American Indian Natural Resources: Oil & Gas

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producing areas and for different producing horizons within each producing area Crude oil prices depend upon the following factors

a The geographical area in which the well is located

b The "vintage" of the oil "Old oil" (lower tier) is oil from a property where production began before 1974 "New oil" (upper tier) is oil from a well where production began after that date

c Whether the oil comes from a "stripper" well As with natural gas, stripper wells are wells with very low or economically marginal production Stripper well production sells at the world crude oil price

d Whether the oil is "sweet" or "sour" Sweet oil has little or no sulfur content Sour oil contains sulfur Sour oil brings a lower price than sweet because the sulfur must be removed from petroleum products made from sour oil to prevent air pollution by the sulfur dioxide which is formed when the product is used or burned

e The gravity of the oil The base price for each category of oil is established for forty degree gravity oil For every degree in gravity below forty the price of the oil drops by 2 cents per barrel For gravity above 40 degrees the price remains the same as the base price

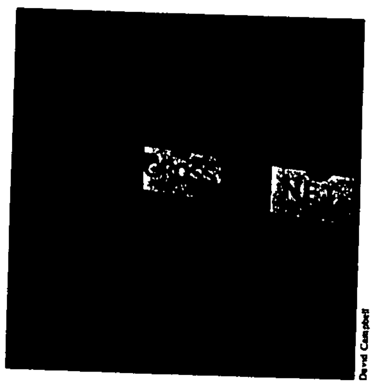
f Whether the oil is produced from a secondary or tertiary recovery project Oil produced by secondary and tertiary recovery receives the stripper oil price

g Whether the oil qualifies for the "incentive price for newly discovered oil " Crude oil from an onshore property that did not produce in 1978, and which is sold after May 1, 1979 sells at the world price

h Whether the oil qualifies for the price of oil produced from "marginal property " Marginal property oil gets the "new oil" (upper tier) price regardless of when it was discovered A marginal property must have an average daily production from all of its wells of between twenty and thirty-five barrels per day Whether such a property qualifies for "marginal" status depends on well depth

In May 1979 President Carter announced a phased decontrol of domestic crude oil prices to be completed in 1985 He was acting pursuant to authority which he had been previously granted by Congress It is unlikely, however, that the decontrol policy announced by the President will result in a simplification of the domestic crude oil pricing system Despite the President's decontrol policy, categories g and h of the above list were added to the pricing system as of June 1, 1979 The President's policy began with the decontrol of "new" oil prices and will gradually extend to all other crude oil price categories There is a good possibility, however, that Congress will fail to extend the President's decontrol authority through 1985, or that a subsequent administration will adopt a different policy

Under the Natural Gas Policy Act of 1978, "new" natural gas prices will be decontrolled in 1985 Nevertheless, natural gas pricing will not be greatly simplified because most pricing categories for natural gas will be in effect for many years beyond 1985



David Campbell

D. Oil and Gas Leases

An oil and gas producer very rarely owns the land on which his wells are located This is because the oil and gas explorers and producers do not need, and are not interested in, full ownership of the land All they are interested in is the oil and gas beneath the surface Moreover, purchasing

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the land would be extremely expensive In the United States the petroleum industry is built upon a system of agreements called leases Almost all the oil and gas produced in the United States comes from leased property, either private, state, federal or Indian land An oil and gas operator acquires a lease from a landowner which allows him to explore for and produce whatever oil and gas may be present under the surface A lease can be acquired at a fraction of the cost of actually purchasing the land An oil and gas lease can usually be acquired for a few dollars an acre in advance plus an annual delay rental fee, which may be as low as $1 00, that is paid until production begins

For at least the last 60 years, the practice in the United States has been for oil and gas operators to lease from private land owners according to fairly standard lease terms The standard oil and gas lease runs for ten years and so long as oil and gas are produced in paying quantities The standard royalty paid to the land owner is one-eighth of the gross value of the oil and gas produced There is a standard form of oil and gas lease, called the "Producer's 88", which is often used in the industry There are many forms of the "Producer's 88" lease, but the most important terms of the lease are generally similar For instance, most oil and gas leases provide for a bonus payment, delay rentals and 1/8th royalty to the landowner

The provisions of oil and gas leases can and do vary widely They are dependent upon what the parties negotiate An oil and gas lease can be almost anything that the landowner and the operator (lessee) can agree upon There is no rule or standard practice that must be followed

1. Oil and Gas Royalties and Rentals

In the mineral industries a royalty is defined as "a share of the production or profit of a mineral project which is paid by the operator of the project to the mineral owner (landowner) in exchange for the right to produce and sell the mineral " Royalties can be paid either in money or "in-kind " An "in-kind" royalty gives the mineral owner the right to take a certain share of the oil and gas as it is produced and to use it or to sell it himself If money is paid, the amount is a certain percentage of the value of the oil and gas as it is produced and sold

most oil and gas leases provide for a bonus payment, delay rentals and 1/8th royalty to the landowner.

