Minerals Management Advisory Board
Royalty Policy Committee
Summary of Meeting
October 18, 2001

The Royalty Policy Committee (RPC) of the Minerals Management Advisory Board convened its thirteenth meeting at the Sheraton Denver West Hotel, 360 Union Boulevard, Denver, Colorado, on October 18, 2001. In accordance with the provisions of Public Law 92-463, the meeting was open to the public.

Members/Alternates Present:

Perry Shirley, Navajo Nation (Chairman), Dobie Langenkamp, Oklahoma Independent Petroleum Association (alternate), David Landry, National Mining Association, Lee Helfrich, Public Representative, Tom Shipps, Ute Mountain Ute Indian Tribe, Pary Shofner, Western States Land Commissioners Association, George Butler, American Petroleum Institute (alternate), David Darouse, State of Louisiana (alternate), Rosemary Maestas-Swazo, Jicarilla Apache Tribe (alternate), David Harrison, Council of Energy Resource Tribes, Harold Kemp, Wyoming (alternate), Dave Loomis, Western Governors Association (alternate), Karen Anderson, Southern Ute Indian Tribe, Tammy Naron, Independent Petroleum Association of America, Eddie Jacobs, Oklahoma Indian Mineral Owners Association, William Hartzler, National Mining Association, Brad Simpson, Western Governors Association, John Clark, Council of Petroleum Accountant Societies, Carla Wilson, IPAMS, Lucy Querques Denett, Minerals Management Service, Executive Scretary, Pete Culp, Bureau of Land Management

Minerals Management Service Employees Present:

Theresa Walsh Bayani, Mike Baugher, Gary Fields, Keith Good, Martin Grieshaber, Mike Miller, Ken Vogel, Herb Wincentson, Stacy Leyshon, Paula Neuroth, Phil Sykora, Ralph Spencer, John Russo, Edward Shaw, Paul Knueven, Greg Smith, Debbie Gibbs Tschudy, Todd McCutcheon, Merril Anderson, Jan Therkildsen, Milt Dial, Donald Sant, Anita Gonzales-Evans.

Others Present:
Pam Williams, Gary Paulson, Ron Belak, Joanie Rowland, James Haygood, Roger Good, Pat Kent, Ellwood Soderlind,

WELCOME AND OPENING REMARKS:

Meeting began at 8:36 a.m. Mr. Perry Shirley confirmed the presence of a quorum to convene the meeting with 19 of 21 voting members present.

UPDATES FROM LUCY QUERQUES DENETT:

Ms. Querques Denett expressed appreciation to all attendees who were able to rearrange their schedules to attend the RPC meeting. Ms. Querques explained the reasons for the agenda changes and provided updates on the appointments of Departmental positions, offshore activities including MMS's proposed Five-Year Oil and Gas Leasing Program, and lease sale activities. She also updated the Committee on the status of Minerals Revenue Management's Financial Management system conversion efforts.

APPROVAL OF THE MARCH 27, 2001 MINUTES:

Ms. Lee Helfrich requested the minutes be clarified to accurately capture what she said at the March 27, 2001 meeting. Ms. Helfrich pointed out that given the fact that there was correspondence that went to the Secretary and the minutes are public, that the views of the people that opposed a motion should have been stated instead of reduced to "lively discussion" as reflected in the minutes. She also pointed out that the minutes do not state that an appeals letter was to be forwarded to the Secretary. The minutes should reflect what was agreed to so that people can go back and evaluate these things when they do get set to paper. She noted that the eventual letter that did go out was modified.

Mr. Shipps recommended that on page 2, under Motion to Add Appeals to the Agenda the second sentence, which reads: “In the discussion that followed, Ms. Helfrich expressed concern that the appeals regulations were on hold and the current status is unknown be amended to show that her concern was addressed to our reconsidering this issue in amending our agenda. And with that change I would move that the minutes be approved”.

Minutes will be amended so that it states, "In the discussion that followed, Ms. Helfrich expressed concern that the agenda be amended to reconsider the appeals regulation," and with that change Mr. Shipps moved that the minutes be accepted.

