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The Gift that Keeps on Giving: An Examination of the Growing Problem of Offshore Oil and Gas Royalty Relief

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THE GIFT THAT KEEPS ON GIVING: AN EXAMINATION OF THE GROWING PROBLEM OF OFFSHORE OIL AND GAS ROYALTY RELIEF

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I. INTRODUCTION

In recent months, our country has become a place where the government has been increasingly forced to subsidize big business. With the federal takeover of Fannie Mae and Freddie Mac,¹ the massive \$700 billion bailout of the financial giants,² and most recently, a \$17.4 billion executive bailout of Detroit's automobile industry,³ it appears that the American people are becoming more and more responsible for the operations of corporate America. There is a government bailout of another sort, however, going on in the Gulf of Mexico — only in this case the bailout is financing oil companies that are already basking in record profits. Originally designed to spur offshore production, this superfluous “bailout” could cost the American people up to \$53 billion in lost revenue.⁴ In today's troubling financial times, the American people deserve a hard look at a potential remedy to what many have called “corporate welfare.”⁵ This is especially true when the \$53 billion is not being allocated to a failing company or industry, but to one of the most profitable industries in the nation today.⁶

In 1995, oil and gas in the deep waters of the Gulf of Mexico were a virtually untapped resource.⁷ Oil and gas prices were low at the time, and it was simply too expensive to explore and drill in the deepest waters.⁸ In an attempt to

¹ Press Release, U.S. Dept. of the Treasury, Statement by Sec'y Henry M. Paulson, Jr. on Treasury and Fed. Hous. Fin. Agency Action to Protect Fin. Markets and Taxpayers (Sept. 7, 2008), available at <http://www.ustreas.gov/press/releases/hp1129.htm>.

² See Mark Landler & Edmund L. Andrews, *Bailout Bill Wins Approval: Democrats Vow Tighter Rules*, N.Y. TIMES, Oct. 4, 2008, at A1; see also Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 1 (2008).

³ See David E. Sanger, David M. Herszenhorn & Bill Vlasic, *Bush Aids Detroit, but Hard Choices Wait for Obama*, N.Y. TIMES, Dec. 20, 2008, at A1.

⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, OIL AND GAS ROYALTIES: LITIGATION OVER ROYALTY RELIEF COULD COST THE FEDERAL GOVERNMENT BILLIONS OF DOLLARS 4 (June 5, 2008) [hereinafter 2008 GAO REPORT].

⁵ See 141 CONG. REC. H11854-01, 81159 (1995) (statement of Rep. Vento) (“This policy is an unjustified giveaway, a tax break for big corporations at the expense of the American taxpayer. Unfortunately, House conferees completely ignored the wishes of the majority of the House and supported the corporate welfare approved by the Senate.”).

⁶ See, e.g., David Ellis, *Exxon Shatters Profit Records: Oil Giant Makes Corporate History by Booking \$11.7 Billion in Quarterly Profit: Earns \$1,300 a Second in 2007*, CNN MONEY, Feb. 1, 2008, http://money.cnn.com/2008/02/01/news/companies/exxon_earnings/ (“Exxon Mobil made history on Friday by reporting the highest quarterly and annual profits ever for a U.S. company, boosted in large part by soaring crude prices. Exxon, the world's largest publicly traded oil company, said fourth-quarter net income rose 14% to \$11.66 billion, or \$2.13 per share. The company earned \$10.25 billion, or \$1.76 per share, in the year-ago period.”).

⁷ Emily Heersink, *Royalty Robbery: How Statutory Supremacy and the Christian Doctrine Require Oil Companies to Pay Royalties on Leases Missing the Deep Water Royalty Relief Price Threshold Clause*, 37 PUB. CONT. L.J. 303, 306 (2008).

⁸ 141 CONG. REC. S17019-03, S17023 (1995) (statement of Sen. Murkowski) (“With modern technology, we will be able to allow oil and gas extraction in deep-water areas in excess of this 2,000 to 3,000 feet, but the cost would be tremendous, Mr. President.”).

correct this problem and slow down the United States' growing dependence on foreign oil, Congress passed the Deep Water Royalty Relief Act of 1995 ("DWRRA" or "the Act").⁹ The Act provided that oil and gas companies would not have to pay the federal government royalty on certain leases in the deep waters of the Gulf of Mexico.¹⁰ Congress believed that the royalty relief would immediately spur production, lead to additional and elevated signing bonuses,¹¹ and create new, high paying jobs for American citizens.¹²

However, the Act contained a controversial provision that provided mandatory and automatic royalty relief for all leases signed within the first five years of the DWRRA's enactment, up to a specified volume of oil or gas.¹³ To many oil and gas companies, this provision meant that no matter how high prices rose, they would receive royalty-free production up to the statutory volumes.¹⁴ On the other hand, the Department of the Interior, the agency charged with the administration of federal oil and gas leasing, construed the statute more loosely, in a way that did not limit its ability to halt royalty relief if prices rose above a certain threshold.¹⁵ Because these leases are operative for as long as oil or gas is produced from the site, many leases signed during those five years continue to be in effect today and will continue to be for years to come.¹⁶

⁹ Deep Water Royalty Relief Act of 1995, Pub. L. No. 104-58, tit. 3, §§ 301–306 (codified in part at 43 U.S.C. § 1337 (2006)).

¹⁰ *Id.* § 302–04.

¹¹ 141 CONG. REC. H11854-01 (1995) (statement of Rep. McInnis) ("The Minerals Management Service has estimated that the revenue impacts of the new leasing under § 304 of Senate 395 [the DWRRA] for lease sales in the central and western Gulf of Mexico between 1996 and 2000, the deep water royalty relief provisions would result in an increased bonus of \$485 million, \$113.5 million in additional bonuses on tracts that would have been leased without relief, and \$350 million in bonuses from tracts that would not have been leased until after the year 2000, if at all, without relief.").

¹² 141 CONG. REC. H11854-01 (1995) (statement of Rep. Brewster) ("Since 1982, 450,000 jobs were lost in just the exploration sector of the U.S. petroleum industry. That is almost half the number of jobs lost in the entire domestic manufacturing sector. More than one out of every two workers who searched for oil and natural gas, or helped recover it, lost their job. But today, Mr. Speaker we can begin to make a difference for oil and gas workers, for those in related industries, and for their families and communities.").

¹³ *See* Pub. L. No. 104-58, § 304 (uncodified, but present in a note to 43 U.S.C. § 1337 (2006)).

¹⁴ *See infra* Parts V.A–B.

¹⁵ *Id.*

¹⁶ The leasing of oil and gas on federal lands is governed by 30 U.S.C. § 226:

Competitive and noncompetitive leases issued under this section shall be for a primary term of 10 years: *Provided, however,* That . . . [e]ach such lease shall continue so long after its primary term as oil or gas is produced in paying quantities. Any lease issued under this section for land on which, or for which under an approved cooperative or unit plan of development or operation, actual drilling operations were commenced prior to the end of its primary term and are being diligently prosecuted at that time shall be extended for two years and so long thereafter as oil or gas is produced in paying quantities.

Further complicating the issue, the Interior Department's leases issued in the five-year time span following the Act's enactment were inconsistent, clouding the interpretation of the already-vague statute.¹⁷ Leases issued in 1996, 1997, and 2000 contained price thresholds, which cut off royalty relief if oil and gas prices rose above the threshold.¹⁸ However, the 1031 leases issued in 1998 and 1999 did not contain price thresholds.¹⁹ Therefore, these leases could produce oil and gas free of any obligation to pay royalty up to the statutory volumetric threshold, no matter how high oil and gas prices soared. The issuance of these leases in 1998 and 1999 has been called a "monumental blunder" and "one of the greatest train robberies in the history of the world."²⁰ Others, however, argue that the DWRRA makes royalty relief in all leases issued from 1996 through 2000 automatic, up to the volumetric threshold, and thus it is not the 1998 and 1999 leases that were the problem. Rather, the leases in 1996, 1997, and 2000 that contained illegal price thresholds in conflict with the statute are the true "blunder."²¹

Kerr-McGee,²² a Houston-based oil company operating in the Gulf of Mexico, recently took this issue to court.²³ Ruling in favor of Kerr-McGee, the Western District Court of Louisiana held that price thresholds in leases issued between 1996 and 2000 are in conflict with the clear and unambiguous language

30 U.S.C. § 226(e) (2006).

¹⁷ Edmund L. Andrews, *Vague Law and Hard Lobbying Add up to Billions for Big Oil*, N.Y. TIMES, Mar. 27, 2006, at A1 [hereinafter *Vague Law*] ("But in what administration officials said appeared to be a mistake, Clinton administration managers omitted the crucial escape clause [price threshold] in all offshore leases signed in 1998 and 1999. At the time, with oil prices still below \$20 a barrel, the mistake seemed harmless. But energy prices have been above the cutoff points since, 2002, and Interior Department official estimate that about one-sixth of production in the Gulf of Mexico is still exempt from royalties.").

¹⁸ MARC HUMPHRIES, CRS REP. FOR CONG., ROYALTY RELIEF FOR U.S. DEEPWATER OIL AND GAS LEASES 6 (Sept. 18, 2008), available at http://assets.opencrs.org/rpts/RS22567_20080918.pdf ("According to the Minerals Management Service, although the Secretary of the Interior is not required to impose price thresholds in each lease (but has the discretion to do so), all lease sales held since the enactment of DWRRA included price thresholds except those held in 1998 and 1999.").

¹⁹ *Oil and Gas Royalty Management at DOI: Hearing Before the S. Comm. on Energy and Natural Resources*, 110th Cong. 15 (2007) (statement of Mark Gaffigan, Acting Dir., U.S. Gov't Accountability Office).

²⁰ Edmund L. Andrews, *U.S. Royalty Plan to Give Windfall to Oil Companies*, N.Y. TIMES, Feb. 14, 2006, at A1 [hereinafter *Royalty Plan*] (quoting U.S. Rep. George Miller).

²¹ See *infra* Parts V.A–B.

²² Kerr-McGee Oil and Gas Company is now owned by Anadarko Petroleum Corporation. See Russell Gold, *Anadarko to Buy Kerr-McGee and Western Gas: Two Separate Deals Valued at Combined \$21.1 Billion*, WALL ST. J., June 24, 2006, at A3.

²³ See *Kerr-McGee Oil & Gas Corp. v. Allred*, No. 2:06CV0439, 2007 WL 3231634 (W.D. La. 2007) [hereinafter *Kerr-McGee* District Court].

of the DWRRA.²⁴ This ruling was affirmed by the Fifth Circuit on January 12, 2009, and the Department of Interior's petition for certiorari was denied by the United States Supreme Court on October 5, 2009.²⁵ While the decision was the legally correct one, its ultimate impact proved costly to the federal government. Because of this ruling, there is virtually no distinction between the "blundered" 1998 and 1999 leases, and those which contained unenforceable price thresholds.

As of the date of publication of this Note, all actions by Congress attempting to mitigate the unforeseen impact of the Deep Water Royalty Relief Act have focused only on the 1998 and 1999 leases. The *Kerr-McGee* ruling, while legally accurate, strikes a major blow to congressional efforts in renegotiating the leases without price thresholds. The ruling also complicates Congress's efforts in imposing price thresholds for future production from all 1996–2000 leases, and virtually eliminates its ability to retroactively collect royalty from these leases.²⁶

The issue of royalty relief in offshore drilling is both complicated and controversial — a troubling combination. This Note will attempt to clarify the purpose and effect of royalty relief on offshore oil and gas production, and highlight the controversial and costly issues that have arisen because of royalty relief. Ultimately, this Note endorses legislative action in order to mitigate the damaging effect the Deep Water Royalty Relief Act of 1995 has had on the American people, and it assures the constitutionality of one example of such an action.