at the wellhead Ordinarily, the owner of an oil and gas property will want his royalty in money rather than in-kind This is because the landowner usually doesn't have much use for large amounts of natural gas or raw crude oil, nor does he ordinarily have a transportation and marketing system It is usually much easier to have the operator take care of handling, storing and marketing the product, and to receive the royalty in cash out of the proceeds of sales Sometimes, however, it can be advantageous to the mineral owner to take the royalty in-kind *

*The Jicarilla Apache Tribe of northwestern New Mexico, which is fortunate to have large oil and gas production from its lands, recently decided to exercise the right stated in its leases to take royalty in kind The Jicarilla tribe is able

There are two basic types of royalties They are 1) the gross value royalty, and 2) the net profit royalty

a. *Gross Value Royalty*

Most oil and gas leases provide for payment of a gross value royalty This is a percentage of the value of the oil and gas as it comes from the well, before any of the costs of exploration, production, marketing or taxes are deducted Although the standard oil and gas royalty is 1/8th of the gross value of the product, the percentage can be lower or higher, depending on the agreement between the mineral owner and the operator For instance, some leases of Indian land now provide for a 3/8ths royalty

b. *Net Profit Royalty*

A net profit royalty is defined as a certain percentage of net profit after deductions have been taken for such things as exploration, drilling, completion, production, transportation and marketing costs, and taxes Net profit royalties are not very common in the domestic petroleum industry, but they can be used in leases or joint venture agreements

c. *Overriding Royalty*

Sometimes the term overriding royalty or override is used in the oil industry An overriding royalty is a gross value royalty just like an ordinary oil and gas royalty, but the term is used to describe a royalty which is payable to someone other than the mineral owner Overriding royalties are often created when someone who holds an oil and gas lease (lessee) transfers (assigns) the lease to someone who wants to drill on the land Instead of taking money for transfering the lease, the original leaseholder (lessee) might take an overriding royalty on any oil and gas discovered The overriding royalty comes off the top before expenses, just like the ordinary landowner's royalty There are advantages to this kind of transaction for both parties The operator who wants to drill the land gets the lease without any additional cash expense, thus keeping his costs down, and the original leaseholder may make far more in the long run if oil is discovered than he would have if he had sold the lease for cash On the other hand, if the well is a "duster," he gets nothing

to qualify as a "small producer" under the natural gas pricing regulations issued by the Federal Energy Regulatory Commission and can sell its royalty gas for a higher price than the operator can get for it

d. *Rental Payments*

If you read an oil and gas lease you will usually find a provision requiring the operator (lessee) to make rental payments every year until he drills on the property Sometimes these payments are called "delay rentals " The rental is generally set at a level between $1 00 and $2 00 per acre The delay rental's purpose is to provide the mineral owner with some income from the lease,while he is waiting for the operator either to drill and discover oil or to abandon the lease This rental can also provide the lessee with some encouragement to drill rather than to hold on to the lease for years without developing it Unfortunately, the amount of the rental is usually too low to provide much incentive for the operator to drill sooner rather than later

e. *Advance Royalty and Minimum Royalty*

The standard form BIA oil and gas leases (Form 5-154h and Form 5-157) specify an annual rental of $1 25 per acre to be paid in advance, but they also provide for the rental to be deducted from oil and gas production royalties in the year in which oil or gas is discovered (if it is discovered) and in subsequent years In this BIA form the rental is really an advance royalty It is also sometimes called a minimum royalty because it is the minimum amount due every year whether or not oil and gas is discovered or produced As with standard delay rentals, the advance royalty provision in the BIA lease does very little to encourage early development of the lease by the lessee A more effective way is to require that the lessee drill a well within a certain period of time or give up the lease

f. *Bonus Payments*

Usually when an oil and gas lease is signed, the operator who is acquiring the lease makes a bonus payment or bonus This is a certain amount per acre paid to the landowner at the time when the lease is signed It is paid as an encouragement to the mineral owner to accept the lease

