

# **Minerals Management Advisory Board**

## **Royalty Policy Committee**

### **Summary of Meeting**

#### **September 7, 2000**

The Royalty Policy Committee (RPC) of the Minerals Management Advisory Board convened its eleventh meeting at 8:45 a.m. on September 7, 2000, at the Sheraton Denver West Hotel, 360 Union Blvd., Lakewood, CO 80228. In accordance with the provisions of Public Law 92-463, the meeting was open to the public.

#### **Members/Alternates Present:**

Karen Anderson, John Clark, David Darouse, Lucy Querques Denett,<sup>1</sup> David Harrison, J. David Hall, William Hartzler, David Landry, Dave Loomis, Charles Mankin, Kirk Moore, Tammy Naron, Steve Reynolds, Walt Rosenbusch,<sup>2</sup> Hugh Schaefer, Tom Shipps, Perry Shirley, Pary Shofner, Brad Simpson, Alan Taradash, Steve Williams, Carla Wilson, and Kermit Witherbee.<sup>3</sup>

#### **Minerals Management Service Employees Present:**

Connie Bartram, Mike Baugher, Walter Cruickshank, Barbara Desiderio, Gary Fields, John Hovanec, Nicolette Humphries, Tom Kitsos, Paul Knueven, Mike Miller, Donald Sant, Greg Smith, Debbie Gibbs Tschudy, Herb Wincentsen and Ken Vogel.

#### **Others Present:**

Rusty Bayles, Floyd Deloney,<sup>4</sup> Steve Dilsaver, Jim Fairchild, Fred Fisher, Edward Gilliard, Chris Hyer, Paul Kelly, Brian McGee, David Pickard, Mary Robyn, Joanie Rowland, Stephen Stabile, and Akhtar Zaman.

#### **Welcoming and Opening Remarks - Presented by Perry Shirley**

#### **UPDATES FROM WALT ROSENBUSCH (Director, MMS):**

Mr. Rosenbusch provided an update of current agency programs.

#### **UPDATES FROM LUCY QUERQUES DENETT:**

Ms. Querques Denett provided an update of the Royalty Management Program's reengineering proposed reorganization and business processes.

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<sup>1</sup> Associate Director for Royalty Management, Minerals Management Service, ex officio member, RPC Executive Secretary, and Designated Federal Officer.

<sup>2</sup> Ex officio member representing the Minerals Management Service

<sup>3</sup> Ex officio member representing the Bureau of Land Management

<sup>4</sup> Representing the U.S. Forest Service, USDA

A question and answer session followed the presentations.

**ELECTION OF THE CHAIRPERSON**

[After further review after the last meeting on February 4, 2000, the Parliamentarian determined the vote was insufficient to meet the two-thirds requirement. The Agenda for this meeting included a vote for the Chairperson.]

Mr. Schaefer, as parliamentarian, explained the situation to the Committee.

Mr. Mankin motioned to nominate Perry Shirley of the Navajo Nation as Chairperson.

Mr. Clark seconded the motion.

Vote: Motion passed unanimously.

**APPROVAL OF THE FEBRUARY 4, 2000, MINUTES**

Motion was made that the minutes be accepted as drafted.

Motion seconded.

Vote: Motion passed unanimously.

**TEXAS'S PROGRAM OF EXCHANGING NATURAL GAS FOR ELECTRICITY.**

Mr. David Hall, deputy land commissioner at the Texas General Land Office, provided a presentation on the Texas State Power Program where in-kind royalties are converted into electricity. He also provided a detailed handout of the program. A question and answer session followed the presentation.

**NATIONAL PETROLEUM COUNCIL'S NATURAL GAS STUDY**

Paul Kelly and Ed Gilliard discussed and presented the National Petroleum Council's natural gas study entitled "Meeting the Challenges of the Nation's Growing Natural Gas Demand" published December 1999; providing each member with a copy of the report and explaining key issues. A question and answer session followed the presentation.

**OTHER LEASABLE SOLID MINERALS SUBCOMMITTEE FINAL REPORTS**

Mr. Steve Reynolds, chairman of the subcommittee, announced that as required by the RPC at the last meeting, the subcommittee prepared both majority and minority reports. (In accordance with the RPC's Operating Procedures and Bylaws, Section VI, the written reports were transmitted to the members more than 20 days before the meeting for their consideration.)

**Majority Report**

Mr. Reynolds explained that the subcommittee has completed a three year process of developing recommendations for new regulations valuing sodium and

potassium for royalty purposes. One of the main goals of the subcommittee was to follow trends seen in other commodities, oil, gas and coal, make the valuation and regulations more comprehensive, and increase lessee and government certainty. What currently exists for rules is a paragraph, and basically the industry has been following secretarial guidelines, but those guidelines are old. Most of the long-standing policies that have evolved from the guidelines are not in current regulations. Contradictions exist between the regulations and the guidelines, and the subcommittee has sought to rectify those inconsistencies and then codify the bulk of the varying regulation practices. Mr. Jim Fairchild from IMC in California, along with Rusty Bayles and Dave Pickard, provided a background of the industry for the majority, with Mr. Reynolds then summarizing the majority report. Questions from the membership frequently spiced the discussions.