Part II of this Note outlines the statutory framework surrounding the issuance of offshore oil and gas leases, providing a clear understanding of the basics of federal offshore leasing. Part III will familiarize the reader with offshore royalty relief, a concept that has been riddled with strife since its inception. Part IV outlines the cost of royalty relief to the government and the American people, currently estimated at around \$53 billion in lost revenue.²⁷ Part V summarizes the recent ruling in *Kerr-McGee Oil & Gas Corp. v. Allred*, and explains the vast impact this case will have on royalty relief in the Gulf of Mexico as well as the congressional efforts to recoup billions in lost revenue because

²⁴ *Id.* at 4 (holding that “[t]he price threshold requirement found in Kerr-McGee’s Mandatory Royalty Relief leases is similarly unlawful under the plain text of the DWRRA because DWRRA’s § 304, applying to new leases, clearly requires minimum royalty relief. The Interior has no discretion to enact a price threshold requirement that applies to volumes below the minimum volume of royalty-free production.”).

²⁵ *Kerr-McGee Oil & Gas Corp. v. U.S. Sec’y of Interior*, 554 F.3d 1082 (5th Cir. 2009), *cert. denied*, 130 S. Ct. 236 (2009) [hereinafter *Kerr-McGee* Fifth Circuit].

²⁶ Because the *Kerr-McGee* litigation was upheld by the Fifth Circuit, the 1998 and 1999 leases without price thresholds are absolutely legal and enforceable, and a retroactive application of price thresholds in contradiction to a valid statute could be considered a taking of a property right in contradiction of the Takings Clause of the Fifth Amendment. *See infra* Part VII for more discussion on this subject.

²⁷ *See* 2008 GAO REPORT, *supra* note 4, at 4.

of royalty relief. Part VI discusses the proposed congressional actions to impose price thresholds on 1998 and 1999 leases — specifically the Royalty Relief for American Consumers Act. Part VII analyzes whether such efforts would be an unconstitutional “taking” given the recent ruling in *Kerr-McGee*. Finally, Part VIII discusses this author’s recommendations for future congressional action while taking into account the *Kerr-McGee* ruling as well as the constitutional issues that may arise from what will obviously be a highly controversial and likely litigated statutory enactment.

II. A BRIEF HISTORY OF OFFSHORE OIL & GAS LEASING

Offshore oil and gas leasing is governed by the Outer Continental Shelf Lands Act of 1977 (“OSCLA”), and is run by the Department of the Interior.²⁸ By the 1940s, it had been postulated by many geologists that vast petroleum reserves existed beneath the continental shelf in the Gulf of Mexico.²⁹ Recognizing the value of this reserve, President Harry Truman implemented the now-famous Truman Doctrine, claiming exclusive federal jurisdiction over the natural resources on and below the outer continental shelf of the United States.³⁰ The governance of offshore minerals and regulation of development activities are bifurcated between state and federal law.³¹ Generally, states have the power to control offshore activities within three miles of its coast, while the federal government and its regulatory regime governs from the state’s offshore boundary to a minimum of 200 miles offshore.³²

Recognizing the national value of the outer continental shelf reserves, Congress implemented the Outer Continental Shelf Lands Act in 1977.³³ This Act gives the Secretary of the Interior the power to lease the resources beneath this federal land, and to deposit any revenue from these resources into federal treasuries.³⁴ The Act provides a comprehensive system that spans the entire life of an oil and gas lease from development planning, leasing, exploration, to ultimate production.³⁵ In February of 2006, the Department of the Interior released a comprehensive inventory of outer continental shelf (“OCS”) resources that

²⁸ See 43 U.S.C. § 1331 (2006).

²⁹ Heersink, *supra* note 7, at 305.

³⁰ *Id.*

³¹ JON O. SHIMABUKURO, CRS REPORT FOR CONGRESS, OFFSHORE OIL AND GAS DEVELOPMENT: LEGAL FRAMEWORK 1–2 (July 14, 2006), available at https://www.policyarchive.org/bitstream/handle/10207/2821/RL33404_20060714.pdf?sequence=1.

³² *Id.* at 2–3.

³³ See 43 U.S.C. § 1331 (2006).

³⁴ 43 U.S.C. § 1334(a) (2006) (“The Secretary shall administer the provisions of this subchapter relating to the leasing of the outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions.”).

³⁵ SHIMABUKURO, *supra* note 31, at 4.

estimated that 8.5 billion barrels of oil and 29.3 trillion cubic feet of natural gas were present in the OCS.³⁶

In order to take advantage of these vast natural resources, OSLA envisions a leasing process that both protects the environment and produces a financial return to the federal government.³⁷ The Department of the Interior's Minerals Management Service ("MMS") is responsible for managing the exploration and development of offshore federal resources, and awards leases to interested parties through a competitive, sealed bonus-bidding process.³⁸ The highest bidder is awarded the lease, and must pay an up-front cash payment called a "bonus bid" in order to secure the lease.³⁹ The successful bidder must also pay an annual rental fee in order to retain the right to develop the resources in the leasing area for the life of the lease.⁴⁰ The rental fee is replaced by a royalty payment — an annual payment to the federal government based on the amount of the mineral produced that year — when and if the lease begins to produce oil or natural gas.⁴¹ The total revenue collected by the MMS each year from offshore leasing fluctuates based on a number of factors including the market prices of minerals, the location of the oil and gas wells, the lease terms, and the number of lease sales.⁴² According to the MMS, the total revenue from the federal offshore oil and gas leasing program has recently averaged between five and seven billion dollars per year.⁴³ Thus, offshore oil and gas activities can be highly profitable for both the oil and gas lessees and the federal government. Economic realities in the early and mid-1990s, however, made drilling in the deepest parts of the continental shelf an unattractive investment.⁴⁴ The Secretary of the Interior struggled to lease these lands to oil and gas companies which left the United States with a potentially valuable yet untapped resource.

³⁶ MARC HUMPHRIES, CRS REP. FOR CONG., OUTER CONTINENTAL SHELF: DEBATE OF OIL AND GAS LEASING AND REVENUE SHARING 14 (Jan. 22, 2008), available at <http://www.au.af.mil/au/awc/awcgate/crs/rl33493.pdf> [hereinafter OUTER CONTINENTAL SHELF].

³⁷ HUMPHRIES, *supra* note 18, at 2.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ See ERIN MASTRANGELO, ENERGY INFORMATION ADMIN., OFFICE OF OIL AND GAS, OVERVIEW OF THE FEDERAL OFFSHORE ROYALTY RELIEF PROGRAM 1 (June 2006), available at <http://tonto.eia.doe.gov/ftproot/features/ngoffshore.pdf>.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ 141 CONG. REC. H11854-01, H11860 (1995) (statement of Rep. Wicker) ("Let us look at the facts. Right now, restrictive royalties have effectively shut down deep-water drilling. Only 6 percent of the deep-water leases are in production. That is compared to 50 percent of leases which are in production in shallow waters.").

III. ROYALTY RELIEF

A. *The Need for an Incentive*

By the early 1990's, oil and gas production in the Gulf of Mexico had slowed to a standstill as most oil reservoirs in shallow waters had already become depleted.⁴⁵ Oil and gas reservoirs in deeper waters remained untapped, but with oil prices at a mere \$16 a barrel, production from these deep reservoirs was simply not an economic reality.⁴⁶ Oil and gas companies began to lobby for help from Congress in order to spur production from these potentially lucrative deep water reserves.⁴⁷ With oil and gas companies paying the United States at least a 12.5% royalty from all production under the Outer Continental Shelf Lands Act, the concept of royalty relief became the incentive of choice for oil companies.⁴⁸ In short, royalty relief allows oil and gas companies to develop and sell oil and gas belonging to the United States without having to pay the usual 12.5% royalty. After several years of failed efforts at implementing a royalty relief scheme, Congress finally answered with the Deep Water Royalty Relief Act of 1995.⁴⁹

B. *The Deep Water Royalty Relief Act of 1995: Enactment and Purpose*

Recognizing the controversial nature of the Act, its supporters buried its language in a much less controversial bill which lifted the ban on exporting crude oil from Alaska's North Slope.⁵⁰ While the Act had the support of the

⁴⁵ Heersink, *supra* note 7, at 306.

⁴⁶ See *supra* note 8 and accompanying text; see also *Vague Law*, *supra* note 17, at A1 (“With crude oil selling for about \$16 a barrel, scores of wildcatters and small exploration companies had gone out of business. Few companies had any stomach for drilling in water thousands of feet deep, and industry leaders like Exxon and Royal Dutch Shell were increasingly focused on opportunities abroad.”).

⁴⁷ 141 CONG. REC. H11854-01, H11875 (1995) (statement of Rep. Miller) (“[O]il company lobbyists have swarmed over the Hill. The oil corporations have hired Republicans, Democrats, anybody to plead their special interest case. And the lobbying has come from the Clinton administration, too, that cut a special deal with the oil industry. It has been a massive lobbying effort. You’d spend a lot of money on well-connected lobbyists, too, if the prize was a half billion dollars for doing nothing more than you are doing right now.”).

⁴⁸ HUMPHRIES, *supra* note 18, at 2 (“In addition to the cash bonus bid, a royalty rate of 12.5% or 16.66% has been imposed on the value of production, with royalties sometimes paid ‘in kind.’ More recently, the MMS imposed an 18.75% royalty rate on its offshore leases.”).

⁴⁹ Pub. L. No. 104-58 (codified in part at 43 U.S.C. § 1337 (2006)).

⁵⁰ Officially called the “Alaska Power Administration Asset Sale and Administration — Exports of Alaskan North Slope Oil Act,” the Bill ended the 22-year ban on exporting crude oil from Alaska's North Slope. Speaking to the inclusion of the DWRRA into the Alaskan North Slope Act, Representative Beilenson stated, “[t]his controversial provision ought not to be a part of the conference report before us; we ought not to waive the rule requiring germaneness so that this controversial exemption for oil and gas producers — a provision the house voted to oppose — can become law attached to a much less controversial bill.” 141 CONG. REC. H11854-01, H11857 (1995) (statement of Rep. Beilenson).

Clinton Administration and passed both the House and the Senate with ease,⁵¹ the Act's potential cost to the government was not withheld from congressional debate.⁵² Democratic Congressman George Miller of California, the key opponent of the Act, was well aware of its potential price tag to the American people. He stated in debate:

[T]his debate today will not be about the underlying bill which is overwhelmingly supported in this House but, rather, it is about the hijacking of this bill by the Senate to include a royalty holiday for the major oil companies that drill in what the Senate says is deep water. That is a provision that we should not allow to stand because it simply cannot be justified. It cannot be justified because it is a raid on the taxpayers of this country to provide one of the wealthiest industries in this country help that they do not need.⁵³

While Congressman Miller and others made spirited efforts to block the DWRRA's enactment, it nonetheless passed the Senate sixty-nine to twenty-nine, with one abstention, and the House 289 to 134, with nine abstentions.⁵⁴ It was signed by President Clinton on November 28, 1995.⁵⁵ The White House Press Secretary stated that "providing deepwater royalty relief will reduce America's dependence on unreliable sources of imported oil," noting that the bill would also "contribute an extra \$200 million in bonus and royalty payments to the U.S. Treasury."⁵⁶

C. *Exploring the DWRRA: Three Types of Leases*

The DWRRA creates three categories of deepwater leases based on the location of the lease and the date of issuance of the lease.⁵⁷ Leases issued prior to the DWRRA's enactment on November 28, 1995 are generally referred to as Pre-Act Leases.⁵⁸ The amount of royalty relief provided for these leases is determined by an economic evaluation in which the oil and gas company must

⁵¹ See 1995 WL 699656, Press Secretary's Statement on North Slope Oil Bill Signing (Nov. 28, 1995) [hereinafter Press Secretary's Statement] ("The Administration-backed measure also provides new incentives that will stimulate oil and gas production in the United States . . .").

⁵² The Act was verbally opposed by Representative Miller, Representative Beilenson, Representative Vento, and Representative Scarborough, among others in House debate. 141 CONG. REC. H11854-01 (1995).