2. Negotiating Oil and Gas Leases

Title 25 of the Code of Federal Regulations allows Indian allottees and tribes to negotiate leases directly with oil and gas operators, instead of leasing through the Bureau of Indian Affairs Ordinarily it is possible for an Indian mineral owner to get a better price for his minerals through negotiation than through BIA lease sales

a. *Gather Information*

The key to successful negotiation is information! The Indian mineral owner's objective in negotiations should be to get the maximum package of benefits that the oil and gas operator is willing to pay If a lease or agreement is signed for less than the maximum amount that the operator was ultimately willing to pay, then it is said that the negotiator "left money on the table " Of course, the operator (lessee) is not going to tell the mineral owner just how much he is ultimately willing to pay When negotiations start he may not even know himself, how much he is really willing to pay The landowner must figure out for himself just how high the oilman is willing to go If the price is too low, the landowner is getting less than the full economic benefit of his property If the price is too high, no deal, and the landowner gets no benefit The secret to getting the right price is knowing enough about all of the facts and circumstances which may affect the lessee's thinking to figure out what the lease or agreement is worth to him

The key to successful negotiation is information!

b. *Determine Objectives*

Before any negotiations begin, the mineral owner should analyze and determine his objectives The landowner can approach the problem in several different ways The landowner may decide that what he wants most is quick cash, and that he is willing to sacrifice other objectives for a high bonus payment Or, he may prefer to try to maximize the annual rentals in order to assure himself of an income over several years if the operator keeps the lease A third approach would be to emphasize production income and in turn to sacrifice bonus and rentals for a higher cut if the well actually comes in This approach sacrifices cash-in-hand for a higher payout if the well hits If the operator (lessee) has a strong belief that a prospect or proposed well will be successful, he may prefer to pay a high bonus and rentals in order to keep as much of the production for himself as possible On the other hand, if his cash is in short supply, the operator might prefer to make lower bonus and rental payments and in turn to give the landowner a higher royalty If the landowner thinks the odds for production on his land are good, he should emphasize a information he needs to negotiate a good deal? One good way to start is to obtain an oil and gas map for the area. Under state laws, data on oil and gas wells and on dry holes is provided to the State Oil and Gas Commission. This data includes well logs which show the geologic formations through which the wells were drilled. Maps are available from the State Oil and Gas Commission or from private publishers which show all of the known producing wells and oil and gas fields in each state.* These maps allow the landowner to pinpoint the nearest producing area to his land. The landowner should also ask around in his area to see what the oil companies are doing. The landowner may be able to find out roughly how many companies or operators are buying leases, how active they are, where they are leasing, and how much they are paying. This should provide an idea about the supply and demand for lease land in the area.

The oil and gas supervisor is responsible for managing oil and gas operations on federal and Indian lands.

In addition, there is an "oil and gas supervisor" headquartered in several cities in the West and Midwest. (See appendix for list of areas, addresses, and phone numbers.) The oil and gas supervisor is an employee of the United States Geological Survey. The supervisor is responsible for managing oil and gas operations on federal and Indian lands within his district. He also has a duty under federal regulations and under the trust relationship between the federal government and Indians to furnish scientific and technical information and advice to Indian mineral owners. The oil and gas supervisor has geologists and other technical people on his staff who should be able to provide much of the information a landowner needs to negotiate successfully with an oil and gas lessee. Remember that the Indian mineral owner is entitled to the advice and information which the United States Geological Survey can provide. Sometimes, however, the U.S.G.S. may not have up-to-date information, or may not give good advice. It is always a good idea to do your own investigation into the situation.

Several of the larger tribes with existing oil and gas production are able to employ full-time petroleum geologists. A geologist can review all of the available technical data and provide the tribe with a professional opinion on the likelihood of finding oil and gas in a given area. This information can then be used to formulate a strategy for the tribe's oil and gas development program, and to formulate the tribe's bargaining position with the oil companies.

*The United States Geological Survey maintains maps showing all producing oil and gas wells on federal and Indian lands. Copies of these maps are available from the Survey for the cost of copying.

4. Provisions of the Standard BIA Oil and Gas Lease; Form 5-154h, October, 1964 (Allotted Indian Lands) and Form 5-157, July 1964 (Tribal Indian Lands)

The following is an explanatory review of the major provisions of the standard form BIA oil and gas lease.

a. Paragraph 1 – Cash Bonus and Term of Lease

The lease form provides for payment of a cash bonus payment when the lease is signed. The term, or period of time for the lease to run, is for ten years and so long as oil and gas are produced in "paying quantities." This means that the lease will expire in ten years if oil and gas have not been discovered and the well or wells are not producing at least enough to pay for the cost of operation.

b. Paragraph 2.(b) – Wells

This provision requires that the oil and gas operator drill any wells which are necessary to protect the Indian leased land from being drained by wells on other properties.

c. Paragraph 3.(c) – Rental and Royalty

This paragraph requires that the operator pay at the beginning of each year advance royalties of $1.25 per acre and a production royalty of 1/6 of the value of all hydrocarbons produced. This section also provides that the advance royalties are to be deducted from production royalties if oil or gas are produced. It should be noted that this is an undesirable and unnecessary requirement of the lease form and the applicable federal regulations.[3] This provision also requires that the royalties be paid to the oil and gas supervisor (United States Geological Survey) for forwarding to the Indian owner.