Mr. John Clark seconded Mr. Shipps motion.

Vote: 17 in favor, 0 opposing and 2 abstaining votes. Motion carries.

APPEALS:

Ms. Querques Denett explained that appeals was added to the agenda because we believed that the Deputy Secretary, as a political appointee, would be in attendance and would be able to discuss appeals and appeals issues with the Committee. However, in the absence of the Deputy Secretary MMS has nothing new to report on the appeals regulations since our last meeting. Revisions to the current regulations will remain on hold until a new Director comes on board and has the opportunity to review the complete record.

Mr. Shirley summarized what occurred with this issue since the last meeting. The Committee drafted a letter that was revised by Mr. Shirley and forwarded to the Secretary for a second time asking consideration of the Appeals Subcommittee recommendations that were previously made in March 1997. Mr. Shirley received a response back from Secretary Norton in a letter dated August 7, 2001. Copies were provided to Committee members. The letter stated:

Dear Mr. Shirley: Thank you for your May 23, 2001, letter on behalf of the RPC concerning revisions of the Minerals Management Service’s appeal process. In particular, you requested that I reconsider the RPC's March 1997 report on the matter. This administration, as with any new administration, will take a fresh look at many of the processes within the Department of the Interior, including the process used for appeals challenging orders applicable to royalty under mineral leases. I can assure you and the RPC that the appeals process is a priority issue for the Department and will be evaluated fully upon arrival of the new director of the MMS. I appreciate the valuable contribution that the RPC

provides in all areas regarding the Department's mineral programs and will have the new MMS director contact the RPC at the earliest time possible.

SOLICITOR's OPINION ON COAL WASTE PILES:

Mr. Geoff Heath presented the opinion on the royalty consequences of recovering coal from waste piles. The MMS was asked to look at the question of whether royalty is owed on coal recovered from washing waste piles in six different situations. Those situations are: (1) is the lease effective or relinquished; (2) is the mine operating or closed; (3) the location of the waste pile; (4) if the lease is effective and the mine is operating and the waste pile is either on or off the lease; (5) if the lease is effective but the mine is not operating and the waste pile is on or off the lease; and (6) if the lease is relinquished and the waste pile is either on or off of federal land.

The basic statutory provision is in the middle of the leasing act as amended by the Federal Coal Leasing Amendments Act at 30 USC 207, which provides for a royalty as a percentage of the value of coal as defined by regulation. This is different from the provisions on oil and gas, which provide for royalty as a percentage of the value of the production saved, removed or sold. The coal statute doesn't say that, and the difference becomes fairly critical.

There is a rule that has been in effect since July 1982, that's codified in 30 CFR 206.253(c), that provides the lessee "shall pay royalty" on coal recoverd from washing waste piles at the rate specified in the lease at the time the recovered coal is used, sold, or otherwise disposed of. And it specifically so provides regardless of whether the waste pile is located on or off of federal lands.

Now, the ultimate crucial question that's the foundation of the legal analysis is the question of when royalty liability accrues on coal, including coal recovered from washing waste piles. In oil and gas, royalty accrues upon production and removal from the lease, but the coal situation is a little bit different. And the answer begins with considering the phrase from the quoted rule specifically applicable to waste piles: "at the time the recovered coal is used, sold, or otherwise disposed of." The question for the lawyer in the construction of the rule is whether the phrase "at the rate specified in the lease" or by the phrase, "at the time the coal is used, sold, or otherwise disposed of" modifies the phrase "at the rate specified in the lease" as well as the phrase "shall pay royalty". Because you can read the rule two ways, although "except" and "can" as a grammatical construction would indicate that the "at the time the coal is used, sold, or otherwise disposed of" doesn't modify both.

The preamble to the proposal of this provision that became 206.253(c) fortunately leaves little doubt in the question. We do specify in the preamble discussion that even if a lessee had extracted coal that ended up in the waste pile under a cents per ton royalty regime before readjustment, if the coal is recovered from the waste piles during the time the ad valorem rate was in effect after readjustment, the royalty is due on the ad valorem rate at the time of recovery from the waste pile. So there's pretty much no ambiguity of what the rule says.