⁵³ 141 CONG. REC. H11854-01, H11868 (1995) (statement of Rep. Miller).

⁵⁴ See H.R. REP. NO. 104-312 (1995) (Conf. Rep.).

⁵⁵ *Id.*

⁵⁶ See Press Secretary's Statement, *supra* note 51.

⁵⁷ See Pub. L. No. 104-58, § 302; see also MASTRANGELO, *supra* note 40, at 2.

⁵⁸ See 30 C.F.R. § 203.0 (2009).

prove that drilling in that locality would not be economically feasible without royalty relief.⁵⁹ These leases are governed by section 302 of the DWRRA, which expressly provides that no royalty relief is allowed if the price of oil or gas meets a price threshold, as defined by Congress.⁶⁰ These price thresholds have also been defined and implemented by MMS regulations. Specifically, the regulations suspend royalty relief if oil prices exceed \$28.00 per barrel.⁶¹

Leases issued after November 28, 2000 are called Post-Act Leases.⁶² Royalty relief incentives under these leases are granted on a lease-specific basis, based on an economic evaluation, and limited by specific royalty suspension volumes.⁶³ These leases are governed by section 303, and the Secretary is authorized to provide royalty relief and to impose price thresholds.⁶⁴

The final category of leases are referred to as Eligible Leases and are the leases at issue in this controversy.⁶⁵ These leases were issued between November 28, 1995 and November 28, 2000 — the five years after the DWRRA was passed.⁶⁶ Under these leases, royalty relief is not based upon an economic evaluation, but rather it is mandatory and automatic up to a specified volume of product.⁶⁷ These leases are governed by section 304 of the DWRRA.⁶⁸ This

⁵⁹ See Pub. L. No. 104-58, § 302(C)(ii) (“Upon submission of a complete application by the lessee, the Secretary shall determine within 180 days of such application whether new production from such lease or unit would be economic in the absence of the relief from the requirement to pay royalties provided for by clause (i) of this subparagraph. In making such determination, the Secretary shall consider the increased technological and financial risk of deep water development and all costs associated with exploring, developing, and producing from the lease.”).

⁶⁰ See Pub. L. No. 104-58, § 302(C)(v) (“During the production of volumes determined pursuant to clauses (ii) or (iii) of this subparagraph, in any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds \$28.00 per barrel, any production of oil will be subject to royalties at the lease stipulated royalty rate.”).

⁶¹ 30 C.F.R. § 203.78(a) (2009) (“Suppose your base oil price threshold set under paragraph (a) is \$28.00 per barrel, and the daily closing NYMEX light sweet crude oil prices for the previous calendar year exceeds \$28.00 per barrel, as adjusted in paragraph (h) of this section. In this case, we retract the royalty relief authorized in this section and you must: (1) Pay royalties on all oil production for the previous year at the lease stipulated royalty rate plus interest . . . and (2) Pay royalties on all your oil production in the current year.”).

⁶² See 30 C.F.R. § 203.0 (2009).

⁶³ See MASTRANGELO, *supra* note 40, at 2.

⁶⁴ See Pub. L. No. 104-58, § 303(H) (“[C]ash bonus bid with royalty at no less than 12 and ½ per centum fixed by the Secretary in amount or value of production saved, removed, or sold, and with suspension of royalties for a period, volume, or value of production determined by the Secretary, which suspensions may vary based on the price of production from the lease . . .”).

⁶⁵ See 30 C.F.R. § 203.0 (2009).

⁶⁶ See Pub. L. No. 104-58, § 304.

⁶⁷ *Id.*

⁶⁸ Section 304 of the DWRRA reads as follows:

For all tracts located in water depths of 200 meters or greater in the Western and Central Planning Area of the Gulf of Mexico, including that portion of the

provision specifically states that “the suspension of royalties shall be set at a volume of *not less than*” the specific statutory volumes enumerated in the statute.⁶⁹

The language of section 304 was recently interpreted in the *Kerr-McGee* case — explained in detail in Part V — to mean that price thresholds added to any lease in this five-year time period are illegal and unenforceable.⁷⁰ These price thresholds, according to the Louisiana district court, would force royalty payments at a volume *less than*, rather than “*not less than*” the statutory volumes.⁷¹ As this ruling was unanimously affirmed by the Fifth Circuit on appeal, royalty relief from all leases issued between 1996 and 2000 will be granted up to the specified volume without any price threshold.⁷² Thus, as oil and gas prices continue to rise, oil companies will continue to reap the benefits of royalty relief.

Despite the foregone royalty payments that have and will continue to result from the royalty relief provisions of the DWRRA, the royalty “holiday”⁷³ had an immediate impact on offshore oil and gas leasing in the deep Gulf. According to the MMS, 3401 deepwater leases were sold under the DWRRA — nearly 1400 more than would have been sold during the 1996–2000 period absent the DWRRA.⁷⁴ Additionally, the added cash bonus bids and rentals col-

Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, any lease sale within five years of the date of enactment of this title, shall use the bidding system authorized in § 8(a)(1)(H) of the Outer Continental Shelf Lands Act, as amended by this title, *except that the suspension of royalties shall be set at a volume of not less than the following:*

- (1) 17.5 million barrels of oil equivalent for leases in water depths of 200 to 400 meters;
- (2) 52.5 million barrels of oil equivalent for leases in 400 to 800 meters of water; and
- (3) 87.5 million barrels of oil equivalent for leases in water depths greater than 800 meters.

Id. (emphasis added).

⁶⁹ *Id.* (emphasis added).

⁷⁰ See *infra* Part V.

⁷¹ See *Kerr-McGee* District Court, 2007 WL 3231634 at *4 (“The Interior has no discretion to enact a price threshold requirement that applies to volumes below the minimum volume of royalty-free production.”).

⁷² *Kerr-McGee* Fifth Circuit, 554 F.3d at 1082.

⁷³ The word “holiday” was first introduced in congressional debate to describe the five-year royalty-free period after the Act’s enactment. See, e.g., 141 CONG. REC. H11854-01 (statement of Rep. Miller) (“So there should be no doubt: this *holiday* is mandatory, regardless of need, regardless of facts, regardless of cost.” (emphasis added)).

⁷⁴ See MASTRANGELO, *supra* note 40, at 6.

lected by the federal government from these leases totaled about \$2 billion as of June 2006.⁷⁵

D. Royalty Relief in Other Acts

Royalty relief is not unique to the DWRRA. The Outer Continental Shelf Lands Act (“OSCLA”), as amended in 1978, authorizes the Secretary of the Interior to grant royalty relief to promote increased oil and gas production.⁷⁶ Even more recently, Congress passed the omnibus Energy Policy Act of 2005, which provided additional royalty relief for certain offshore oil and gas leases.⁷⁷ Specifically, this energy Act expanded the “Post-Act” royalty relief program of the DWRRA by providing automatic suspension volumes at specified depths in each lease.⁷⁸ The Energy Policy Act of 2005, like the “Post-Act” leases under the DWRRA, allows the Secretary of the Interior to “place limitations on royalty relief . . . based on market price.”⁷⁹ Royalty relief, whether stemming from the DWRRA, the Energy Policy Act of 2005, or the Outer Continental Shelf Lands Act, represents a balancing of interests. It must properly induce production in

⁷⁵ *Id.*

⁷⁶ See 43 U.S.C. § 1337(a)(1) (2006) (“The Secretary is authorized to grant to the highest responsible qualified bidder or bidders by competitive bidding, under regulations promulgated in advance, any oil and gas lease on submerged lands of the outer Continental Shelf which are not covered by leases meeting the requirements of subsection (a) of § 1335 of this title. Such regulations may provide for the deposit of cash bids in an interest-bearing account until the Secretary announces his decision on whether to accept the bids, with the interest earned thereon to be paid to the Treasury as to bids that are accepted and to the unsuccessful bidders as to bids that are rejected. The bidding shall be by sealed bid and, at the discretion of the Secretary . . .”).

⁷⁷ See Energy Policy Act of 2005, Pub. L. No. 109-58, § 345 (codified at 42 U.S.C. § 15905 (2006)):

(b) SUSPENSION OF ROYALTIES. — The suspension of royalties under subsection (a) shall be established at a volume of not less than--

- (1) 5,000,000 barrels of oil equivalent for each lease in water depths of 400 to 800 meters;
- (2) 9,000,000 barrels of oil equivalent for each lease in water depths of 800 to 1,600 meters;
- (3) 12,000,000 barrels of oil equivalent for each lease in water depths of 1,600 to 2,000 meters; and
- (4) 16,000,000 barrels of oil equivalent for each lease in water depths greater than 2,000 meters.

(c) LIMITATION.--The Secretary may place limitations on royalty relief granted under this section based on market price.

⁷⁸ *Id.*

⁷⁹ *Id.*

areas that would not otherwise be exploited, yet not provide unfair benefits to corporations that do not need it.⁸⁰

IV. ROYALTY RELIEF'S COST TO THE AMERICAN PEOPLE

This issue is unique because the problem of royalty relief does not immediately reveal itself. Because production of oil and gas, especially offshore, takes a significant amount of time to research, explore, and eventually produce, any problem with royalty payments may not be exposed for many years.⁸¹ By the time many leases issued between 1996 and 2000 began producing oil or gas, most members of Congress had forgotten about the Deep Water Royalty Relief Act entirely. In fact, it was not until a *New York Times* article broke in February 2006 that the major problem of offshore royalty relief once again reached the halls of Congress.⁸²

The story reported on a projection “buried in the Interior Department’s just-published budget plan” which found that the government would give up more than \$7 billion in foregone royalty payments from 2006–2011, “even though the administration assumes that oil prices will remain above \$50 a barrel throughout that period.”⁸³ This projected foregone royalty was based on 1031 leases issued between 1998 and 1999 that did not contain language limiting royalty relief based on the market value of oil and natural gas. It was assumed in this article, and all subsequent reactions to the article, that it was the 1998 and 1999 leases that were faulty. It was inconceivable at the time that the so-called “blunder” of leaving out price thresholds in the 1998 and 1999 leases was actually consistent with the language of the statute, and that the 1996, 1997 and 2000 leases that did contain price thresholds were in fact flawed and unenforceable.⁸⁴

California Congressman George Miller, who opposed the DWRRA from the beginning, stated that the lack of price thresholds in the 1998 and 1999 leases is “the gift that keeps on giving” and is “one of the greatest train robberies in the history of the world.”⁸⁵ Because it takes years to explore and build huge offshore drilling rigs, most of the oil and gas wells from the 1996–2000

⁸⁰ Congress has struggled with this balance since the inception of royalty relief in the OCSLA in 1978. The idea of a price threshold seems to be the best solution thus far conceived to strike this proper balance.

⁸¹ In fact, most offshore leases never make it past the exploratory phase. Only about 8% of DWRRA-eligible leases issued between 1996 and 2000 have been drilled. However, proved oil and gas reserve and resource estimates have more than doubled since 2000 and the development time has decreased from ten years in the mid-1990s to seven years in 2006. HUMPHRIES, *supra* note 18, at 5.

⁸² See *Royalty Plan*, *supra* note 20.

⁸³ *Id.*

⁸⁴ See *infra* Part V.

