislature, recognizing the profound impact of human activity on the interrelations of all components of the natural environment, particularly the profound influences of population growth, high-density urbanization, industrial expansion, resource exploitation, and new and expanding technological advances, recognizing the critical importance of restoring and maintaining environmental quality to the overall welfare and human development, and further recognizing that governmental regulation may unnecessarily restrict the use and enjoyment of private property, declares that it is the continuing policy of the state of Montana, in cooperation with the federal government, local governments, and other concerned public and private organizations, to use all practicable means and measures, including financial and technical assistance, in a manner calculated to foster and promote the general welfare, to create and maintain conditions under which humans and nature can coexist in productive harmony, to recognize the right to use and enjoy private property free of undue government regulation, and to fulfill the social, economic, and other requirements of present and future generations of Montanans.

For each bureau within the Trust Land Management Division of the DNRC, the council allocated 68 hours of staff time.

## Minerals Management

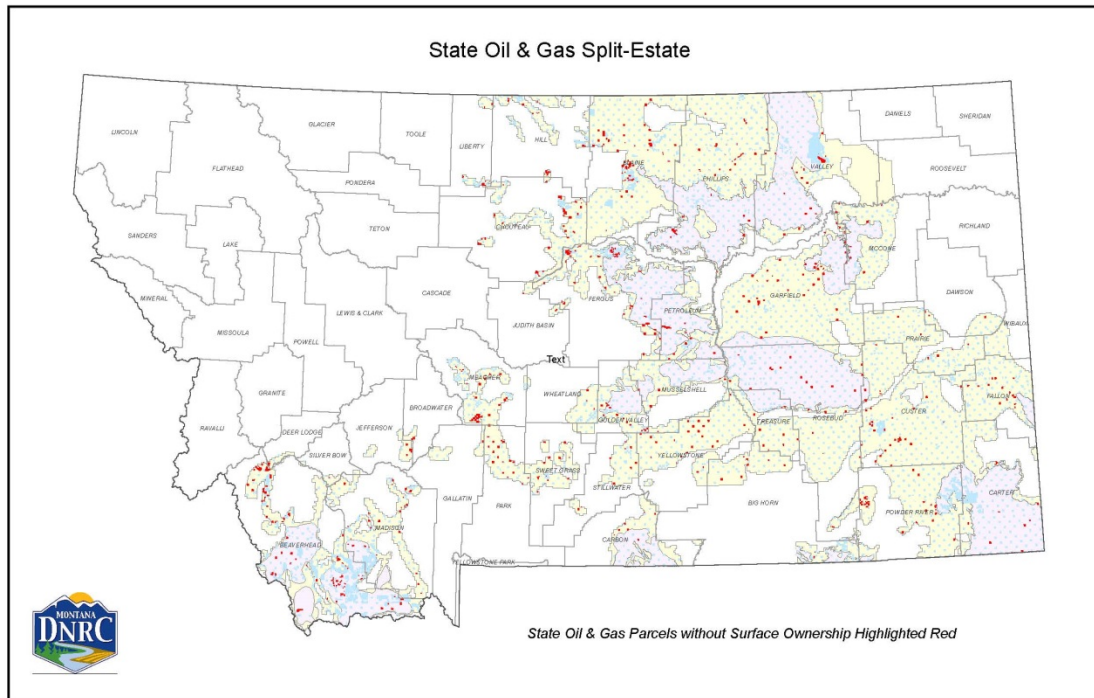
The state owns about 5.2 million surface acres and 6.2 million subsurface mineral acres, the difference the result of the sale of surface but the retention of mineral rights as required by law. Much of the land leased traces its history to the Enabling Act approved by Congress in 1889 granting sections 16 and 36 in every township within the state to Montana for the benefit of education. Subsequent acts also granted land for educational and state institutions.<sup>1</sup>

The Land Board oversees the management of the trust lands as well as some other state-owned land. Subsurface mineral leases are overseen by the Minerals Management Bureau within the



<sup>1</sup> DNRC Trust Land Management Division [Annual Report, 2014](#), 77-2-304, MCA

Trust Land Management Division of the Department of Natural Resources and Conservation. As of July 2015, the bureau managed 3,726 leases on about 1.5 million acres. The vast majority of those are for oil and gas, with coal leases a distant second. Leases also are in place for gravel, hard rock minerals, seismic activities, gas storage, and other land uses associated with minerals. Minerals may be leased by the state whether or not the state owns the surface. Minerals also may be leased on land owned by the state under navigable rivers and lakes.