Now, the consequence of that is that royalty liability for coal recovered from waste piles accrues at the time of the sale and disposition of the

coal and not at the time of physical extraction from the ground. Otherwise the royalty would have become fixed at the cents per ton rate upon physical severance, and that's not what happens. Physical severance may occur, but royalty liability does not at that point accrue.

That principle also follows from two other rules which like 206.253 are longstanding government challenge. The first one is the rule that governs the royalty consequences of extracting coal before readjustment but selling it after the effective date of readjustment. That is just coal mining generally, not that deposited in the waste piles. The reference for that is 30 CFR 206.256(d). Royalty is required at the readjustment rate that's in effect at the time of sale except for the fact that the rule provided for a 30-day grace period, that if it's sold within 30 days after the readjustment, you could still pay at the cents per ton rate. Everything else then is extracted during a cents per ton regime that's sold more than 30 days after a readjusted ad valorem rate comes into effect, is subject to royalty at the ad valorem rate.

Likewise, the principle follows from the royalty treatment of stockpiled coal. See, again, 30 CFR Section 206.255(b) and (c). The rule provides the coal provision added to stockpiles or inventory is subject to royalty when it's used, sold, or otherwise disposed of. The preamble discussion makes that clear.

Royalty liability accrues on coal, including coal recovered from waste piles, at the time of sale and disposition. No one has ever suggested that royalty is due on coal that is in stockpile and inventory. If the lease is in effect, the royalty is due when coal in the waste pile is sold, used or otherwise disposed of by the lessee, and at the lease rate that is in effect at the time. The regulations specify that the location of the waste pile is irrelevant, and it necessarily also follows that whether the mine is operating or closed is also not relevant to accrual of royalty liability as long as the lease itself is in effect.

Two notes here before we get to the consequences if the lease is not in effect. We are assuming here in this analysis that royalty has been paid on the basis of post washing weight or volume. If royalty was originally paid on the coal and sold on the basis of pre-washing weight, then royalty has already been paid on the product that's in the waste pile. And the rules do provide that we don't charge royalty twice. So in that circumstance royalty would not be due. But assuming, as appears to be the general rule, that royalty is paid on the post washing weight, then additional royalty is due upon recovery from the waste pile sale.

Also, when the coal in the waste pile is used, sold, or otherwise disposed of is a question of the specific contract terms between the lessee and the purchaser or between the lessee and a third party with whom the lessee agrees to come in and recover the coal from the waste pile. Now, the opinion gives a couple of hypothetical examples. For example, the lessee might agree with the purchaser that it will recover coal and then for every ton sold it's going to pay a couple of bucks a ton and that the sale occurs incrementally as the coal is recovered from the waste pile. And so in that case royalty would become due incrementally. Alternatively, the lessee might simply grant to somebody the right to recover all the coal in the waste pile in return for $10,000 up front. In this case the coal in the waste pile has been sold or otherwise disposed of. Even though it hasn't been dug up from the waste pile, it's been sold and royalty would be due at that point.

So in each of these cases we're going to have to take a look at the contractual arrangements between the lessee and whoever it's dealing with to figure out the point at which sale or disposition occurs. The principle that the royalty liability accrues upon sale or disposition implies that the result is different if the lease has been relinquished before sale or disposition. There's another provision in the MLA at 30 U.S.C. 187 that provides that "the Secretary's acceptance of lease relinquishment relieves the lessee of all the future obligations under the lease." There is BLM rule, 43 CFR 3452.1, that says "The authorized officer must determine that the accrued royalties have been paid before accepting relinquishment." But the principle obviously is if the coal in the waste piles has not been sold or otherwise disposed of before lease relinquishment, any prospective royalty on that coal is a future obligation, which upon acceptance of a lease relinquishment has been notified by 30 USA 187. It is not an accrued obligation at that point because sale and disposition is not happening. Consequently, if the lessee sells or disposes of the waste pile coal after lease relinquishment, there is no royalty on it. And that is true regardless of the location of the waste pile, whether or not it's on federal land.