⁸⁵ *Royalty Plan*, *supra* note 20 (quoting Rep. George Miller).

leases are just beginning to produce.⁸⁶ According to the MMS, the amount of royalty-free oil production, stemming entirely from the 1998 and 1999 leases lacking price thresholds, will quadruple from 2006 to 2011, to 112 million barrels.⁸⁷ In part because of the *New York Times* article, House Republicans called a hearing to address concerns over royalties being collected by the Interior Department from offshore oil and gas leases.⁸⁸ A report by the Government Accountability Office (“GAO”) was requested on the subject, and its results were released on January 18, 2007.⁸⁹

According to the original GAO report, royalty relief under the Outer Continental Shelf Deep Water Royalty Relief Act of 1995 had cost the government over \$1 billion as of the date of the report, and the cost could rise to as high as \$80 billion for the life of the leases.⁹⁰ The report admitted, however, that there was much uncertainty to its estimates because of the oscillating nature of oil and gas prices, the ongoing *Kerr-McGee* litigation, and other inherent complexities in forecasting future royalties.⁹¹ Nonetheless, according to the report, “[t]he MMS estimated that the cost of not including price thresholds on the 1998 and 1999 leases could be as high as \$10 billion.”⁹² Additionally, at the time of the report in early 2007, the District Court’s ruling in *Kerr-McGee* was still ten months from issuance. While the report reflected no inherent prediction as to the outcome of the case, it noted that if *Kerr-McGee* would win and “price thresholds are disallowed for the leases [the Department of Interior] issued in 1996, 1997, and 2000, an additional \$60 billion in royalty revenue could be lost.”⁹³ While it noted the legal challenge posed in *Kerr-McGee* and the potential consequence of an unfavorable ruling, the focus of the report, and all subsequent legislative reaction to it, still remained centered around the 1998 and 1999 leases lacking price thresholds. Perhaps foreseeing inevitable legislation on this issue in the future, the report’s authors concluded by reiterating the importance of striking a balance between encouraging offshore production and ensuring a fair rate of return for the American people.⁹⁴

⁸⁶ See *id.*; see also HUMPHRIES, *supra* note 18, at 5 (In the mid-1990s, it took nearly ten years for a lease to enter the production phase, though this number has fallen to seven years in 2006.).

⁸⁷ *Royalty Plan*, *supra* note 20.

⁸⁸ See Edmund L. Andrews, *Official Says Oil and Gas Giveaway Was Probably an Error*, N.Y. TIMES, Mar. 2, 2006, at C3 [hereinafter *Official Says Error*].

⁸⁹ See U.S. GOVERNMENT ACCOUNTABILITY OFFICE, OIL AND GAS ROYALTIES: ROYALTY RELIEF WILL LIKELY COST THE FEDERAL GOVERNMENT BILLIONS, BUT THE FINAL COSTS HAVE YET TO BE DETERMINED (2007), available at <http://www.gao.gov/new.items/d07369t.pdf> [hereinafter 2007 GAO REPORT].

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.* at 7.

⁹³ *Id.* at 8.

⁹⁴ *Id.* at 13 (additionally stating that “[d]evelopment, however, should not mean that the American people forgo a reasonable rate of return for the extraction and sale of these resources, espe-

V. *KERR-MCGEE OIL & GAS CORP. V. ALLRED*⁹⁵A. *The District Court Ruling: Price Thresholds in § 304 Leases Are Contrary to the Unambiguous Language of the DWRRA.*

On October 30, 2007, the U.S. District Court for the Western District of Louisiana issued a ruling in *Kerr-McGee Oil & Gas Corp. v. Allred* that rebuffed efforts of the U.S. Department of the Interior to collect royalties from certain offshore oil and gas production leases based on price thresholds. More simply, the Court held that the Secretary of the Interior does not have the authority to impose price thresholds on any deepwater leases issued between 1996 and 2000 under the DWRRA.⁹⁶

Specifically at issue in *Kerr-McGee* were eight leases held by Kerr-McGee Oil & Gas Corporation in the deepwater Gulf of Mexico.⁹⁷ All eight leases were issued between 1996 and 2000 — making them section 304 leases under the DWRRA — and all eight leases contained language limiting royalty relief based on the market price of oil and natural gas.⁹⁸ It was not until 2003 and 2004 that the price of natural gas and oil, respectively, exceeded the price threshold specified in the leases.⁹⁹ When Kerr-McGee was ordered by the Secretary of the Interior to begin paying royalties on these eight leases in what was called the “Burton Decision,”¹⁰⁰ the company refused and challenged the order in federal court.¹⁰¹

Kerr-McGee argued that section 304 of the DWRRA, which addresses lease sales during the five-year period between 1996 and 2000, barred the inclusion of royalty relief price thresholds to these leases, and therefore the collection of royalties resulting from the imposition of price thresholds contradicted section 304 of the DWRRA.¹⁰² The Secretary of the Interior responded, arguing that section 304’s reference to section 303, which contains language relating to

cially in light of the current and long-range fiscal challenges facing our nation, high oil and gas prices, and record industry profits.”).

⁹⁵ *Kerr-McGee* Fifth Circuit, 554 F.3d 1082; *Kerr-McGee* District Court, 2007 WL 3231634 (W.D. La. 2007).

⁹⁶ *Kerr-McGee* District Court, 2007 WL 3231634 at *4.

⁹⁷ *Kerr-McGee* Fifth Circuit, 554 F.3d at 1083.

⁹⁸ *Id.*

⁹⁹ *Id.* at 1084.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² See Kerr-McGee Oil & Gas Corporation’s Opposition to Defendant’s Cross-Motion for Summary Judgment and Reply in Support of Motion for Summary Judgment at 3, *Kerr-McGee Oil & Gas Corp. v. U.S. Sec’y of Interior*, No. 08-30069 (5th Cir. Jan. 12, 2009), available at 2007 WL 2969695 (“There is no disputing that Interior’s price threshold clauses reduce the volume of royalty-free production below the minimum volumes fixed by Congress in § 304 of the [DW]RRA.”).

the Secretary's power to implement price thresholds, exhibits the proper congressional intent to allow price thresholds in section 304 leases as well.¹⁰³

The Court ruled in favor of Kerr-McGee's interpretation of the statute, holding that the language of the statute was unambiguous and barred the inclusion of price thresholds in 1996–2000 leases.¹⁰⁴ The Court based its ruling on a previous Fifth Circuit opinion construing the language of section 304.¹⁰⁵ In *Santa Fe Snyder Corp. v. Norton*, the Fifth Circuit held that royalty relief under section 304 leases applied to individual leases, rather than “fields.”¹⁰⁶ A field is an area consisting of a single reservoir or multiple reservoirs within the same geological structure or stratigraphic trapping condition and may contain more than one lease.¹⁰⁷ Section 302, which governs Pre-Act leases, makes royalty relief contingent on the lease being a part of a non-producing field before the DWRRA was enacted.¹⁰⁸ The Secretary of the Interior took this language from section 302 and applied it to section 304 leases.¹⁰⁹ The *Santa Fe Snyder* court found that the Interior's usurpation of section 302 language added a new production requirement for section 304 leases — that the field had to be non-producing prior to 1995 — which was contrary to the DWRRA.¹¹⁰

Basing its decision primarily on the *Santa Fe Snyder* ruling, and its own interpretation of sections 302, 303, and 304 of the DWRRA, the *Kerr-McGee* court stated that

The Fifth Circuit interpreted Sections 303 and 304 of the DWRRA as they pertain to new production requirements for Mandatory Royalty Relief leases. Section 303 added a new bidding system that gave the Interior the authority to lease any water depth in any location with royalty relief fashioned according to the Interior's discretion. The [Fifth Circuit] found that this power, however, was tempered by the next section, where Congress replaced the Interior's discretion to fashion royalty relief with a fixed royalty suspension scheme based on volume

¹⁰³ *Id.* (“Attempting to justify this reduction in royalty-free volumes, Interior relied on § 303 of the [DWRRA], which gives the agency the discretion to ‘vary’ royalty relief ‘based on price of production.’”).

¹⁰⁴ *Kerr-McGee* District Court, 2007 WL 3231634 at *4.

¹⁰⁵ *See Santa Fe Snyder Corp. v. Norton*, 385 F.3d 884 (5th Cir. 2004).

¹⁰⁶ *Id.* at 892.

¹⁰⁷ *See* 30 C.F.R. § 260.102 (2009).

¹⁰⁸ *See* Pub. L. No. 104-58, § 302.

¹⁰⁹ *Santa Fe Snyder*, 385 F.3d at 889–90.

¹¹⁰ Specifically, the court stated that “Section 304 mandates that, without exception, based only on the objective factors of water depth, location of the lease block and date of the lease sale, all leases meeting these objective criteria are entitled to receive the suspensions of royalties benefit, which the Secretary may not set at a volume less than the particular volume assigned for each water depth. The statute is unambiguous on this point.” *Id.* at 891.

and water depth. Thus, the royalty relief for Mandatory Royalty Relief leases is automatic and unconditional.¹¹¹

Thus, the district court found that section 304 mandates royalty relief up to a certain minimum volume of production, regardless of the market price of oil or natural gas.

B. The Fifth Circuit Affirms: Price Thresholds in § 304 Leases Are Unenforceable

The Fifth Circuit heard oral arguments for the *Kerr-McGee* appeal on December 12, 2008, and released its unanimous affirmance of the District Court's ruling on January 14, 2009.¹¹² In oral argument, the Secretary of the Interior continued to argue that the Interior has the discretionary authority to impose price thresholds based on section 303 of the DWRRA.¹¹³ The Department of the Interior's attorney, Michael Grey, stated that "the case, of course, turns on the relationship between sections 303 and 304 of the Act,"¹¹⁴ and that the exception under section 304 "preserves the price threshold authority and takes away Interior's discretion only to determine the period volume or value of production."¹¹⁵ *Kerr-McGee* continued to argue that section 304 is unambiguous and gives oil and gas companies the right to produce a fixed volume of oil or gas without paying royalties to the federal government. Jonathan Hunter, the attorney for *Kerr-McGee*, argued that the *Santa Fe Snyder* ruling controlled and that "section 304 modified the entirety of the discretion otherwise granted in section 303."¹¹⁶

Because an agency's interpretation of its own statutory authority was at issue in this appeal, under the first step of the *Chevron*¹¹⁷ test the Fifth Circuit first had to consider whether the statute, as passed by Congress, *unambiguously* granted the Secretary of the Interior the authority to establish price thresholds in section 304 leases.¹¹⁸ The Court started its analysis by noting a cardinal rule of

¹¹¹ *Kerr-McGee* District Court, 2007 WL 3231634 at *4 (citations omitted).

¹¹² *Kerr-McGee* Fifth Circuit, 554 F.3d 1082.

¹¹³ Oral Argument Before the Fifth Circuit Court of Appeals on Dec. 12, 2008, *Kerr-McGee Oil & Gas Corp. v. U.S. Secretary of Interior*, No. 08-30069 (5th Cir. Jan. 12, 2009) (Dec. 12, 2008), available at <http://www.ca5.uscourts.gov/OralArgumentRecordings.aspx> (search "and/or Docket number is:" for "08-30069"; then follow "Windows Media" hyperlink).

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). The *Chevron* test is a two-step analysis used when a judicial court reviews an agency's interpretation of a federal statute. *Id.*

¹¹⁸ *Kerr-McGee* Fifth Circuit, 554 F.3d at 1084.

statutory interpretation — that “a statute is to be read as a whole.”¹¹⁹ After noting the language of sections 302 and 303 of the DWRRA, the Court stated that “the pertinent language of [section 304] states that ‘the suspension of royalties shall be set at a volume of not less than the following’ specifically established volume thresholds.”¹²⁰

The Court then directly analogized this case to its own *Santa Fe Snyder* ruling, stating that “[t]he current case is the logical and inevitable extension of *Santa Fe Snyder*, as the district court correctly reasoned. Here, as in that case, Interior seeks to employ a royalty-relief limitation present in § 302 (which applies to leases existing prior to the DWRRA’s enactment) in order to limit the royalty relief granted to new leases by § 304.”¹²¹ Addressing the Department of the Interior’s argument that section 304’s reference to section 303 of the Act extends the price threshold authority to section 304, the Court noted that “the plain language of the statute does not bear Interior’s interpretation.”¹²² The Court went on to reason that:

Interior’s reading would render § 304’s mandatory language meaningless: if price thresholds trigger royalty payments before § 304’s production volumes are exceeded, then the royalty payment suspension *is* being set at a volume less than § 304’s specified production levels. While § 303 grants Interior discretion to “vary” royalty relief for all new leases of submerged lands on the Outer Continental Shelf based on the price of production, § 304 “immediately excepts and replaces Interior’s discretion with a fixed royalty suspension for [n]ew [l]eases on a volume basis” where those new leases are located in the geographic region specified by § 304. Had Congress intended to impose price thresholds on the royalty relief for these new leases, it certainly knew how to do so.¹²³

Based on this reasoning, the court correctly held that “Section 304 is unambiguous in this regard, and it does not grant Interior the authority to impose price thresholds that suspend royalty relief at production volumes less than those established by Congress in § 304.”¹²⁴

The court correctly alluded to its duty to read the statute in its entirety. When read as a whole, it becomes clear that Congress intended royalty relief for

¹¹⁹ *Id.* (citing *In re Supreme Beef Processors, Inc.*, 468 F.3d 248, 253 (5th Cir. 2006) (en banc)).