d. Paragraph 3.(d) – Monthly Statements

This section requires that the operator furnish the oil and gas supervisor with a monthly statement of the amount, quality, and value of all oil and gas produced from the leased lands. When this is done, the office of the oil and gas supervisor will compute the dollar amount of the royalty due and will send to the operator a statement of the royalty to be paid.

e. Paragraph 3.(e) – Well Logs

This provision requires that the operator provide the oil and gas supervisor with a copy of well logs for all wells drilled on the leased lands.

f. Paragraph 3.(f) – Diligence and Prevention of Waste

This section requires that the operator drill and produce any oil or gas well responsibly, and that he take any measures necessary to prevent the waste of oil and gas. This section also requires that the wells be managed in the proper way to obtain maximum production and earnings from the well.

g. Paragraph 3.(h) – Assignment of Lease

This section requires the approval of the Secretary of the Interior for any transfer of this lease or any interest in this lease from the original lessee to a new operator.

h. Paragraph 4.(a) – Disposition of the Surface

This section states and protects the right of the Indian owner to use the surface of his land in any way he wants, including farming, so long as it does not interfere with the oil operator's right to use as much of the surface necessary for oil and gas operations.

i. Paragraph 4.(b) – Use of Gas

This provision allows the Indian owner to make a direct connection to the well, if it produces natural gas, and to use the gas free of charge for home heating and lighting. The Indian owner has a right to this gas for home use in addition to the royalty. The tribal form of the lease provides for the use of the gas in any school or tribal building.

j. Paragraph 4.(c) – Royalty in Kind

This section allows the Indian owner to take his royalty in actual oil and gas instead of in a dollar payment.

k. Paragraph 5. – Surrender and Termination

This provision allows the oil operator to terminate the lease at any time he wishes after payment of $1.00 and any royalty or other financial obligations due under the lease.

l. Paragraph 6 – Cancellation and Forfeiture

This is an extremely important provision It allows the Secretary of the Interior to terminate the lease after 30 days notice to the operator, and after a hearing if the operator requests it, for violation of any of the lease terms by the oil operator

m. Paragraph 6.(a) – Lesser Interest Clause

This section provides that if an Indian allotment owner who signs the lease owns less than a full 100% of the allotment, any royalty or other payments under the lease will be divided according to the proportions of each owner's interest

n. Paragraph 7. – Removal of Buildings, Improvements and Equipment

This section states that anything left on the land by the lessee for more than 90 days after the termination of the lease belongs to the allotment owner

o. Paragraph 9. – Division of Fee (This section appears in Indian Allotment form of lease only)

This section provides that if the allotment is ever physically divided up among several owners (heirs), the oil operator may continue his operations and pay each separate owner his fair share of rentals and royalties according to the proportion of the total area of the allotment which he owns

p. Paragraph 8* or 10* – Drilling and Production Restrictions

This provides that the Secretary of the Interior may control the time of drilling of wells and production from wells, or may shut down wells The purpose of this is to allow the Secretary to protect the oil and gas resource and the interest of the Indian owner

q. Paragraph 9 or 11 – Unit Operation

This provision allows for the unitization of the leased lands Turn to page 33 of this book for an explanation of unitization

r. Paragraph 10 or 12 – Conservation

This provision requires that the oil operator abide by any laws or regulations of the federal government which govern the conservation, production or marketing of oil and gas This section provides for the enforcement of federal regulations governing such things as spacing, unitization, and drilling and production practices

s. Paragraph 11 or 13 – Heirs and Successors in Interest

This section provides that the lease will not be cancelled if the Indian owner or owners die and the land is passed along to their heirs and descendants

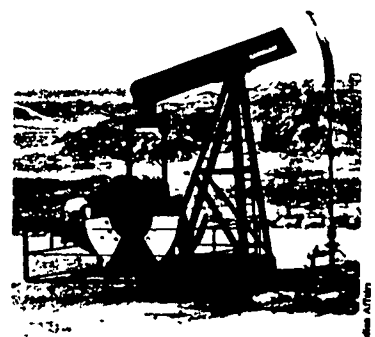
E. Joint Venture Arrangements in the Oil and Gas Industry

When a major or independent oil company, or a group of independent petroleum investors, has located and leased an interesting prospect, it is very common for them to make joint venture agreements or joint financing arrangements which bring in other persons or companies to share the costs, the risks and the rewards This practice is far more widespread in the petroleum industry than in any other mineral industry The following paragraphs name and describe some of the important terminology and the more common joint venture or joint financing arrangements Understanding both these terms and joint venture arrangements is essential to understanding the oil and gas industry Tribes and associations of individual Indian oil and gas owners can use these methods to increase their own participation in, and benefits from, the exploration of their oil and gas resources