During the preparation of the opinion the question was raised as to whether this royalty treatment of coal and waste piles was inconsistent with how the OSM treats coal in waste piles for AML fee purposes. The opinion addresses that question.

Mr. Brad Simpson asked Mr. Heath exactly what he meant by relinquished. He used the following example. If someone owns a lease and they move federal coal to an off site and it's not sold, and a few years down the road they relinquish the lease, then they can never pay royalties?

Mr. Heath answered as a matter of law you’re correct. If somebody decides to put a stockpile somewhere off the lease, leaving aside all of the operational permissions, and the lessee moves to relinquish the lease, BLM is not obligated to accept that relinquishment at that point.

Mr. Simpson: Regardless of what you call it, coal or waste coal, because of new technology they're now selling that coal in those waste piles. The waste piles are huge. Are we telling the previous lessee that they have no royalty obligation?

MR. HEATH: Yes, sir, that's right.

Mr. Tom Shipps asked if there is a definition in the Secretary's regulations of "disposition" for purposes of construing the underlying statute?

MR. HEATH: No.

MR. SHIPPS: Wouldn't a properly formulated regulatory definition of that statutory term help deal with the situation that Brad's referencing where in fact you could essentially prevent kind of a gratuitous contribution to the coal company's coffers at the expense of the United States in that situation?

MR. HEATH: That's something we have not explored, but we have a potential obstacle. One of the facts that immediately crops up in the waste pile context is that the waste piles now are past occurrences and there is very little washing that is still going on according to our understanding. In fact, most of the waste piles of which this question

will accrue are pre-SMCRA waste piles. The piles have been there for a long time. I am not sure whether a definition of disposition at that time could be imposed retroactively.

In the BLM rule at 43 CFR 3452.1, the authorized officer has to determine that accrued royalties have been paid before approving relinquishment.

MR. SIMPSON: I believe that this ought to be very concerning to all the states and tribes that receive royalties from production. I think that we probably need to go back to our coffers, talk to our state and tribal representatives, because I think this opens up a door that's never been opened up before. We know where the coal comes from, we knew it came from federal leases, and they're saying it's not royalty bearing. It doesn't matter if it's 1 year, 5 years or 10 years later, we know it, the facts are there, and I'm concerned about that and I know that the State of Utah will be taking that back to our governor's office and also to the Western Governors Association.

MS. HELFRICH: I just wanted to point out that that BLM regulation says that "The accrued rentals and royalties have been paid and that all the obligations of the lessee under the regulations in terms of the lease have been met." I know that this is a matter of some dispute, but I think that there is a duty to market, or a duty not to waste. Putting it on non-federal lands and then not paying royalties would breach the duty not to waste the assets of the United States. And these issues apparently have not been considered by the Solicitor's Office in addressing this. Assuming that I even agree with the interpretation of the word "accrued".

MR. SIMPSON: In Utah the lessee actually took the coal to an off-site location that's not federally owned. That's why nobody from the BLM has done any inspections. If I had some waste piles I would move them off lease, wait for a few years and relinquish the lease. There's nothing that stops that from happening because the Solicitor’s opinion is saying that's an acceptable practice. No inspection occurs once the coal waste is moved off lease and there is no way of knowing who's obligated. The lease can be relinquished without royalty payment. That bothers me that we can take federal coal somewhere else and not be required to pay royalty.

MR. SHIPPS: I've got a question for the BLM. Brad just suggested that there is nothing that the BLM can do under this opinion and that in fact it's very easy for a coal lessee to mine the coal, remove it, take it off site, and then if the lease terminated, there would be no royalty obligation. Isn't there a BLM process of reviewing how that coal is mined and the disposition of that coal and some kind of approval process that would ensure that there is payment of royalty with respect to that removed coal?

MR. SIMPSON: Currently, they have regulations where that cannot happen.

MR. CULP: I guess what I'm wondering is if at the time we approved the relinquishment there was any basis to believe that hauling these waste piles had any value. I don't know the answer to that. But clearly we have a duty and responsibility associated with approving the relinquishment to try to avoid this kind of situation I don't know the specific issue, I guess it does raise that question in my mind about whether anybody thought at the time there was any value to those waste piles.