¹²⁰ *Id.* at 1085 (citing Pub. L. No. 104-58, § 304).

¹²¹ *Id.* at 1086.

¹²² *Id.*

¹²³ *Id.* (citation omitted).

¹²⁴ *Kerr-McGee* Fifth Circuit, 554 F.3d at 1087.

section 304 leases to be mandatory up to a specified volume.¹²⁵ Section 302, which deals with Pre-Act Leases, specifically includes a price threshold requirement.¹²⁶ By including this requirement for one set of leases but not another, Congress demonstrated its intent that the price threshold requirement would not be applied to new leases issued between 1996 and 2000. Congress clearly knew how to impose a price threshold requirement, but chose not to do so for a specified five-year period of leases. Presumably, Congress wanted to immediately spur production in the Gulf of Mexico, and allowing mandatory and unconditional royalty relief for just a five year period would be a tempting incentive to begin exploring and producing in the Gulf of Mexico within that period.¹²⁷

C. *The Legislative History of the DWRRA Supports the Kerr-McGee Ruling*

The legislative history of the DWRRA supports both Kerr-McGee's argument and the Fifth Circuit's decision. Congressional debate reveals that Congress was willing to give up royalty payments in order to help free the United States from dependence on foreign oil and create valuable jobs to bolster the nation's economy.¹²⁸ During the legislative process, the House and Senate passed differing bills designed to strengthen the energy sector.¹²⁹ While the uncontroversial Alaskan North Slope Act was common to both bills, only the Senate version contained provisions relating to royalty relief in the Gulf of Mexico.¹³⁰ The bills then went to a conference committee to work out the differences between the two bills.¹³¹ The conference committee agreed to the Senate version of the bill, though it included several technical corrections and a new provision clarifying that nothing in the royalty relief provisions shall be con-

¹²⁵ Read in its entirety, the DWRRA clearly sets up three categories of deepwater leases based on the location of the lease and the date of issuance of the lease. One must construe the statute as a whole and assume the doctrine of *expressio unius est exclusio alterius* — that the expression of the one is the exclusion of the other. BLACK'S LAW DICTIONARY 620 (8th ed. 2004).

¹²⁶ Pub. L. No. 104-58, § 302(C)(v) (“During the production of volumes determined pursuant to clauses (ii) or (iii) of this subparagraph, in any year during which the arithmetic average of the closing prices on the New York Mercantile Exchange for light sweet crude oil exceeds \$28.00 per barrel, any production of oil will be subject to royalties at the lease stipulated royalty rate.”).

¹²⁷ Representative Brewster stated in debate that “[i]n just 15 years, the U.S. Department of Energy warns that we will rely on foreign sources for 60 percent of our oil. Mr. Speaker, we must invest in American workers. It is time to turn this situation around, and rely on our own abundant oil and gas resources.” 141 CONG. REC. H11854-01, H11860 (1995) (statement of Rep. Brewster).

¹²⁸ See 141 CONG. REC. H11854-01, H11868 (1995) (statement of Rep. Jackson-Lee) (“[The DWRRA] provides a real incentive to allow them to create the opportunity for jobs and to enhance the domestic energy industry, which I believe is vital for this Nation's national security.”).

¹²⁹ See H.R. CONF. REP. 104-312 (1995).

¹³⁰ *Id.*

¹³¹ *Id.*

strued to affect any offshore moratoriums.¹³² Both the House and Senate then debated over the conference report, with both branches eventually passing the bill, including the controversial Senate-backed royalty relief provisions.¹³³

The question remains as to whether Congress intended royalty relief during the five-year post-Act period to be automatic and mandatory up the specified volume, or whether it intended to allow the Secretary to retain the ability to implement price thresholds, thus cutting off royalty relief if prices rose high enough. In Senate debate, a proponent of the bill, former Democratic Senator John Bennett Johnston of Louisiana stated, “For the next 5 years, deep water leases will be offered for sale under the following terms: First, payment of an upfront bonus bid, and second, *waiver of the royalty on a fixed volume of oil and gas* based on the water depth of the lease.”¹³⁴ It seems clear from Senator Johnston’s remarks that royalty relief for Eligible Leases would be based on volume, not price.¹³⁵ In House debate, which was far more spirited, the major opponent of the Act was Congressman George Miller of California.¹³⁶ He repeatedly warned of the mandatory nature of the five-year royalty holiday, even proposing a failed amendment to make royalty relief discretionary.¹³⁷ He stated in debate, “Don’t let anyone tell you the royalty holiday is discretionary for new leases. My amendment, offered in the conference, to make it clear the holiday is discretionary was voted down. So there should be no doubt: this holiday is mandatory, regardless of need, regardless of facts, *regardless of cost.*”¹³⁸

It is clear from congressional debate that at least some representatives recognized the mandatory nature of Eligible Leases, stated this knowledge on the record, and warned others of the potential problems that would be created by a non-discretionary royalty relief policy. Nonetheless, Congress enacted the Bill into law, and President Clinton signed it a few weeks later.¹³⁹ This legislative history overwhelmingly supports Kerr-McGee’s argument that the five-year royalty “holiday” is mandatory, and any efforts by the Secretary of the Interior

¹³² *Id.*

¹³³ See 141 CONG. REC. H11854-01 (1995); 141 CONG. REC. S17019-03 (1995); see also Deep Water Royalty Relief Act of 1995, Pub. L. No. 104-58 (codified in part at 43 U.S.C. § 1337 (2006)).

¹³⁴ 141 CONG. REC. S17019-03, S12023 (1995) (statement of Sen. Johnston) (emphasis added).

¹³⁵ Interestingly, see Senator’s Johnston’s remarks in the *New York Times* eleven years later, in 2006, when he stated that “[t]he one thing I can tell you is that this is not what we intended.” *Vague Law*, *supra* note 17.

¹³⁶ See 141 CONG. REC. H11854-01 (1995) (statement of Rep. Miller).

¹³⁷ *Id.*

¹³⁸ *Id.* at H11875-76. Miller also stated that “[t]here is no need for this. The problem with this is, it is mandatory. It is not that the oil company makes a showing that, but for this, they would have drilled the well, or that they need it. It is mandatory. When they sink the well, they get up to 72 million barrels of oil, royalty free, for simply being there, doing what they were already going to do.” *Id.* at H11857.

¹³⁹ See 1995 WL 699656, Press Secretary’s Statement on North Slope Oil Bill Signing (Nov. 28, 1995).

to implement a price threshold that would cut off royalty relief below the statutory minimum volumes would be contrary to Congress's intent. This history, along with the clear language of the statute, supports the finding of both the District Court of Louisiana and the Fifth Circuit on appeal.

D. The Impact: The Federal Government Will Lose Billions of Dollars in Expected Royalty Revenue

The Fifth Circuit's ruling in *Kerr-McGee* was simple and direct. The federal government could not enforce price thresholds on *any* leases issued in the deep water Gulf of Mexico between 1996 and 2000 under the DWRRA.¹⁴⁰ Thus, the repeated accusations of a colossal rip-off by the oil and gas industry since 2006 by lawmakers and the media were immediately tempered by the realization that the 1998 and 1999 leases — for an entire year loathed as an industry swindle — were in fact made pursuant to a valid statute. The irony, though, did not land softly on legislators, who continued to attempt to rectify what many still deem to be corporate welfare at its worst.¹⁴¹

Even after *Kerr-McGee* filed suit in the District Court of Louisiana, the focus on Capitol Hill remained centered around the leases entered into in 1998 and 1999 that did not include price thresholds. Democratic Representative Edward Markey of Massachusetts downplayed the *Kerr-McGee* lawsuit as mere intransigence on the part of the oil company and accused it of attempting a “colossal rip-off.”¹⁴² Representative Markey went on to state that the *Kerr-McGee* suit “is nothing more than a brazen attempt to fleece the American people out of billions of dollars.”¹⁴³ Media reports and congressional debate repeatedly referred to the “inexplicable” mistake made by the MMS in failing to include price threshold provisions in 1998 and 1999 offshore leases.¹⁴⁴ MMS's initial attempt to rectify its “mistake” focused on renegotiation. Government officials attempted to negotiate with twelve of the fifty-six companies holding these 1998 and 1999 leases,¹⁴⁵ eventually succeeding in renegotiating price thresholds into the leases held by four oil and gas companies.¹⁴⁶

Until the *Kerr-McGee* holding in October 2007, the government had significant bargaining power in renegotiation. Government negotiators had legislators, President Bush, and most importantly, the media on their side. As re-

¹⁴⁰ See *supra* Part V.B.

¹⁴¹ See *infra* Parts VI.A–B.

¹⁴² Edmund L. Andrews, *Oil Company Revives Suit on Avoidance of Royalties*, N.Y. TIMES, Mar. 3, 2007, at C3 [hereinafter *Oil Company Revives Suit*].

¹⁴³ *Id.*

¹⁴⁴ See, e.g., *Official Says Error*, *supra* note 88.

¹⁴⁵ Edward T. Pound, *A Billion Here, a Billion There . . . How One Big Goof in a Little-Known Federal Agency Gave Taxpayers a Big Black Eye*, U.S. NEWS & WORLD REP., Dec. 18, 2006.

¹⁴⁶ *Id.*

ported in the *New York Times*, “According to Republicans and Democrats alike, [the DWRRA] was supposed to include an escape clause: in any year when average spot prices for oil or gas climbed above certain threshold levels, companies would pay full royalties instead.”¹⁴⁷ Even the bill’s principal architect and supporter, Senator John Bennett Johnston of Louisiana, stated that “[t]he one thing I can tell you is that this is not what we intended. . . . I got out the language [of the DWRRA] a few days ago. . . . I had it out just long enough to know that it’s got a lot of very obscure language.”¹⁴⁸

There were few involved in the matter that gave the Kerr-McGee argument much weight, including oil and gas industry lobbyists. John Northington, a lobbyist who worked in the Energy Department under President Clinton, stated that “there are a lot of folks in the industry, particularly those involved in advocating the original legislation, that absolutely don’t agree with Kerr-McGee.”¹⁴⁹ Even the Bush administration repeatedly admitted that Kerr-McGee’s argument lacked merit.¹⁵⁰

After the District Court’s holding in *Kerr-McGee*, Congress recognized that it would need further ammunition if it wished to put an end to the oil industry’s offshore oil and gas royalty “holiday.” Therefore, in June of 2008, when oil prices had reached an all-time high and the price of oil was well over \$100 per barrel, Congress asked the GAO to update its scenario as to the potential losses from foregone royalty in DWRRA leases.¹⁵¹ Assuming that oil and gas prices remained over \$100 per barrel, the GAO reported that the government could sustain losses as high as \$14.7 billion over the next twenty-five years from the 1998 and 1999 leases alone.¹⁵² With regard to the 1996, 1997, and 2000 leases, the report found that if *Kerr-McGee* is upheld — which it now has been — the federal government would have to refund \$1.13 billion in royalties that have already been collected from these leases.¹⁵³ In addition, the GAO estimated that the government would be facing additional foregone royalty revenues as high as \$38.3 billion over the next twenty-five years.¹⁵⁴ Thus, according to this report, the overall total of future foregone royalties could be as high as \$53 billion now that the *Kerr-McGee* decision has been upheld.¹⁵⁵ This number is less than the MMS estimation of 2004, which estimated the total loss to be as

¹⁴⁷ *Vague Law*, *supra* note 17.