## Leasing Procedure – Oil and Gas

Lease sales are generally held quarterly through a competitive oral bid process. The department accepts nominations of tracts for lease for 77 days prior to the sale date. Once nominated, the location of the tract is public; however the identity of the applicant is confidential to prevent potential bidders from colluding with each other to keep the rental price low.<sup>2</sup>

Public notice is provided through the department’s website, a mailing list, and newspaper publication. First-class notice is also issued to surface owners for land where the minerals are owned by the state but the surface is not.<sup>3</sup>

The minimum bid set by law is \$1.50 an acre for a total of at least \$100 a year. The term bonus bid is applied to the amount the winning bid is over the statutorily required minimum.<sup>4</sup> Leases are issued for at least 5 years but not more than 10 years.<sup>5</sup>

<sup>2</sup> A 2013 Legislative [performance audit](#) of oil and gas leasing procedures concluded the agency is adequately protecting the integrity of the bid process.

<sup>3</sup> 77-3-411, MCA

<sup>4</sup> 77-3-423, MCA

<sup>5</sup> 77-3-421, MCA

Lease activity is regulated by rule, the lease, and additional provisions to the lease. The lessee must comply with specific restrictions on surface activity, including no seismic activity within 300 feet of water, including wells, springs, rivers, or lakes. No seismic drilling or blasting is allowed within 1,320 feet of a building, water well, or spring or within 660 feet of a dam, unless the DNRC director determines the activity will not cause significant environmental effects.<sup>6</sup>

For damages to the surface caused by oil and gas operations, including necessary roads or other alterations related to the oil or gas operations, the lessee shall reach an agreement with the surface owner. If no agreement can be reached the lessee must abide by the decision of a board of arbiters.

Prior to the sale, the DNRC is required to list proposed restrictions necessary to protect the land and its resources. At any time during the lease, the agency may restrict surface activity to prevent erosion, fires or disruption of seasonal wildlife use. The agency must consult with the lessees and may require mitigation measures. Restrictions may also apply if historical or archaeological resources are discovered. However, for any restrictions imposed after the sale, the department may extend the lease to comply with the requirements with the goal of preventing the cancellation of the lease.<sup>7</sup>

Because the state makes additional money from oil and gas produced on state land, the lessee is required to start drilling within five years of the sale. If drilling is not started, the lessee is subject to a penalty of \$1.25 per acre for the sixth year and \$2.50 an acre for years 7 through 10. Failure to drill or pay the penalty is grounds for canceling the lease.<sup>8</sup>

The royalty payment is a percentage of the oil or gas produced on the land. The royalty must be at least 12.5% by law, but the statute allows the board to set a higher percentage. The current percentage is 16.67% of the oil or gas produced on the premises and not used for operations. The royalty may be collected on the market value of the oil or gas in the field.<sup>9</sup>

A company recently sued the state contending that it could deduct the cost of getting its gas to a marketable conditions, including compression, storage, and transportation from its royalty payment. A district court in 2012 sided with the state on that issue. The company also argued that the royalty should be calculated on the sale price of the product to a corporation affiliated with the producing company. The judge said there was no “factual underpinning” that the DNRC could require the royalty based on a price to a third party and remanded that back to the agency. The decision was not appealed. DNRC settled the case for about half the amount of money the agency originally said the company owed.<sup>10</sup>

To make sure royalty payments are accurate, which often means checking market value and possible deductions, the bureau employs two auditors who reconcile payments with state records as well as company records. As of December 2015, five audits were in progress, three were in the settlement phase, three were completed, and three were in the preliminary assessment phase.

The drop in oil prices has affected the number of active leases. In July of 2015, there were 3,588 oil and gas leases. In mid-December of 2015, there were 2,553 though the bureau reports that most of the leases dropped were

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<sup>6</sup> [36.25.233, ARM](#)

<sup>7</sup> [36.25.224, ARM](#)

<sup>8</sup> [36.25.209, ARM](#)

<sup>9</sup> 77-3-432, MCA and [35.25.210 ARM](#)

<sup>10</sup> Ranck Oil Co. Inc. v. State of Montana, BDV-2011-831.

speculative and in mostly nonproducing areas of the state. A lease where no drilling or surface disturbance occurred can be canceled by providing notice to the bureau. The lease and the bonus payment are nonrefundable.