*The first number refers to the paragraph number in the Tribal Lands lease form The second number refers to the paragraph number of the same provision in the Allotted Lands lease form

1. Working Interest

The person or company which holds an oil and gas lease (lessee) and pays the cost of drilling a well is the owner of the working interest A working interest in an oil or gas well is the right to drill the well, produce the oil and gas, and collect the profits A 100% working interest owner pays all of the costs of drilling, completing and producing the well, and collects all of the profits after payment of the royalty The working interest can be divided among several participating investors and oil and gas operators



Bureau of Indian Affairs

2. Carried Interest

A carried interest is a special kind of working interest A carried interest means that the working interest owner pays the share of the drilling and completion cost ("carries" the share of the cost) which the owner of the carried interest would otherwise contribute, until the well starts producing The owner of the carried interest must start sharing in the costs of the well at that point There can be many kinds of carried interests Sometimes the carried interest is carried only up to the start of well completion, and the carried interest owner must put up his share of the cost of completion Ordinarily, the operator is entitled to be paid back all of his costs before the carried interest owner begins to receive a share of the profits Sometimes as the price for bearing the risk, the working interest owner is given the right to receive 200% or 300% of his costs of production before the carried interest begins to share in the profits The carried interest arrangement can be seen as a kind of loan from the working interest owner to the carried interest owner which is paid back out of production The carried interest owner has the great advantage, however, in that he bears none of the risk if the hole is dry At the point where the carried interest begins to share in the costs and the profits of the well, it becomes a working interest Although the percentage of a carried interest can be almost anything the parties agree upon, carried interests commonly run from 10% to 50%

3. Net Profits Interest

A net profits interest is a right to receive a percentage of only the net profits of the oil or gas well This is in contrast to an overriding royalty which is paid off before any other expenses The owner of the overriding royalty will be paid no matter what, if there is any production from the well The owner of the net profit interest will be paid only if there is a net profit after payment of over-

Under actual conditions, however, all of the various tracts of land in a unitized field are not equally productive Some tracts may have a larger share of the producing formation than others Because of this, unitization agreements usually provide for the owners of lessees of the various tracts to share proportionately in the total field production according to the "value" of each tract, or according to the capacity of the tract to produce oil and gas relative to the capacity of the whole field

8. State Regulation of Oil and Gas Operations on Indian Lands

Lands held in trust for Indians and Indian tribes are not properly subject to state jurisdiction over oil and gas operations located thereon [6] The standard BIA Oil and gas lease forms for both tribal and allotted lands provide, however, that "in the exercise of his judgment the Secretary [of the Interior] may take into consideration, among other things, Federal laws, State laws, or regulations by competent Federal or State authorities regulating either drilling or production, or both " In practice, the

Lands held in trust for Indians and Indian tribes are not subject to state jurisdiction over oil and gas operations..

United States Geological Survey, in its role as oil and gas supervisor for federal and Indian lands, often permits states to exercise jurisdiction on Indian lands States are permitted to require oil and gas lessees to comply with many state statutes, rules and regulations governing oil and gas operations, so long as they are not in conflict with federal regulations Generally, the drilling phase of oil and gas operations is conducted under Geological Survey regulations, while well completion and production are governed by state regulations For instance, a federal drilling permit is required to begin drilling on Indian lands, but a state permit is required for multiple completion (production from more than one horizon)

In practice, the United States Geological Survey often permits states to exercise jurisdiction on Indian lands.

A state permit is required to sell and transport production from the lease in all cases States have been known to take enforcement action to compel operators on Indian land to comply with their regulations

There is no federal statute which permits states to exercise this regulatory jurisdiction over Indian lands There is also no federal regulation which mentions or authorizes state jurisdiction The provision quoted above from the standard form BIA leases, which purports to authorize the Secretary of Interior to permit the exercise of state jurisdiction on Indian lands, is probably in conflict with federal law What the lease provision is probably intended to do is to notify the lessee (operator) that the Secretary may adopt and enforce rules and regulations which are the same as or consistent with state rules and regulations In no case, however, has the Secretary actually adopted regulations, the same as or similar to state regulations, in order to make oil and gas operations on Indian lands conform to operations outside of Indian jurisdiction The BIA and the Geological Survey appear to have allowed states to exercise direct jurisdiction to regulate oil and gas operations on Indian lands, despite the lack of any Congressional action giving that power to the states The situation is similar to the states illegal enforcment of state hunting and fishing regulations on Indian lands