¹⁴⁸ *Id.*

¹⁴⁹ *Oil Company Revives Suit*, *supra* note 142.

¹⁵⁰ *Id.* (“The Bush administration has repeatedly argued that Anadarko’s case has no merit, but Interior officials have tried at least twice to settle the dispute without going to trial.”)

¹⁵¹ 2008 GAO REPORT, *supra* note 4, at 2.

¹⁵² *Id.* at 3.

¹⁵³ *Id.* at 3–4.

¹⁵⁴ *Id.* at 4.

¹⁵⁵ *Id.*

high as \$80 billion.¹⁵⁶ This is largely because of an over assumption of the productivity of the 1996–2000 leases.¹⁵⁷

The GAO further noted that there are currently eighty-four leases issued in 1996, 1997, and 2000 that are producing or capable of producing in the future.¹⁵⁸ Because seventy-six of those will never be able to produce enough to exceed the royalty suspension volume, only eight leases will be subject to royalty payments at all because of the recent decision in *Kerr-McGee*.¹⁵⁹ Thus, a mere 14% of these leases are royalty bearing. There were 1031 leases issued in 1998 and 1999, and of those 526 are active and 19 are currently producing.¹⁶⁰ Because these leases do not contain price thresholds, all would be royalty free until the statutory volumetric limit is met. These numbers reveal a simple fact: a huge majority of deep water Gulf of Mexico leases will never be subject to royalty payments for the entire life of the lease. This adds up to billions of dollars that the oil companies will keep, and the federal government will not collect.

Oil and gas companies operating under leases issued between 1996 and 2000 are now, thanks to *Kerr-McGee*, legally free of the burden of royalty payments. Is it *fair*, though, to give the oil and gas companies this benefit now that oil and gas prices are high enough to sustain exploration and production in the deep waters of the Gulf of Mexico? The DWRRA's goal was to incentivize immediate exploration of offshore areas that would otherwise be uneconomical to explore.¹⁶¹ Oil and gas prices are now *over 600%* higher than they were at the time the Act was passed.¹⁶² Is it *fair* for oil and gas companies to continue to reap the benefit of an incentive that is no longer needed? Many lawmakers feel that it is indeed not fair, and despite the Fifth Circuit's ruling in *Kerr-McGee*, have attempted to enforce a remedy through legislation.

VI. PROPOSED CONGRESSIONAL ACTIONS

A. *Congressional Efforts to Correct the "Blundered" 1998–1999 Leases: The RRACA*

Both the House and Senate have made several attempts to correct the "blunder" of not including price thresholds in the 1998 and 1999 leases under

¹⁵⁶ See 2007 GAO REPORT, *supra* note 89, at 2.

¹⁵⁷ 2008 GAO REPORT, *supra* note 4, at 7.

¹⁵⁸ *Id.* at 8.

¹⁵⁹ *Id.*

¹⁶⁰ HUMPHRIES, *supra* note 18, at 6.

¹⁶¹ See *supra* Part III.B.

¹⁶² See 2008 GAO REPORT, *supra* note 4, at 8.

the DWRRA.¹⁶³ However, despite several bills that have been passed in the House, no bill containing language that would impose a price threshold in Eligible DWRRA leases has yet been enacted into law. The purpose of these bills has focused largely on the 1998 and 1999 leases that do not contain price threshold language.¹⁶⁴ No bill has yet to properly address the ramifications of the *Kerr-McGee* litigation, which now signifies that the 1996, 1997 and 2000 leases also lack enforceable price thresholds. If Congress wishes to properly include price thresholds in all 1996–2000 DWRRA leases, it must address the outcome of the *Kerr-McGee* case specifically and clearly include all 1996–2000 leases.

The first major Act to include a remedy for missing price thresholds in the 1998 and 1999 leases was found within H.R. 2809, and was known as the Royalty Relief for American Consumers Act of 2007 (“RRACA”).¹⁶⁵ This Act was applicable to all leases issued “during the period of January 1, 1998, through December 31, 1999.”¹⁶⁶ The Act first clarified the Secretary of the Interior’s authority to impose a price threshold on all section 304 leases of the DWRRA.¹⁶⁷ The Act then attempted to rectify the missing price thresholds of the 1998 and 1999 leases by creating an incentive system that would encourage the lessees of these applicable leases to do one of three things: (1) the lessee could renegotiate the lease to include a price threshold, (2) the lessee could pay a “conservation of resources” fee established by the Secretary of the Interior, or (3) the lessee could refuse to either renegotiate or pay the fee, and become ineligible for future Gulf of Mexico leases.¹⁶⁸ The Act, then, required the lessee to either abide by a price threshold which it did not originally agree to, pay a fee, or never get a lease again in the Gulf of Mexico.

Though H.R. 2809 did not pass the House, nearly identical language was introduced and passed in the House as incorporated into the CLEAN Energy Act of 2007,¹⁶⁹ the Renewable Energy and Energy Conservation Tax Act of 2007,¹⁷⁰ and the Comprehensive American Energy Security and Consumer Pro-

¹⁶³ See, e.g., Comprehensive American Energy Security and Consumer Protection Act, H.R. 6899, 110th Cong. (2008); Renewable Energy and Energy Conservation Tax Act of 2007, H.R. 3221, 110th Cong. (2007); CLEAN Energy Act of 2007, H.R. 6, 110th Cong. (2007); New Apollo Energy Act of 2007, H.R. 2809, 110th Cong. (2007).

¹⁶⁴ See, e.g., CLEAN Energy Act of 2007, H.R. 6, 110th Cong. (2007) (The Act was applicable to all leases issued “during the period of January 1, 1998, through December 31, 1999.”).

¹⁶⁵ New Apollo Energy Act, H.R. 2809, 110th Cong., Title VIII, Subtitle B (2007) (Title VIII is entitled the “Royalty Relief for American Consumers Act of 2007.”).

¹⁶⁶ See *id.* § 812.

¹⁶⁷ *Id.* § 813.

¹⁶⁸ See *id.* § 814; see also ADAM VANN, CRS REPORT FOR CONGRESS, IMPACT OF THE *KERR-McGEE OIL & GAS CORP. V. ALLRED* RULING ON THE PROPOSED ROYALTY RELIEF FOR AMERICAN CONSUMERS ACT OF 2007 2 (2007), available at <http://globalwarming.house.gov/tools/assets/files/0203.pdf>.

¹⁶⁹ CLEAN Energy Act of 2007, H.R. 6, 110th Cong. (2007).

¹⁷⁰ Renewable Energy and Energy Conservation Tax Act of 2007, H.R. 3221, 110th Cong. (2007).

tection Act of 2008.¹⁷¹ All of these Acts include the RRACA as a subtitle, which continues to utilize the incentive system to incorporate price thresholds in the 1998 and 1999 DWRRA leases. The RRACA applies to what it refers to as a “covered lease.”¹⁷² The Act defines a covered lease as “a lease for oil or gas production in the Gulf of Mexico” which: (1) is “in existence on the date of enactment of this Act;” (2) was “issued by the Department of the Interior under § 304 of the Outer Continental Shelf Deep Water Royalty Relief Act;” and (3) is currently “not subject to limitations on royalty relief based on market price that are equal to or less than the price thresholds described in” section 302 of the DWRRA.¹⁷³

As of the date of publication of this Note, neither the RRACA nor any other bill with similar language has yet become law. All House bills containing the RRACA during the 110th Congressional term failed to pass in the Senate. The 111th Congress has yet to introduce a bill with language similar to the RRACA. However, the U.S. Supreme Court’s recent denial of the Department of Interior’s petition for writ of certiorari in the *Kerr-McGee* case on October 5, 2009 may provide the spark necessary to reinvigorate the debate on Capitol Hill.¹⁷⁴ Furthermore, President Barack Obama has expressed a concern over “excessive royalty relief,” urging Congress to assess ways to target oil and gas companies receiving unwarranted windfalls.¹⁷⁵

B. *The Failure to Specifically Account for the Kerr-McGee Ruling*

Even though the RRACA was clearly an effort to remedy the perceived “error” in the 1998 and 1999 leases by forcing a renegotiation of those leases, the definition of “eligible leases” in the RRACA would likely include all 1996–2000 leases, given the recent ruling in *Kerr-McGee*. The definition of covered leases is not restricted to those leases without price thresholds in the terms and conditions of the lease, or any other definition contingent upon the language of the lease. The definition encompasses any lease that is not “subject to limitations on royalty relief” based on oil or natural gas market prices.¹⁷⁶ As the Fifth Circuit has now affirmed the District Court in *Kerr-McGee*, all leases from 1996–2000 are no longer subject to limitations on royalty relief based on the market price of oil and gas, and thus all would be eligible leases under the Act.

¹⁷¹ Comprehensive American Energy Security and Consumer Protection Act, H.R. 6899, 110th Cong. (2008).

¹⁷² See New Apollo Energy Act of 2007, H.R. 2809, Title VIII, Subtitle B § 814(d), 110th Cong. (2007).

¹⁷³ *Id.*

¹⁷⁴ See Jennifer A. Dlouhy, *High Court Rebuffs U.S. Bid to Halt Energy Royalty Relief*, MY SA NEWS, Oct. 6, 2009, available at http://www.mysanantonio.com/business/High_court_rebuffs_US_bid_to_halt_energy_royalty_relief.html.

¹⁷⁵ *Id.*

¹⁷⁶ H.R. 2809, Title VIII, Subtitle B § 814(d).

This means, then, that all section 304 DWRRA lessees, whether or not their leases contain language concerning price thresholds, would either have to renegotiate their lease, pay the conservation of resources fee, or forfeit eligibility for future oil or gas production leases in the Gulf of Mexico.

If Congress wishes to ensure that all leases issued within the first five years after the passage of the DWRRA are limited by price thresholds, then it should pass the RRACA as it is currently written.¹⁷⁷ Congress should, however, expressly note that the RRACA applies to all section 304 DWRRA leases. This would specifically address the *Kerr-McGee* holding, and clarify the RRACA's current ambiguity in this regard. If, however, Congress wishes to force only the 1998 and 1999 lessees to renegotiate their leases, then the definition of an "eligible lease" should be amended accordingly.¹⁷⁸ This route, however, would allow three years of deepwater leases to remain completely free of the obligation to pay royalty, and would preserve an inconsistency with the 1998 and 1999 leases.

As discussed *supra* in Part V, it seems clear that the congressional intent of the DWRRA was to immediately spur production in the Gulf of Mexico by offering a five-year royalty-free "holiday" up to the specific volumetric limit.¹⁷⁹ The District Court and the Fifth Circuit in *Kerr-McGee* affirmed that reasoning, holding that Congress intended there to be no price-threshold on any section 304 leases.¹⁸⁰ If Congress now wishes to unilaterally back out of its contractual agreement, it must be wary of a nearly certain impending litigation by oil and gas companies.¹⁸¹ The holders of 1998 and 1999 leases will argue that they

¹⁷⁷ See VANN, *supra* note 168.

¹⁷⁸ *Id.*

¹⁷⁹ See *supra* Part V.C.

¹⁸⁰ See *Kerr-McGee Oil & Gas Corp. v. Allred*, 2007 WL 3231634 (W.D. La. 2007) (holding that "[t]he price threshold requirement found in Kerr-McGee's Mandatory Royalty Relief leases is similarly unlawful under the plain text of the DWRRA because DWRRA's § 304, applying to new leases, clearly requires minimum royalty relief. The Interior has no discretion to enact a price threshold requirement that applies to volumes below the minimum volume of royalty-free production."); *Kerr-McGee Oil & Gas Corp. v. U.S. Sec'y of Interior*, 554 F.3d 1082 (5th Cir. 2009).