MR. SIMPSON: That’s my concern. Utah has also believed that someday the waste piles were going to be recoverable and have a value. In retrospect we should have gone out and assessed the coal waste piles and taken it to court. I think we're still not done with the actions at this point.

MR. HEATH: The OSM has routinely made a case by case determination of no value in situations where coal--or the waste,is taken from the waste pile and used unrefined in small power producing or cogeneration plants that qualify for special regulatory treatment relative to their dealings with the utilities. Now, what I'm about to say doesn't apply if they recover coal from the waste piles and then clean it further and make it better and then blend it with other coal. But when they take the unrefined waste and use it in one of these "FRT-qualifying cogenerator small power producing facilities," the OSM has made a determination of no value for AML fee purposes.

Under the SMCRA the AML fee is imposed at either 35 cents per ton or 10 percent of the value of the coal, whichever is less. Now I mean all the waste stuff is always less than 35 cents per ton, so you're dealing with 10 percent of whatever the value is.

The OSM had taken the position as a matter of secretarial discretion. Because, there was a value determined by the Secretary in the SMCRA provision, that because the coal was not worth as much as it cost to recover it that its value for AML fee purposes was zero. Now, we explain in the opinion why that's not inconsistent with the royalty rules that will require royalty if the lease is in effect as long as there is some consideration flowing to the lessee for the product extracted from the waste pile. But the Department clearly, in view of goals of SMCRA, had something of an incentive to encourage the clean up of the waste piles at private expense.

If it costs more to recover it than what the recovering party or person was willing to pay for the coal, the reason why it was nevertheless economical to do so was to determine a Section 29 tax break. But the development of this course of use of the unrefined waste is of pretty recent origin.

MR. SIMPSON: I think where we are at now is we're not sure how many of these are still in operation, how many have been relinquished. We'll go back and do the numbers. I do think our biggest concern right now is not so much the coal waste piles it is that the federal government is willing to relinquish payment that was due for natural resources.

MR. SHIPPS: As a policy committee our principal concern should be with how the ongoing regulatory framework within the Department of Interior impacts points where we see or perceive there to be some inequity either to the United States, states, tribes, or to the industry. The potential inequity is that a coal lessee on federal or tribal lands could remove product from the lease without having to pay royalty. There could be a relinquishment of that lease and at that point there could be a windfall to that former lessee or to a successor to that stockpile.

I think it's important for the Committee to seek additional guidance from the MMS and the BLM and perhaps the Solicitor's Office. A written report describing why this particular situation is an aberration and why under existing policies a lessee couldn't go forward and do what apparently happened here consciously with respect to future lease activity. If the

report can't come back with some kind of satisfactory assurance to the Committee that there aren't windfalls given in these situation, then a committee should be formed to see what kind of alternative courses of action we might recommend to the Secretary. But I'd really like to have something that comes back from the agencies indicating to us why this doesn't create a major concern under existing practices and regulations.

MR. SIMPSON: I think the proper procedure is to let the coal subcommittee analyze the comments that come from the Solicitor's Office. I think we owe it to our subcommittee, they're the ones that did the research the first time, put the comments in front of the committee. We asked for this opinion, so I think we owe it to the subcommittee to let them take a chance over the next months to make a recommendation back to the Committee. I motion that we send this back to the subcommittee for further review and comments before our next RPC meeting.

MR. LANGENKAMP: Second the motion. Will the Committee be able to quantify this problem? I see litigation looming and it ought to be sooner rather than later if it's inevitable. If this problem is not a significant problem in terms of dollars, then I think we ought to treat it as a historical quirk or so forth. But if it's a substantial dollar issue for your state and others, then that is one thing that the Coal Committee will report back on, will they be able to quantify this?

MR. SIMPSON: I think that's the biggest question at this point, is how big of a problem it is, does it affect other solids? I recommend we have the coal subcommittee make some recommendations back to this Committee.
MR. HEATH: There are no royalty appeals involved in this issue.

VOTE: motion passes. 19 in favor, 0 opposed and 0 abstaining votes.