B. Federal Regulations

Because of the trust relationship between the United States and Indian people, the Department of the Interior and the United States Geological Survey are given broad authority by statutes and regulations to supervise and control oil and gas operations on Indian lands Normally, the federal government leases the land, writes the lease, issues drilling permits, supervises drilling and production, collects the money, enforces the lease, and finally gives the Indians the royalty There are, however, opportunities for tribes and individual Indians to play a much greater role in the entire process than they have in the past Greater Indian involvement will almost certainly result in better management and protection of Indian oil and gas resources,

Greater Indian involvement will almost certainly result in better management and protection of Indian oil and gas resources

and a greater return to the Indian mineral owners Proposed new oil and gas regulations could also help to increase the role that Indians can play in the leasing of their land

Federal statutes which govern the leasing of oil and gas on Indian lands include the following Sections of Title 25 (Indians) of the United States Code

- §396 Leases of *allotted* lands for mining purposes
- §396a Leases of *unallotted* lands for mining purposes, duration of leases
- §396b Public auction of oil and gas leases, requirements
- §396d Rules and regulations governing operations, limitations on oil and gas leases
- §398 Leases of *unallotted lands* for oil and gas mining purposes
- §398a Leases of unallotted lands for oil and gas mining purposes within executive order Indian reservations
- §398b Same, proceeds from rentals, royalties, and bonuses, disposition
- §398c Same, taxes
- §476 Organization of Indian tribes, constitution and bylaws, special election
- §477 Incorporation of Indian tribes, charter, ratification by election

Federal regulations which apply to Indian oil and gas leasing include 25 Code of Federal Regulations (CFR) Part 171—Leasing of Tribal Lands for Mining, and Part 172—Leasing of Allotted Lands for Mining There are special regulations governing oil and gas leasing for the Crow Reservation, the Five Civilized Tribes of Oklahoma, the Osage Reservation, and the Wind River Reservation [7] In addition, the provisions of 30 Code of Federal Regulations Part 221 governing the United States Geological Survey apply The Department of the Interior has proposed new oil and gas regulations (25 Code of Federal Regulation Part 182—Oil and Gas Contracts) which would replace 25 CFR Parts 171, 172, 173, and 174 if they are adopted These proposed new regulations were not yet in effect as of June, 1979

1. Procedure for Leasing Tribal Lands for Oil and Gas

The basic procedure for leasing tribal lands provides for interested companies and persons to request that the Bureau of Indian Affairs advertise a lease sale A lease sale is similar to an auction with sealed bids Tribes themselves may also initiate a lease sale by request to the Agency Superintendent Either way, the tribe must approve the holding of the sale

On the date of the lease sale, interested prople submit bids which include delay rentals and royalties as specified by the Agency Superintendent at the time the lease sale is advertised The Agency Superintendent may fix the royalty rate for the leases offered in the sale at the standard 1/8 as provided in the regulations, or he may provide for a higher royalty rate The most recent versions of the standard form BIA leases for tribal and allotted lands provide for a 1/6 royalty A sale of oil and gas leases on Navajo lands was held recently which specified a royalty of 1/5

Bidding competition is usually limited to the amount of the bonus payment This means that the royalty rate for all of the leases in the sale will be the same as that fixed by the Agency Superintendent People and companies bidding for the leases will bid a higher or lower bonus payment depending upon how rich in oil and gas they think the land may be The winners in the lease sale will be the bidders who bid the highest per acre bonus payment for each lease

Oil and gas leases may be negotiated between the tribe and the lessee with the consent of the Secretary of the Interior.

There have been lease sales which allowed the bidders to bid on the royalty rate In this kind of sale the bidders who offer the highest royalty rate for each lease pracel get the lease When this kind of lease sale was held for Navajo tribal lands, the high bid was a 72% gross value royalty Oil was discovered, but the lease had to be renegotiated because the operator could not make a profit after paying the royalty The renegotiated lease provides for a net profit royalty

The Secretary of the Interior has the right to reject all bids when he believes they are too low and that it would not be in the best interest of the Indians to issue the leases The tribe may also reject leases if it is not satisfied with the bids In this case the leases may be readvertised and a new lease sale may be held

Oil and gas leases may be negotiated privately between the tribe and a lessee with the consent of the Secretary of the Interior [8] The Secretary has delegated the authority to approve negotiations to the Agency Superintendents Agreements are now being negotiated more frequently as tribes become more sophisticated in managing their mineral resources Just as with oil and gas leases of private lands, a negotiated lease of tribal lands may contain any provisions and any kind of royalty structure that the parties can agree upon, so long as the Secretary of the Interior approves