¹⁸¹ See Letter from John B. Breaux, on behalf of the Ad Hoc Deep Water Exploration and Production Coalition, to the Honorable Max Baucus, Chairman of the Committee on Finance, and the Honorable Chuck Grassley, Ranking Member of the Committee on Finance (Nov. 6, 2007) (on file with Patton Boggs, LLP). The letter stated, in part:

Enactment of legislation directly or indirectly imposing price thresholds now on 1998–99 deep water OCS leases would unfairly confiscate an important property interest of leaseholders and violate their contractual rights. Without question, the legislation would be subject to serious legal challenges as an unconstitutional 'taking' without just compensation under the Fifth Amendment, as well as a breach of contract. An adverse ruling could subject the government to injunctive and declaratory relief, and billions in compensatory damages. Given the court's decision for summary judgment in the *Kerr-McGee* litigation, Congress should know a lawsuit is likely.

Id.

properly bargained for their price-threshold-less leases, and do not deserve to be punished simply because the price of oil and gas has risen faster than expected.¹⁸² Additionally, the holders of 1996, 1997, and 2000 leases will argue that the Department of the Interior unilaterally imposed the price threshold in their leases, and collected royalties accordingly. These lessees will argue that, because of this prior cooperation, they should not be forced to forego future leases in the Gulf of Mexico according to the new Act. These arguments raise an array of constitutional and contractual issues which will undoubtedly arise if the RRACA is enacted into law.

VII. CONSTITUTIONALITY OF THE PROPOSED CONGRESSIONAL ACTIONS: THE TAKINGS ARGUMENT

The strength of the American legal system is due, in part, to its combination of statutory, regulatory, constitutional, and common law mechanisms into a single system of law.¹⁸³ This diversity of law allows a creative and opportunistic attorney to apply a variety of arguments to any legal issue.¹⁸⁴ As the price thresholds included in section 304 leases under the DWRRA have now been found to be contrary to an unambiguous statute, any legislative attempt to impose a threshold will raise a host of legal challenges by the oil and gas industry. The opportunistic oil and gas industry lawyer will take advantage of this legal system's diversity and argue a multitude of legal theories in order to halt proposed legislative action. These theories will likely include: (1) an unconstitutional taking, (2) substantive due process and equal protection violations, (3) the doctrine of unconstitutional conditions, (4) breach of contract, and (5) unilateral and mutual mistake.¹⁸⁵ As the scope of this Note is limited, only the first and most likely argument of the oil and gas industry will be analyzed.

The takings argument was raised by those lawmakers who opposed the proposed legislation in congressional debate, as well as by oil and gas industry lobbyists. While debating what was then titled the "CLEAN Energy Act of 2007"¹⁸⁶ on the floor of the House of Representatives, several Representatives strongly urged that the incentive system utilized in the provisions regarding royalty relief would constitute an unconstitutional regulatory taking. Representative Steve Pearce from New Mexico stated that "the very damaging thing about

¹⁸² Perhaps the holders of 1998 and 1999 leases paid a higher bonus or rental value for a lease which did not contain a price threshold term.

¹⁸³ ZYGMUNT J.B. PLATER ET AL., ENVIRONMENTAL LAW AND POLICY: NATURE, LAW, AND SOCIETY 74 (3d ed. 2004).

¹⁸⁴ *Id.*

¹⁸⁵ See ROBERT MELTZ & ADAM VANN, CRS REPORT FOR CONGRESS, LEGAL ISSUES RAISED BY PROVISION IN HOUSE ENERGY BILL (H.R. 6) CREATING INCENTIVES FOR CERTAIN OCS LEASEHOLDERS TO ACCEPT PRICE THRESHOLDS (Apr. 16, 2007), available at http://assets.opencrs.com/rpts/RL33974_20070416.pdf.

¹⁸⁶ CLEAN Energy Act of 2007, H.R. 6, 110th Cong. (2007).

this bill today was it violated a constitutional provision that prohibits the Federal Government from taking private property.”¹⁸⁷ Representative Doug Lamborn of Colorado added that “there is a flaw in this bill that goes even deeper and touches on our oath to uphold the United States Constitution. . . . This bill forces owners of certain oil and gas leases to renegotiate those leases and forces them to forgo all economic benefits from those leases until they do so. This is a clear violation of the fifth amendment.”¹⁸⁸ Finally, Representative Gohmert of Texas vehemently opposed the bill, stating that:

Our forefathers tried to protect against [a king who broke his word regularly], so they inserted in the Bill of Rights a fifth amendment provision called the takings clause that says you shall not take private property for public use without just compensation. Now this bill basically says if you don’t renegotiate your lease, you can’t get any more leases on your existing lease. You can’t have economic benefit. That is one of the things. The Penn Central case from 1978 made clear what the test was, and this rises to the level of a regulatory taking.¹⁸⁹

Industry lobbyists have also indicated that a takings argument will be first on their list of potential claims if the proposed Royalty Relief for American Consumers Act is passed into law. The Ad Hoc Deep Water Exploration and Production Coalition has stated that enactment of legislation imposing price thresholds on DWRRA leases would “be subject to serious legal challenges as an unconstitutional ‘taking’ without just compensation under the Fifth Amendment.”¹⁹⁰ The Coalition also added that “[a]n adverse ruling could subject the government to injunctive and declaratory relief, and billions in compensatory damages,” and noted that “Congress should know a lawsuit is likely.”¹⁹¹ Given that an unconstitutional takings argument has been mentioned by multiple parties in several settings, it is the most likely and most visible argument the oil and gas companies will argue in litigation if the proposed legislation is passed.

The Fifth Amendment of our Constitution provides, in pertinent part, that “private property [shall not] be taken for public use without just compensation.”¹⁹² The purpose of the Takings Clause is to prevent the government “from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”¹⁹³ However, because an Act of

¹⁸⁷ 153 CONG. REC. H750 (daily ed. Jan. 18, 2007) (statement of Rep. Pearce).

¹⁸⁸ *Id.* at H704 (daily ed. Jan. 18, 2007) (statement of Rep. Lamborn).

¹⁸⁹ *Id.* at H705 (daily ed. Jan 18, 2007) (statement of Rep. Gohmert).

¹⁹⁰ See Letter from John B. Breaux, *supra* note 181.

¹⁹¹ *Id.*

¹⁹² U.S. CONST. amend. V.

¹⁹³ *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

Congress is being challenged, the oil and gas companies must mount a facial challenge to the Act and show that the “mere enactment of the [Act] constitute[s] a taking.”¹⁹⁴ Additionally, “[a] facial challenge to a legislative act is . . . the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exists under which the Act would be valid.”¹⁹⁵ This is a stringent test, and the burden is high for the oil and gas companies at the outset.¹⁹⁶

The U.S. Supreme Court has distinguished between two separate types of Takings Clause situations: a physical taking and a regulatory taking. A physical taking occurs when there is a condemnation of property or where there is a physical appropriation of property in which the property transfers from one entity to another.¹⁹⁷ A regulatory taking, on the other hand, occurs when there is some sort of significant restriction placed upon an owner’s use of his property for which “justice and fairness” requires that compensation be given.¹⁹⁸ A separate analysis structure has developed for the two types of cases. Courts generally apply uncomplicated per se rules when addressing physical takings.¹⁹⁹ For regulatory takings, a three-part factual inquiry has developed. A court evaluating whether a regulation “goes too far”²⁰⁰ must ask: (1) what is the economic impact of the regulation, (2) whether the government action interferes with reasonable investment-backed expectations, and (3) what is the character of the government action?²⁰¹ This is known as the *Penn Central* analysis.²⁰²

Because both types of takings require an interference with a property right, the first issue in a takings analysis is to determine whether a property right exists at all. What property rights will the oil and gas companies argue are being improperly taken by this proposed legislation? Several potential interests include: (1) a property interest in future Outer Continental Shelf (“OCS”) leases, (2) a property interest in the existing leases lacking price thresholds, and (3) a property interest in their money that would have to be paid as the “conservation of resources fee.” In effect, the oil and gas companies will argue that the government is forcing them to renegotiate an important and valuable lease term, and that coercion of this nature is either a physical or a regulatory taking. If the

¹⁹⁴ Philip Morris, Inc. v. Reilly, 312 F.3d 24, 52 (1st Cir. 2002) (dissenting opinion) (quoting Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg’l Planning Agency, 535 U.S. 302, 318 (2002)).

¹⁹⁵ *Id.* (quoting Pharm. Research & Mfrs. of Am. v. Concannon, 249 F.3d 66, 77 (1st Cir. 2001)).

¹⁹⁶ *Id.*

¹⁹⁷ *Tahoe-Sierra Pres. Council*, 535 U.S. 302.

¹⁹⁸ Goldblatt v. Hempstead, 369 U.S. 590, 594 (1962).

¹⁹⁹ *Tahoe-Sierra*, 535 U.S. at 312.

²⁰⁰ Penn. Coal Co. v. Mahon, 260 U.S. 393, 415 (“The general rule at least is, that while property may be regulated to a certain extent, if that regulation goes too far it will be recognized as a taking.”).

²⁰¹ Penn Cent. Transp. Co. v. New York, 438 U.S. 104, 124 (1978).

²⁰² *Id.*

companies refuse to negotiate they would lose property right (1) above, while if they decide to negotiate they would lose either property right (2) or (3) above. Thus, the oil and gas companies will argue that the incentive system of the proposed legislation is an unconstitutional taking of property without just compensation no matter whether they: (a) refuse to negotiate and lose their future right to lease OCS property, or (b) choose to negotiate with the federal government and either pay a fee or insert a price threshold into existing OCS leases.

A. Because There Is No Property Right in Future OCS Leases, There Is Not an Unconstitutional Taking if the Oil and Gas Companies Refuse to Negotiate.

The oil and gas companies' argument will likely fail, however, for a number of reasons. To begin with, the first argument that the oil and gas companies have a valid property right in future OCS leases is, according to the facts currently available, untrue.²⁰³ An existing lease is in the nature of a contract, and contract rights are generally deemed to be a property right in Takings Clause jurisprudence.²⁰⁴ However, it does not appear that there is any language in any OCS lease issued under the DWRRA that contains an explicit right to bid on future OCS leases.²⁰⁵ According to the leases issued to Kerr-McGee Oil & Gas Corporation in 1998 and 1999 — the leases at issue in the *Kerr-McGee* case — the oil company had no express contractual right to bid on future leases in the Gulf of Mexico.²⁰⁶

Thus, while a valid contract is considered a form of property under takings jurisprudence, the right to obtain future contracts is not considered a “property right.” The government may negotiate, or refuse to negotiate, with any party that it wishes.²⁰⁷ Therefore, lacking language in an existing contract that in some way expresses or guarantees an explicit right to bid on future OCS leases, the oil and gas companies have no property right in future OCS leases. Because there is no existing property right, there can be no unconstitutional taking if the oil and gas companies refuse to negotiate with the federal government.

B. Because Negotiation Is Voluntary, There Is Not an Unconstitutional Taking if the Oil and Gas Companies Choose to Negotiate

The oil and gas companies' more cogent argument is that the “incentive” of future OCS leasing is so important and economically vital for their

²⁰³ MELTZ & VANN, *supra* note 185, at 3.

²⁰⁴ See, e.g., *United States Trust Co. v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) (“Contract rights are a form of property and as such may be taken . . . provided that just compensation is paid.”).

²⁰⁵ MELTZ & VANN, *supra* note 185, at 3.

²⁰⁶ See 62 Fed. Reg. 39863-01 (1997).