ROYALTY-IN-KIND:

Wyoming Oil RIK Program:

Mr. Todd McCutcheon from MMS Policy and Management Improvement gave a presentation on the status of the Wyoming Oil RIK program and updated the Committee on public comments received through MMS's Federal Register requests. The comments focused on four main areas: (1) the application of the oil valuation regulations as a benchmark for the pilot; (2) using Canadian pricing as the benchmark, because a lot of the oil from Canada flows down and competes with Wyoming oil; (3) questions about the calculation of the value uplift and how we did that process in the report; and (4) the type of companies that were bidding on the RIK in Wyoming. Much of the discussion focused on price forecasting and why prices vary in given areas as well as, explaining how pricing strategy is carried out in the Wyoming RIK arena.

Texas 8g Pilot RIK Project:

Mr. Martin Grieshaber from MMS Policy and Management Improvement presented information about the recent review and analysis of the Texas 8g Pilot RIK project. The Texas pilot consists of approximately 65,000 mmbtu of gas sold daily from 12 leases.

Mr. Grieshaber briefed the Committee on:

· Selection criteria for determining the pilot's lease universe.

- Understanding market conditions from production volumes to pipeline infrastructures.
- Competitive advantage and packaging to multiple purchasers to develop invoicing and balancing procedures.
- Aggregating volumes to receive beneficial transportation rates.
- Post sale economic analysis.

Mr. Grieshaber informed the Committee that MMS plans to have a draft report available in early December for comment. It appears likely the report will be published in the Federal Register.

RIK Operations:

Mr. Greg Smith discussed the context of Royalty in Kind, where it exists in MRM, and the relationship of RIK in reengineering from a pilot to an operational phase.
Mr. Smith briefed the Committee on:

- The MMS strategy document to realize our goal of integrating RIK with royalty in value.
- Future focus on the Gulf of Mexico and Onshore RIK. Wyoming and Louisiana have expressed interest in gas RIK.
- Development of MMS functional and information requirements.
- Daily volumes of current RIK programs.
- Small refiner program.
- Front office, mid office, back office business arrangement.
- RIK and the Strategic Petroleum Reserve.

SPECIAL GUEST:

Ms. Querques Denett introduced Mr. Ed Shaw, MMS' Schedule C representative to the Committee.

RIK QUESTIONS:

Mr. Tom Shipps asked if RIK ends up being beneficial should we also look at forming a national oil and gas company to produce the resources on federal lands. Also, should we look at alternative measures for valuation that would serve the same purposes without incurring the same kind of costs that the government's going to incur for RIK?

MS. QUERQUES DENETT: To try and do a cost comparison at this point is premature because we don't have a steady state environment and we're not fully operating under the new reengineered compliance process. Our reengineered systems are not operational.

Secondly, we're still developing the RIK process and associated costs. As we're creating efficiencies under the new compliance process and as we move properties into In Kind we are also shifting resources. So at this point we haven't asked for additional people resources to work Royalty in Kind. So the additional resource cost for the government isn't being incurred. What is being incurred are costs for systems development. In our 2002 budget there are dollars for a gas management system and we are going to request resources for developing a liquid management system. We are not seeing an increase in resources but rather a shifting of people from straight compliance into Royalty in Kind. As we gain more experience from selected RIK properties we will be in a better position to determine in-kind expansion or continue operations in-value.

MR. SHIPPS: I think there's a third alternative. What revisions could be made within the existing royalty valuation system that would eliminate either of the in-kind or in-value costs, or portions of them, and still provide the certainty of the industry and same levels of recovery of royalty for the Federal Government.

MS. DENETT: MRM has not looked at regulations and valuation on the federal side. We passed the Federal Oil Rule, which I think does create, a lot more certainty. From the Agency's perspective we think it's a lot easier to do valuation when you're in a non-arm's length situation.