Federal regulations provide that no one oil and gas lease can be larger than 2,560 acres [9] For negotiated leases this acreage limitation is really meaningless, however, because larger acreages can be simply divided up into several parcels and several separate lease documents The terms of the lease could be exactly the same as if it was all done in one document

Regulations specify that the lease term is to be for no more than ten years from the date of approval by the Secretary and so long thereafter as oil and gas are produced in paying quantities [10] This means that the operator must drill, find oil or gas, and put it into production within the term of the lease or lose the lease So long as he continues to pay the annual delay rentals provided in the lease, however, he can hold the lease for at least ten years, or for a shorter term if that is stipulated in the lease

2. Procedure for Leasing Allotted Lands for Oil and Gas

Procedures for leasing allotted lands are very similar to the procedures for leasing tribal lands There are some important differences, however The regulations allow the Agency Superintendent to sign leases for minors and persons who are incompetent because of mental incapacity [11] Rents and royalties are paid to the Treasurer of the United States and transmitted through the Oil and Gas Supervisor (United States Geological Survey) to the Agency Superintendent for deposit to the accounts of the various individual Indian owners If it appears to be in the best interest of any individual Indian owner, the Superintendent may authoize the operator to make rent and royalty payments directly to the Indian owner [12] The regulations also provide that all advance payments will be allowed as a credit on production royalties for the year for which the advance payment is made

Advance payments are the payments of $1 25 per acre rental which the lessee must pay at the beginning of each lease year [13] For example, if an oil company made a rental payment of $500 at the beginning of the second lease year, and discovered oil six months later, it would be entitled to deduct $500 from production royalties owed to the Indian landowner

3. Objectionable Aspects of BIA Leasing Procedures

There are many aspects of the existing federal regulations pertaining to Indian oil and gas leasing which are inadequate or objectionable Many of these problems should be resolved by the proposed new Indian oil and gas regulations (pending as of June, 1979) At this time, however, it is uncertain when or whether the proposed new regulations will be adopted

. Indian oil and gas leasing practices .are too closely modeled after the system used for leasing federal public domain lands.

The broadest criticism of the Indian oil and gas leasing practices is that they are too closely modeled after the system used for leasing federal public domain lands For purposes of resource development, the federal government has long treated Indian lands as if they were a category of federal lands, and has extended the underlying philosophy and policy of federal land leasing to Indian lands The policy underlying the federal land leasing program has been to make resources on federal lands available to American companies at a low price in order to benefit the economy As a result, there has never been any serious attempt by the Department of the Interior to obtain any better terms for oil and gas leases on Indian lands than the federal government itself was getting Petroleum companies prefer to lease private lands because they are not subject to time-consuming and expensive statutory limitations, regulations, approvals and paper-work In leasing Indian lands, petroleum companies are subject to even more regulations and red tape than when leasing federal lands That means that cheap federal leases are more attractive than Indian leases, and Indian lands will be leased last, especially if Indian owners want a better price

Another problem with Indian land leasing is that the BIA has always left the initiative up to the oil companies Tracts are selected for lease sales based upon requests from the companies Usually, tribes have not known what lands were included in the sale until after the sale was completed If a company requested that 50,000 acres be put up for bid, the BIA would dutifully advertise 50,000 acres This allows the requesting company to hide the lands it is really interested in among a much larger tract, and reduce the competition from other companies for what may be a very hot prospect Other companies would have to do extensive geologic and geophysical exploration to find out which lands are most favorable for oil and gas Also, since the market for oil and gas leases is subject to ordinary market forces, the larger the supply of land, the lower the price The indiscriminate leasing of large tracts has kept the bonus bids on Indian lands lower than they might otherwise have been

There has also been a complete lack of

strategy in BIA leasing programs The BIA has leased very large contiguous tracts when a checkboard leasing pattern could have put Indian owners in a much better position for a latter lease sale if oil and gas were discovered In fact, a federal regulation[14] actually requires that tracts put up for bid "shall be in a reasonably compact body"

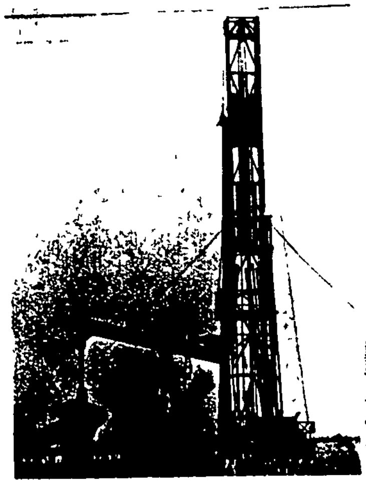
There has been a complete lack of strategy in BIA leasing programs.