²⁰⁷ See 43 U.S.C. § 1331, et. seq. (2006).

companies, that they have no choice but to accept the negotiation offered by the government. According to the oil and gas companies, being unable to obtain future leases in the Gulf of Mexico, one of the largest domestic reservoirs of available oil and gas, is not an economically viable option. Because the companies have no choice, the regulation unfairly and unjustly “takes” a property right to their existing lease contracts. As noted above, a lease is generally deemed to be a property right in Takings jurisprudence.²⁰⁸ Thus, by forcing the companies to write in a lease term that does not currently exist in their leases (an enforceable price threshold), the government is unfairly taking a valid contractual property right.

This argument, however, must also fail. Nothing in the Royalty Relief for American Consumers Act directly forces an oil and gas company to change this term.²⁰⁹ Because the Act simply creates an incentive for the company to renegotiate the term, any change in the contractual lease would be a voluntary action by the lessee. The general rule is that a voluntary action cannot provide grounds for a takings claim.²¹⁰ In the seminal case introducing this principal, *Bowles v. Willingham*, the U.S. Supreme Court was asked to analyze the constitutionality of the Emergency Price Control Act of 1942 (“EPCA”) that called for the stabilization or reduction of rents for housing in what the government deemed to be “defense-rental areas.”²¹¹ In particular, the EPCA led to twenty-eight areas in the United States to be deemed defense-rental areas which became subject to a reduction in housing rents.²¹² Strikingly similar to the current controversy, the 1942 EPCA forced certain landlords to reduce the value of their current leases.

Addressing the argument that this forced rent reduction is an unconstitutional taking, Justice Douglas reasoned that, because nothing in the EPCA “require[s] any person to sell any commodity or to offer any accommodations for rent,” there is no takings violation.²¹³ Essentially, because the landlords could choose to use the apartments for purposes other than housing (leave the building vacant or dispose of it on the market), compliance with the Act would be voluntary and thus not an unconstitutional taking of property. Justice Douglas went on to note that, even though the regulation may reduce the value of the regulated property because of the price control measures, “that does not mean that the regulation is unconstitutional.”²¹⁴ In fact, “[a] member of the class which is regulated may suffer economic losses not shared by others. His property may

²⁰⁸ See *supra* note 204 and accompanying text.

²⁰⁹ See *supra* Part VI.A.

²¹⁰ See *Bowles v. Willingham*, 321 U.S. 503, 517–18 (1944).

²¹¹ Act of July 9, 1952, ch. 608, Part I, § 101, 66 Stat. 481, *repealed by* Act of Aug. 10, 1956, ch. 1041, § 53, 70A Stat. 641, 682; *Bowles*, 321 U.S. at 505–06.

²¹² *Bowles*, 321 U.S. at 506.

²¹³ *Id.* at 517.

²¹⁴ *Id.*

lose utility and depreciate in value as a consequence of regulation.”²¹⁵ The court thus held that, because the price control provisions were voluntary, the federal regulation did not constitute an unconstitutional taking of property.²¹⁶

Several courts have expanded on the notion that an act is voluntary even when there is significant economic pressure on a party to submit to the property deprivation.²¹⁷ In *Garelick v. Sullivan*, a group of New York anesthesiologists claimed that the Omnibus Budget Reconciliation Act of 1989 (“OBRA-89”) was an unconstitutional regulatory taking.²¹⁸ OBRA-89 deals with the Part B Medicare Program that provides Medicare beneficiaries with supplemental benefits.²¹⁹ Originally, the program was entirely voluntary.²²⁰ A physician could charge the patient any amount for his services, of which the patient could then receive the Medicare “allowed charge” as partial reimbursement from Medicare.²²¹ In trying to reduce the practice of physicians charging in excess of Medicare’s “allowed charge,” Congress enacted OBRA-89 which limited the physicians’ charges to a set percentage of the Medicare-defined allowed charge for services.²²² The limit was set at 115% of the allowed charge.²²³ The anesthesiologists claimed that this “limiting charge” formula was a regulatory taking of property without just compensation in violation of the Fifth Amendment.²²⁴

Citing *Bowles*, the Second Circuit noted that “[a] property owner must be legally compelled to engage in price-regulated activity for regulations to give rise to a taking.”²²⁵ The court reasoned that OBRA-89 does not *require* anesthesiologists to provide services to Medicare beneficiaries.²²⁶ The physicians may choose to provide medical services to non-Medicare patients only.²²⁷ However, because hospital physicians are required, according to the *Patients’ Bill of Rights*, to provide services to Medicare beneficiaries, this regulation would limit the physicians to treating patients on an outpatient-only basis.²²⁸ According to the anesthesiologists, that limit would not be “an economically viable option, since most procedures requiring their services are performed in

²¹⁵ *Id.* at 518.

²¹⁶ *Id.* at 518–19.

²¹⁷ *See, e.g.*, *Garelick v. Sullivan*, 987 F.2d 913, 917 (2d Cir. 1993).

²¹⁸ Omnibus Budget Reconciliation Act of 1989, 42 U.S.C. § 1395u (2006); *Garelick*, 987 F.2d at 914.

²¹⁹ *Garelick*, 987 F.2d at 914.

²²⁰ *Id.*

²²¹ *Id.* at 915.

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Garelick*, 987 F.2d at 916.

²²⁶ *Id.* at 917.

²²⁷ *Id.*

²²⁸ *Id.*

hospitals.”²²⁹ Despite the harsh economic limit this Act poses on physicians, the court held that “as the law presently stands, economic hardship is not equivalent to legal compulsion for purposes of takings analysis.”²³⁰ Thus, because OBRA-89 merely creates an incentive to accept the price regulation, adherence with the Act remains voluntary and not an unconstitutional taking.²³¹ Simply put, “[i]t is well established that government . . . regulation does not constitute a taking of property where the regulated group is not *required* to participate in the regulated industry.”²³²

The government has an additional argument to bolster its position that the proposed act does not create an unconstitutional taking of property. Because government contracting is a “heavily regulated field,” any leaseholder in the outer continental shelf (“OCS”) could not claim to be surprised that Congress would want to impose price thresholds on OCS leases.²³³ This is especially true given the current prices of oil and gas. Whether an industry is heavily-regulated plays a role in a takings analysis in that it can put an industry on notice that the government might intervene with subsequent regulation.²³⁴ For example, in *In re Blue Diamond Coal Co.*, the court reasoned that, because “[t]he federal government pervasively regulates the coal mining industry,” it would be unreasonable for a coal company “to believe that Congress would never intervene” with subsequent regulation.²³⁵ Therefore, because the oil and gas industry is heavily regulated by the federal government, the oil and gas companies holding DWRRA leases could not be surprised by subsequent regulation reacting to skyrocketing prices of oil and gas worldwide.

The previously proposed Royalty Relief for American Consumers Act will undoubtedly face litigation and be challenged as an unconstitutional taking if it is passed by the 111th Congress.²³⁶ However, because the Act merely creates an incentive for oil and gas companies to renegotiate their leases, though admittedly a harsh one, the Act does not constitute an unconstitutional taking of property without just compensation. The ability to engage in future OCS leasing with the federal government is more akin to a privilege than a right. Therefore, revoking that privilege as an incentive to induce negotiation does not con-

²²⁹ *Id.*

²³⁰ *Id.* (citing *Minnesota Ass'n of Health Care Facilities v. Minnesota Dep't of Pub. Welfare*, 742 F.2d 442, 446 (8th Cir. 1984)).

²³¹ *Garelick*, 987 F.2d at 917–18.

²³² *Id.* at 917 (citing *Whitney v. Heckler*, 780 F.2d 963, 972 (11th Cir. 1994)).

²³³ MELTZ & VANN, *supra* note 185, at 6.

²³⁴ *In re Blue Diamond Coal Co.*, 79 F.3d 516, 525 (6th Cir. 1996).

²³⁵ *Id.*

²³⁶ See Letter from John B. Breaux, *supra* note 181 (“Enactment of legislation directly or indirectly imposing price thresholds now on 1998–1999 deep water OCS leases would unfairly confiscate an important property interest of leaseholders and violate their contractual rights Given the court’s decision for summary judgment in the Kerr-McGee litigation, Congress should know a lawsuit is likely.”).

stitute a taking. Even though this revocation leads to serious economic hardship for oil and gas companies, they are not “legally compelled” to accept the incentive and participate in future OCS leasing. A court would not even have to take the next step and apply the three-step *Penn Central* analysis. The proposed Act, therefore, does not constitute an unconstitutional taking of property.

VIII. CONCLUSION

While the DWRRA’s five-year royalty “holiday” was an effective stimulus in encouraging immediate exploration in the deep waters of the Gulf of Mexico upon enactment, the recent unexpected increase in oil and gas prices has transformed what was an attractive incentive into an unjust giveaway. Despite what were valid contracts made in accordance with a legal statute,²³⁷ the government does have the power, through congressional lawmaking, to recoup some of its lost revenue. In light of the unpredictable rise in oil and gas prices, and the fact that the revenue from price-threshold-less oil and gas leases will enter the pockets of the most financially successful industry in the nation, the 111th Congress will undoubtedly have tremendous public support in its efforts to recoup billions of dollars in foregone revenue.

Additionally, the overall purpose of the DWRRA was to encourage companies to explore and produce in offshore lands that which they would not otherwise be able to afford to enter.²³⁸ With oil and gas prices at their current levels, and with new technological advancements, these oil and gas companies no longer need royalty relief as an incentive to drill. In fact, Michael Coney, a lawyer for Shell Oil has stated on record that “[u]nder the current environment, we don’t need royalty relief.”²³⁹ Even President Bush has stated that “[w]ith oil at \$50 a barrel, I don’t think energy companies need taxpayer-funded incentives to explore.”²⁴⁰ President Obama has also expressed concern over unjustified subsidies and royalty relief programs, calling on Congress to combat “excessive royalty relief.”²⁴¹ Furthermore, the U.S. Supreme Court’s recent denial of the Department of Interior’s petition for writ of certiorari in *Kerr-McGee* may also refocus a busy Congress on the issue. The only obstacle standing in the way of congressional action, then, would be the nearly certain impending legal action brought by the oil and gas companies when the legislation is enacted.

As discussed in Part VII, it is unlikely that an oil and gas company would be successful in a regulatory taking action against the government if the

²³⁷ See *supra* Part V.A–B (discussing the Fifth Circuit’s holding in *Kerr-McGee*).

²³⁸ See *supra* Part III.A–B.

²³⁹ *Vague Law*, *supra* note 17.

²⁴⁰ *Id.* Even though President Bush placed a top priority on expanding oil and gas production, and urged the government to explore opportunities for royalty reduction and to open areas like the Arctic National Wildlife Refuge in Alaska to drilling, he showed some skepticism about giving new incentives to drillers. *Id.*

²⁴¹ See Dlouhy, *supra* note 174.

Royalty Relief for American Consumers Act were passed as currently written.²⁴² Because the RRACA creates a voluntary incentive — though admittedly a very harsh one — any change in a contract term by an oil and gas lessee would be voluntary. Because a successful taking action requires legal compulsion, rather than mere inducement, the oil and gas companies' takings argument must fail.

The American people have already lost over \$5 billion in foregone revenue because of a lack of enforceable price thresholds in DWRRA leases. This total, because of the ruling in *Kerr-McGee*, will rise to an estimated \$53 billion over the life of the leases.²⁴³ This giveaway no longer represents an “incentive to explore,” as was originally intended. It simply amounts to a gift that keeps on giving. In light of stabilized oil prices well over \$50 per barrel, the Royalty Relief for American Consumers Act, or its equivalent, must be passed by the 111th Congress. The American people, in the midst of “the worst financial crisis since the Great Depression,”²⁴⁴ can no longer afford to subsidize oil and gas companies already swimming in record profits.

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²⁴² See *supra* Part VII.

²⁴³ See *supra* Part V.D.

²⁴⁴ President Obama repeatedly used this language on the campaign trail and during his early months in office to characterize the United States' current financial situation. See Steve Holland, *Obama: U.S. in Worst Crisis Since Depression*, REUTERS, Oct. 7, 2008, <http://www.reuters.com/article/idUSN0749084220081008>.

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