MR. BUTLER: I believe that the benefits--the certainty that Royalty in Kind produces is not a benefit for industry alone, it's a benefit for everyone, it's a benefit for the government, and it certainly is a benefit for the states that share in the additional valuation of certainty. I don't see RIK as strictly a benefit for industry. I also think that there are alternatives to just strict valuation via the regs and RIV and RIK, and I think one of the ways of removing uncertainty is for the lessee and the lessor to sit down with involved states and try to work out what the uncertainties are. And there are lessees that have been doing that, and Chevron is one. We have been working since the new regulations came out on agreements that remove the valuation uncertainty. So I think the agency is doing that and needs to be commended for it because they had the foresight to say to add that provision to the rule that says if you can come up with an alternative valuation method that at least approximates the royalty value that you'd receive under this rule then we can use it.

But nothing is as great as the removal of a tremendous amount of valuation uncertainty through RIK, and I think if you look at the number of people, that you are creating new efficiencies. I understand that you still have to do a certain amount of work beyond the work of the 19 or 20 people that are actually administering the RIK program. I know that there are other employees that have to get involved. But I think if you really look at it, elimination of that valuation uncertainty, agreement on value with the purchaser at the time of severance does a lot to decrease the costs to the government, and therefore accrues the benefit of taxpayers as well as industry.

MR. HAYGOOD: One of the benefits touted for the RIK program is that it removes uncertainty. If that is so, why are the bids from private companies concerning public resources still private and confidential?

MR. SMITH: We've taken a position that pricing and bids are the same as in-value pricing, and we hold those as business confidential and they are treated as proprietary data.

ENERGY ISSUES:

Ms. Lucy Querques Denett siting in for Walter Cruikshank and Bill Condit from the House Authorizing Energy Minerals Committee and Tom Kitsos updated the Committee on the National Energy Policy Report, MMS's offshore permitting processes, and the legislation that has been passed on the House and Senate.

The National Energy Policy Report was actually issued on May 17th. It was led by the vice president, 13 cabinet members, one of which was the Department of Interior Secretary Norton. There are 105 recommendations,

eleven of the recommendations have a direct impact on the Minerals Management Service.

Of the 11 recommendations, MMS has developed 24 action items. At Interior each of the bureaus are developing their actions to implement their recommendations. One of the recommendations involves the Strategic Petroleum Reserve and MMS to resume providing royalty oil to the reserve.

Legislation: The House passed HR-4, called "Securing America's Future Energy Act," and that was passed in July 2001 and it actually comprised a total of four bills from different committees that have oversight over energy and related issues. And what they focus on is increased efficiencies, conservation, different major energy sources from oil and gas to renewables like geothermal.

In HR4 there is a section on Royalty in Kind. The RIK provisions in the bill codify some of the things that we've been doing in the last couple of years. Through appropriations we've been given authority to pay for transportation and processing of RIK volumes. However, the appropriations language only gives us the authority for one year at a time. If HR4 passes it would provide it to us for five years. We believe we can negotiate better transportation rates and better processing rates if we know we have authority for a period beyond a year.

Also, the Secretary has to determine that the benefits are going to be at least revenue neutral or better than an in-value program. We have to report to Congress explaining why we made decisions to take certain properties in kind and what our costs are for the RIK Program. HR4 also provides for the possibility of an RIK program with a state.

HR-4 also provides royalty relief for production of marginal wells both onshore and offshore. And the numbers differ on the barrels. Basically, it's a reduced royalty rate when prices reach a certain threshold for 180 consecutive days, and the prices are: for oil, $15--below $15 a barrel for 180 days, consecutive pricing days; and for natural gas, below $2 for 180 consecutive days. "Marginal wells" are those defined as those producing less than 30 barrels onshore and 300 barrels per day offshore.

Other provisions of HR4 include reduced royalty rates for new geothermal leases; a 3-year royalty holiday for new geothermal production and for qualified expansion of existing production; revises the advanced royalty provision in the Mineral Leasing Act where it increases the number of years of advance royalties for coal.

FINANCIAL MANAGEMENT SYSTEM PANEL:

Mr. Mike Miller and Ms. Paula Neuroth of MMS, Ms. Pat Kent from Exxon and Ms. Pam Williams from Shell participated on the panel. Participants provided overviews of their experiences in preparing for conversion to MRM’s new Financial Management reporting system. Items of discussion included outreach, training, electronic commerce, forms development and modifications, reporting codes, systems conversion, and system testing, and systems costs. The new Financial Management System is scheduled to begin operation on November 1, 2001.