Another federal regulation[15] provides an acreage limitation on Indian oil and gas leases of 2,560 acres This is much too large for one lease without some accompanying requirements that the lease be fully developed if petroleum is discovered As a result, oil and gas operators have been able to hold large acreages for speculative purposes for 20 years or more on the basis of only one producing well, the discovery well As long as any oil is produced in paying quantities, the company can keep the lease The federal regulations actually facilitate this improper practice by providing that the Commissioner of Indian Affairs can allow production from one lease to satisfy the production requirements for any number of additional leases [16]

An especially objectionable provision of the BIA lease form is the requirement that all payments made to the Indian owner prior to production, for the year in which production begins, be deducted from production royalties This requirement does not appear in standard form leases of private land, and seems to have been written as a benefit to oil and gas producers It is entirely unnecessary and inappropriate

4. The Role of the United States Geological Survey

All Indian mineral leases are subject to supervision by the Oil and Gas Supervisor


American Petroleum Institute

The Supervisor is an employee of the United States Geological Survey who is authorized to supervise and direct operations under oil and gas leases, to furnish scientific and technical information and advice, to ascertain and record the amount and value of production, and to determine and record rentals and royalties due and paid [17] The Geological Survey has divided the United States into five oil and gas operations areas They are the Southern Rocky Mountain Area, the Northern Rocky Mountain Area, the Mid-Continent Area (includes Oklahoma), the West Coast and Alaska There is an oil and gas supervisor with a staff, which may number up to two hundred people, for each area

Once an oil and gas lease of Indian lands has been executed by an Indian or by a tribe and has been approved by the Secretary of the Interior, it is turned over to the Geological Survey to be managed by the Oil and Gas Supervisor and his staff The operator of each lease is required to send monthly reports to the Oil and Gas Supervisor There are three reports which must be made monthly on standard forms provided by the Geological Survey The three reports are the

1 Monthly Report of Operations—the production report showing the total amount of petroleum products of all kinds produced on the lease,
2 Monthly Report of Sales and Royalty—the sales report showing the total amount of each category of product sold during the month, the amount received, and the buyer,
3 Rental and Royalty Remittance Advice—the royalty report showing the amount of royalty due

Copies of these forms are included in the Appendix to this book

The operator should send in the royalty report with a check for the proper amount of the royalty Royalties are due and payable monthly on the last day of the month following the calendar month in which the oil and gas are produced In addition, the buyer of petroleum products from each lease must submit a monthly report showing how much of each product he bought, the price he paid, and the seller

Royalty checks for leases on tribal lands may be made out to the tribe or to the BIA (United States Treasury), depending upon the arrangements the tribe has made with the BIA and the Geological Survey If checks are made out to the tribe, the Geological Survey will forward the checks to the tribe for deposit If the checks are made out to the United States, they are forwarded to the BIA Agency for the particular tribe and the Agency deposits the checks to its account and makes the proceeds available to the tribe Royalty checks for allotment owners are usually paid to the BIA and forwarded to the appropriate Agency Superintendent for deposit in individual Indian money accounts from which the proceeds are made available to the allottees

The Oil and Gas Supervisor is responsible for confirming that the operator has paid the royalty each month, that the amount of the royalty is correct, and that all of the requirements of the lease and of the applicable federal regulations are being met Verifying the amounts of production, the prices for which the products were sold, and the proper amount of the royalties has become an enormous job since the early 1970's when oil and gas pricing began to become complex The Oil and Gas Supervisor must now see to it that the correct one of approximately forty-five possible prices for natural gas and approximately twenty-two possible prices for crude oil has been paid and received, and that the royalty has been correctly calculated This is the job of the staff of the product value division of each area office of the Geological Survey Unfortunately, the staff is not large enough to do more than spot check the reports There is an audit staff available, which can do a complete audit of a lease covering a period from one month to several years, but the audit staff is so swamped with work that relatively few leases are ever audited

5. The Role of the Local Indian Agency

The local Agency Superintendent controls the leasing of Indian lands for oil and gas by scheduling lease sales, deciding what the amount of annual rentals shall be, deciding what the royalties shall be, and collecting advance payments (bonus and rental) for the first lease year These decisions are made after consultation with the Oil and Gas Supervisor, and in the case of tribal lands, after consultation with the tribe In the case of allotted lands, the Superintendent makes the decisions after considering Geological Survey recommendations but usually without consulting the allottees The Superintendent also has the power to reject bids when, in his judgment, the interest of the Indians will be best served [18] He is also responsible for obtaining Indian signatures on oil and gas leases of allotments, when he thinks that the bids should be accepted The Superintendent has the responsibility to notify the Secretary of the Interior and the Oil and Gas Supervisor if he learns that oil