## Leasing Procedure – Coal

Land may be nominated for coal leasing either the state or a potential lessee. Notice of a sale is posted on the agency website and published in a coal trade journal. Bids may be oral, written, or both. The Land Board call for bids on the percentage of the royalty, the first-year cash bonus, or a combination. The minimum rental, above which is the bonus for the first year, is \$2 an acre, though the Land Board set the minimum bid at \$3. Bids on the percentage of the royalty may not be less than 10% of the price of the coal at the mine as it is prepared for shipment, except for the amount paid in production taxes.<sup>11</sup> Currently, the royalty is 12.5% and production taxes cannot be excluded.

Both statute and rule say the royalty is based on the price at the mine, as opposed to the price a power plant or other end user might pay. This is similar to the leasing of federal coal, which is a subject of recent national debate.<sup>12</sup>

Coal leases are initially issued for 10 years and then for as long the coal produced can be sold at a profit. If a lease or a mining permit is challenged in an administrative agency or in court, the primary lease must be extended for as long as the lease or permit was subject to the challenge.<sup>13</sup>

## Otter Creek

The state acquired federal mining rights in 13 sections of Otter Creek tracts in eastern Montana in 2002 as part of a deal where the federal government bought out mining rights in the proposed Crown Butte gold mine near Yellowstone National Park.

In anticipation of leasing the coal in the area, the 2001 Legislature amended 77-3-303, MCA to state: “The board is encouraged to lease the property interests acquired from the federal government in the Crown Butte land exchange for coal mining purposes. The proceeds from the leases must be used for the direct funding of education, including K-12 school districts, institutions of higher education, and vocational-technical education, unless otherwise provided in the transfer agreement.”

In 2010, the Land Board approved a lease to a subsidiary of Arch Coal, for a bonus bid of \$85.8 million. The Department of Environmental Quality is reviewing several permitting actions for the Otter Creek Coal Mine.<sup>14</sup>

In light of the lease, the revision to 77-3-303 may no longer be necessary.

## Other Leases & Agreements

The bureau is also in charge of leasing rights for gravel and hard rock minerals and also issues seismic permits, gas storage agreements, and land use licenses. Land use licenses are typically for mineral-related activities not included in the lease, such as disposing of salt water, building access roads, or installing pipelines.

The bureau also managed oil and gas leases on riverbeds owned by the state. There are about 15,000 acres of riverbed leases that last fiscal year generated just less than \$1 million.

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<sup>11</sup> [36.25.304](#) and [36.25.309](#) ARM

<sup>12</sup> Helena Independent Record, “[House lawmakers scramble to block coal, oil, gas royalties from increasing](#)” Dec. 11, 2015

<sup>13</sup> 77-3-314, MCA

<sup>14</sup> DEQ [Otter Creek Project](#)