AGENDA CHANGE:

Because some Committee members could not stay for the entire meeting due to travel arrangements Mr. Shirley motioned for the subcommittee reports

to be moved ahead of the Compliance and Asset Management Reengineering Report. There were no objections.

SODIUM/POTASSIUM SUBCOMMITTEE:

Mr. Harold Kemp the subcommittee's new chair from Wyoming updated the Committee on the status of the Subcommittee. Mr. Kemp reported that the Subcommittee had not reached agreement on the primary product issue and asked the RPC for 60 additional days to resolve the issue. Mr Kemp also pointed out that there are a few issues within the new solid minerals reporting that may have some conflicting information regarding sodium/potassium. He desired to go back and look at those and make sure they were addressed. After discussions whether a motion was required to do so the Committee approved the 60-day extension for the Subcommittee to continue its work

MARGINAL PROPERTIES SUBCOMMITTEE:

Mr. John Clark updated the RPC on the status of the subcommittee.

The purpose of the subcommittee was to make recommendations to the RPC on the prepayment provision of RSFA. Since the last RPC meeting we have met three times, we are scheduled to meet again in November in Houston. I anticipate that the meeting will be our last meeting. We are leaning toward recommending a notice based prepayment, one that would not require approval. This would be on very small volume properties. Some of the requirements: the prepayment would have to cover 100 percent of the production from the property; the value would be determined and published by MMS; the reserves would be handled on a BOE basis; and discount would be published by MMS. This is all very specific information that would be known to both sides so that it's just a mathematical calculation. The information MMS would need to verify is what volume is in the prepayment period and over what length of time they're talking about.

We are thinking about an approval base where the lessee could propose a prepayment. They could propose a prepayment different than the notice base that would be available to all marginal properties. And we still have to work through what information would have to be provided, but basically, whatever a lessee used to come up with the prepayment amount would have to be provided for verification.

Under either form of prepayment the states would have the ability to opt in total or by area within their state or by volume. We have come to agreement on that. The main issue we are currently dealing with and have been dealing with for a couple of meetings is the issue of the minimum royalty provisions of the lease term. What we're coming up with would be a calendar year type thing, and we're trying to work around the minimum royalty provisions and what applies. The prepayment would be on an estimated amount over a period production would occur.

COAL SUBCOMMITTEE:

Mr. Bill Hartzler of the National Mining Association gave the Coal Subcommittee report on behalf of Mr. Cattany.

The Coal Subcommittee has met twice with the focus of both meetings on the proposed rule changes to the solid minerals reporting and the reengineering of the solid mineral reporting itself. In our June meeting

the committee discussed the proposed rule and urged all members that had an interest to submit written comments to the rule.

As far as the reengineering effort, several industry members of the subcommittee participated in the testing of the new internet reporting system once it became available in August. I think the system is going to do a whole lot to reduce our administrative burden of reporting federal royalties.

On the advanced royalty side the MMS is preparing a draft narrative of the subcommittee's discussion of the advanced royalty issues, primarily as to how you go through and determine the value to calculate the advanced royalty. And we plan to use this document to develop a subcommittee position on the issue.

The subcommittee continues to study the feasibility of recommending an index per million btu royalty for federal coal production, primarily in Wyoming. Wyoming has provided the subcommittee with updated production information and royalty information for the year 2000.

NEXT RPC MEETING:

Mr. Shirley tentatively scheduled the next meeting for March 2002. Several locations were proposed including Albuquerque, New Mexico, San Antonio, Texas, Las Vegas, Nevada, and Santa Ana, New Mexico. An exact location will be determined by the chair and executive secretary and communicated to Committee members. Meeting adjourned.

I hereby certify to the best of my knowledge, the foregoing minutes are accurate and complete.

(Original Signature on file)

Lucy Querques Denett, Executive Secretary

(Original Signature on file)

Perry Shirley, Chairperson

These minutes will be formally considered by the RPC at its next meeting, and any corrections or notations will be incorporated in the minutes of that meeting.