**Minority Report**

Mr. Fred Fischer, Director, Colorado Department of Revenue and Taxation, presented the minority report assisted by Mary Robyn. Mr. Fisher explained that Colorado's sodium interests stem from the large oil shale deposits in Colorado, which occur naturally along with the sodium bicarbonate deposits. That's a different kind of deposit than you find in Utah and Wyoming. Wyoming is primarily trona, which is a different chemical formula. Colorado producers are beginning now to produce large amounts of soda ash and some sodium bicarbonate. American Soda Ash has made an investment of \$250 million in these facilities.

The work of the subcommittee over the last three years has been commendable and they've been very diligent in developing regulations, meeting 11 times. Unfortunately, the subcommittee primarily represented the existing industry and did not take into account the new production process that's coming on line in Colorado. Colorado wants producers to pay royalty on the basis of product, not on the basis of process. As stated in the Mineral Leasing Act, "All leases under the section shall be conditioned upon the payment by the lessee of such royalty as may be fixed on the lease, not less than 2 percent of the quantity or gross value of the output of sodium compounds and other related products at the point of shipment to market." We question whether draft regulations contained in the majority report are legal in the first place. The next question we would raise is whether these regulations favor one state over another since they seem to be written around a process that has been going on in Wyoming for any number of years and does not seem to take into account a process that will begin in Colorado here very shortly. Finally, these regulations seem to be unduly complex.

After an extended discussion of the issues, Mr. Shirley noted that the technical issues escape

many of the members whose organizations lack experience with sodium-potassium deposits. He asked the committee to decide how to address the reports that have been presented to us from the subcommittee. After a discussion of the options, Mr. Reynolds agreed to table the reports on the condition that members would e-mail their questions or suggestions to the presenters before the next meeting.

Mr. Harrison motioned that the reports be tabled with the condition that members will provide comments/questions to the subcommittee.

Mr. Shipps seconded the motion.

Vote: Motion passed unanimously

### **COAL SUBCOMMITTEE INTERIM REPORT**

Since subcommittee chairman Mr. Cattany could not attend, Mr. William Hartzler provided an update of the Coal Subcommittee activities. After the last RPC meeting in Houston, the coal subcommittee got back together to continue discussing the valuation study of Wyoming Federal coal royalty to determine if there was a viable unit methodology that would maintain revenue parity. The subcommittee decided to continue this review process. Wyoming production appears an appropriate study subject, since in 1999 there were over 311 million tons of Federal coal produced in Wyoming representing approximately 80 percent of Federal coal production and 62 percent of Federal coal receipts. To avoid the confusion created in Houston, we are now referring to this as an index Federal coal royalty study. The State of Wyoming is enthusiastic about this approach and is even considering changing its state severance tax calculations from the current sales price less deductions to some sort of unit value. The actual review will be limited to Wyoming Federal production only.

The subcommittee continues to evaluate data obtained from the State of Wyoming to consider how a true up-front valuation study might be implemented, considering 1996 through 1999 data. The 1999 information received recently has raised questions. We've asked the State of Wyoming to go back and refine that. Once we complete the four year historical review, we know that we can maintain revenue parity for the State of Wyoming and the MMS. The question is how much shifting would there be between the producers as we move to a unit concept. As part of this process, the subcommittee had two representations from Energy Argus, publishers of Coal Daily, discussing market price determinations of coal in a transparent market. Energy Argus also publishes an oil pricing that can be used in the crude oil spot price for non-arm's-length transactions. We also heard from the MMS about how it is applying the spot prices to value crude oil to determine if the same principles may be used for Wyoming coal.

A second item that we have is on the ownership of coal waste piles in the State of Utah. On

September 25, 1997, the RPC approved the subcommittee's recommendation to the Secretary to request the Solicitor issue an opinion concerning the ownership of coal waste piles in Utah. In response, the Secretary sent a letter to the Solicitor on this issue on March 11, 1998. To date, the Solicitor's opinion has not been issued and this is now an issue in Wyoming as current production uses these waste piles. Nobody knows if royalties are owed on this production or if royalties will be assessed in the future. The subcommittee is now recommending that the RPC send a follow-up request to the Secretary that the Solicitor's opinion be issued as soon as possible.

Finally, the subcommittee was disappointed to receive a copy of Secretary Babbitt's June 1 letter about the two-stage appeal process, and in the last part of that, the Secretary referenced the improvements that have been implemented and that are under consideration. The subcommittee would appreciate it if the RPC could be informed as to both the improvements that have been implemented and those being considered. We understand that there is a draft update of the regulation in process and the coal subcommittee urges the Secretary or those involved to meet with the ADR appeals subcommittee.