## Fiscal Overview

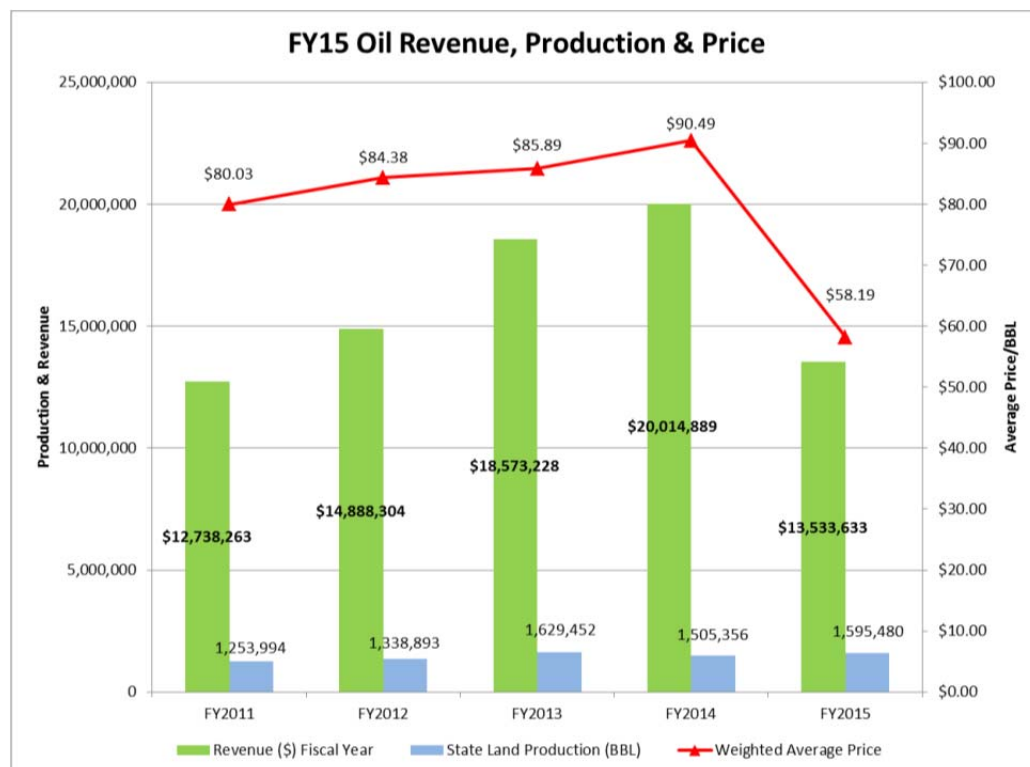
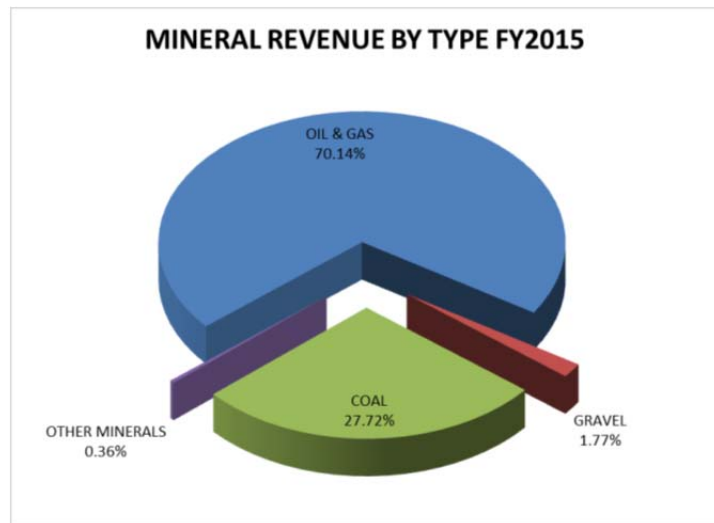
Of the \$28.6 million in mineral revenue generated on state land in fiscal year 2015, most of it came from oil and gas production followed by coal and gravel. Revenues from each of those three minerals declined from the previous year.

Oil and gas leases and the acreage leased declined by 31% between July 2014 and July 2015, which, along with the decline in oil prices, translated into a 33% decline in revenue.

Gravel is the third largest moneymaker and it too declined over the fiscal year from almost \$1 million to just more than \$500,000.

Of the \$28.6 million generated from mineral related activity in fiscal year 2015, \$27.2 million went toward funding K-12 education. Revenue generated on land held by a specific trust, such as the University of Montana, or the School for the Deaf and Blind, is allocated to those trusts.

The bureau has 9.75 full-time equivalent employees, including a geologist, a petroleum engineer, and two auditors. The annual budget is \$751,461.



## Enforcement

Field inspections of surface disturbances are mostly conducted by DNRC staff in regional offices who also inspect other state leases, including grazing and agriculture. Last year, 195 tracts were inspected and of those, action was required on 13 tracts, mostly cleaning up debris or weed control.

Oil and gas operations also are subject to regulatory review by the Board of Oil and Gas Conservation.

## Public Inspection of Records

Each of the mineral leasing sections in state law contains a statute similar to 77-3-451, MCA, which reads:

**Limitation on public inspection rights.** The department may withhold from public inspection any information obtained from an oil or gas lessee under this part if the information, including drill logs, seismic data, and lithographic descriptions, relates to the geology of the oil or gas lease. The withholding is effective for as long as the department considers it necessary either to protect the lessee's economic interest in the geologic information against unwarranted injury or to protect the public's best interest.

Passed in 1989 with support from the former Department of State Lands, the statutes were crafted so the state could keep lessee information confidential instead of releasing it to competitors, which might drive down leases and reduce revenue to the state.

It does not appear the statutes have been challenged, nor has a similar law for hard rock mining upon which the 1989 bill was based. However, the 1989 Legislature added a statement of intent to Senate Bill No. 154 directing the Land Board to adopt rules to implement the new laws:

The legislature intends that the rules be written broadly to cover all information that would legitimately be considered confidential by lessees, including, as appropriate, mineral quality and quantity, mineral location, mineral depth, cost of production, and the extent of the reserves. This information may include economic or engineering data. The legislature also intends that the rules establish a procedure whereby the lessee may notify the department of state lands [now department of natural resources and conservation] of information it considers to be confidential and to be notified whether the department agrees before the lessee submits the information. Furthermore, the legislature intends that the rules include a process to protect the lessee's interests if the department considers declassification of the information at a future date.

The Land Board has not adopted rules to implement the law.

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