Mr. Simpson stated that two and a half years ago we had mountains of coal finds in Utah that were produced from now terminated Federal leases. A company that's not a Federal lessee is now processing and selling those coal finds. And we have been waiting three years to decide whether or not we can collect Federal royalties. It's time to contact our congress people if the Solicitor's Office cannot provide an answer.

Mr. Simpson motioned that the RPC send another letter to the Secretary asking for clarification from the Solicitor's Office.

Motion seconded by Mr. Loomis.

Vote: Motion passed unanimously

#### **MARGINAL PROPERTIES SUBCOMMITTEE INTERIM REPORT**

Mr. Clark, the subcommittee Chair, reported that during the subcommittee's meeting last week they reached a consensus on recommendations that have yet been reduced to a report due to time restraints.

Our early discussions involved processes which are now scheduled to change with the implementation of reengineering. For example, rolled-up reporting as a possible relief option. After October 2001, we will no longer have selling arrangements. So we concentrated on reporting relief under the new system and developed two options:

\$ The first one would allow a lessee on a property with up to 1,000 BOEs per year to report annually. The producer or lessee would just have to notify MMS that they want to report

under that method. Based on MMS information this relief option would apply to approximately 1 to 3 percent of production from Federal onshore properties, but 39 percent of marginal properties.

- \$ The second is an approval based option defined as other relief requested by a lessee. This option was in the original proposed rule, but we extended it to take in everything. To get around appeal issues, States that disagree with an MMS approved issue would have two options. After reviewing calendar year to date and base period reports each September, States would have 30 days from report receipt to decide to either accept annual reporting, other relief, or either or both options. Their choice would be effective for the following year.

At the end of last Wednesday's (August 30) meeting, the subcommittee appeared very comfortable with this approach and is preparing to write a report for distribution to the committee in the November/December time frame. In the very near future we will start the second phase of the subcommittee's work -- prepayments. I invite members to tell us if they would like to be involved. We will also need a vice-chair, since Charles Turpin with State of Mexico is now retired and no longer available.

Mr. Loomis nominated himself for Vice-Chair, and in response, Mr. Shirley appointed him to the position.

#### **ROYALTY-IN-KIND REPORT**

Mr. Cruickshank discussed in detail the current status of the three RIK pilots: Wyoming, the Texas 8-g and the larger Gulf of Mexico pilot, and the ongoing RIK operations. The presentation was followed by a question and answer session.

#### **STATUS OF THE APPEALS RULE**

Mr. Cruickshank provided a brief update on where we are in our continuing saga of performing the appeals process. As you know, in January 1999 we issued a proposed rule that generated a great deal of comment and controversy. Following that in May 1999, we published a final rule for those provisions that were necessary to meet statutory mandates of RSFA, as well as a few other non-controversial items. That obviously left a number of issues unresolved -the most prominent one being how many steps there would be in the appeals process. There is a proposal for a one-step process to IBLA only and also a hybrid one and a half-step process.

In June of this year, the Secretary decided to retain the two-step process. Since then we have been trying to develop some internal processes to improve our administrative appeals procedures that will allow us to resolve cases within a 16-month time frame. We also are returning to the issues that remain from the prior proposed rulemaking, issues raised both in the comments to that proposed rule and by the original Royalty Policy Committee's recommendations. Many of those

recommendations are just as relevant as appeal steps, including recommendations dealing with issue letters before orders, orders that contain the factual and legal basis for their findings, early development of the administrative record, encouraging settlement, and clarifying the role of states and tribes in the appeals process. These, as well as a number of other issues, are on our table right now and will be presented to management before the end of the year.

What we want to do in the proposed rule is close some holes from the May rulemaking. There are certain things that we need to do so we can meet our internal 16-month time frame for director's decisions. There are some procedural needs of the department in processing appeals at a two-level process. There are also a lot of concerns raised in the proposed rule about the procedural complexity of that proposal. So, we need to balance those concerns, as well as trying to incorporate some of the recommendations from the RPC.

A lively discussion of the appeal issues followed. While a motion was made and seconded to inform the Secretary of disagreements with his June 2000 decision regarding appeals, the RPC was unable to formulate an official position since a quorum was no longer present. As a committee of the whole, the group decided to bring the issues to the next RPC meeting.

Mr. Rosenbusch offered the appeals subcommittee members an opportunity to sit in and contribute to the effort to finalize the appeals process within the parameters established by the Secretary of Interior.

**NEXT RPC MEETING**

Mr. Shirley tentatively scheduled the next meeting in February 2001 in either Albuquerque, New Mexico, or in New Orleans, Louisiana. The meeting adjourned at 5:24pm.

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

Lucy Querques Denett, Executive Secretary

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.

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