

**MINERALS MANAGEMENT ADVISORY BOARD
ROYALTY POLICY COMMITTEE
SUMMARY OF MEETING
MARCH 12, 2002
LAS VEGAS, NEVADA**

The Royalty Policy Committee (RPC) of the Minerals Management Advisory Board convened its fourteenth meeting at the Las Vegas Marriott Suites, 325 Convention Center Drive, Las Vegas, Nevada, on March 12, 2002. In accordance with Public Law 92-463, the meeting was open to the public.

Member/Alternates Present:

Pary Shofner, Western States Land Commissioners Association, Robert Price, Oklahoma Independent Producers Association, Tammy Naron, Independent Petroleum Association of America, Tom Shipp, Ute Mountain Ute Tribe, Brad Simpson, State of Utah, Western Governors Association, Gary Paulson, Natural Gas Supply Association, David Landry, National Mining Association, Walter Cruickshank, MMS, Milton Dial, MMS, Perry Shirley, Navajo Nation, John Clark, Council of Petroleum Accountant Societies, Harold Kemp, State of Wyoming, Ronald Cattany, Western Governors Association, David Darouse, State of Louisiana, George Butler, American Petroleum Institute, Karen Anderson, Southern Ute Indian Tribe, Spencer Reid, Western States Land Commissioners Association, Bill Hartzler, National Mining Association, Dell Fortner, Bureau of Land Management.

Other Attendees:

Pam Williams, Roger Good, Cheri Hunter, Anita Gonzales-Evans, Pat Kent, Don Sant, Paul Knueven, Brian McGee, Andrew Bremmer, Greg Smith, Gary Fields, Mark Ferguson, Barbara Desiderio.

Welcome and Opening Remarks

The meeting convened at 8:48 a.m. Mr. Perry Shirley welcomed Committee members, gave opening remarks and confirmed the presence of a quorum with 16 of 21 voting members present.

Acting Director/Acting Associate Director Remarks:

Mr. Milton Dial began by thanking the RPC and all of its members for the continued support and commitment to the Department for improving and guiding royalty management activities. Recently, MMS celebrated its 20th anniversary as a bureau. The MMS was established on January 19, 1982, and the RPC has been an important part of most of those 20 years in helping the Department move along progressively in the area of royalty management.

He announced the appointment of MMS' new Director, Johnnie Burton and Assistant Secretary, Rebecca Watson. This completes our political lineup from the Bureau Director up through the Secretary and provides guidance of the current Administrations policies.

He next discussed the disconnection from the Internet that occurred December 6, 2001. The impacts from the disconnection and the systems shutdown have had impacts across the business sector. All of our clients on the other end of the business transactions, all of the beneficiaries and constituents, state governments, tribes, Indian allottees have suffered adverse impacts from this. Rest assured that we in the Bureau and the Department are making every effort to restore those systems. We're continuously working with the Department, the special master,

and the court to get MMS assistance restored. Some progress has been made with other Bureaus. You've probably seen that on the web sites as other Bureaus have reconnected. But for the most part, any Bureau with information systems that contain Indian trust data have not yet been reconnected. We see progress being made, but as far as a specific date, we can't give one today. We believe it to be close. Later today Don Sant will provide an overview of the shutdown, the ramifications and the things that are being done to restore the systems.

Moving on to the legislative front. Later today Walter Cruickshank will provide us the latest update of the energy legislation from the MMS perspective, in terms of the President's energy plan and the energy bill and all the possible ramifications. Walter will also be speaking on the President's management reform agenda.

From a programmatic perspective, OCS production on the outer continental shelf provides the largest single source of oil and gas for the nation, accounting for some 25 per cent of our domestically produced oil and natural gas. Since the last RPC meeting, sale 181 in the Eastern Gulf, yielded about \$340 million in high bids, and was considered quite a successful sale as structured.

The current five-year plan will end with the Central Gulf sale on March 20th. That sale will be offering about 4,400 tracks for competitive bidding, estimated reserves of somewhere between 150 and 440 million barrels and 1.5 to 4.4 trillion cubic feet of natural gas.

The next five-year leasing schedule and plan is nearly complete. We expect that plan to be in place for later this summer, and what's anticipated is 20 lease sales to be conducted, exposing a potential of 22 billion barrels of oil, 60 trillion cubic feet of natural gas, again to competitive bidding. The program will include annual sales in the Central and Western Gulf and Eastern Gulf in an area similar to the 181 sale. Also, inclusive in Alaska, Beaufort Sea, Chuckche Sea, and Cook Inland sales. The first sale under the new five- year program is scheduled for August 2002, in the western Gulf of Mexico.

Again, on the OCS front, the Alaska OCS office realized its first production from federal intercontinental shelf leases with the Northstar unit recently coming on line. That unit is producing in the range of 60,000 barrels of oil a day and approximately 175 million barrels of recoverable reserves estimated out of that project.

A last note on the offshore program is entering an e-government transformation. Basically, it's somewhat like the royalty program's reengineering initiative. It's a multi-year initiative to establish improved business enterprises between the OCS and the private sector. It's currently for this fiscal year in the planning stages. Money has been requested and is in the President's budget for 2003 to actually start development.

Moving forward to the MRM since the last RPC meeting, a couple of noteworthy programmatic developments. First is the delivery of the financial management system. On November 1st, the new financial system was brought online. A successful processing and accounting cycle, including the distribution and disbursement of funds signaled us that the systems that were delivered by Accenture worked. It was glorious until December 6th. We brought the systems down as a consequence of several orders issued by the District Court. We are working on restoral of those systems. Don Sant will provide an update later today.

The second item to pass along is the President's decision made on November 13th of last year to fill the remaining capacity of the Strategic Petroleum Reserve (SPR) by utilizing outer continental shelf federal royalty oil. This multi-year initiative involves moving oil from the outer continental shelf through a series of arrangements that are being established with the Department of Energy to actually accomplish the fill. Later today Greg Smith will provide an update on the particulars of that initiative.

Also, in the RIK area, MMS has initiated the development of support tools technology to further the RIK initiative

to make it a part of the asset management strategies of the MMS. Development of the asset management system is expected to be complete in December of 2002.

Also, MMS has initiated the development of a liquids management system to support the SPR initiative. We're seeing a two-phased development, a straight volumetric management system and the tools to support a competitive bid for the oil sales program. The development effort is scheduled for completion in late 2003.

The last item I'd like to touch on is the Farmington Indian Mineral Owners' office. The Farmington Indian Mineral Owners' office unites employees from the BIA, BLM and MMS under one director for outreach, inspection enforcement, and mineral revenue compliance services to industry, and American Indian stakeholders. That initiative was declared a success and the FIMO office was established as a permanent DOI office on September 28, 2001. In addition, the Department's Indian Minerals Steering Committee is now assessing the feasibility of expanding the program to other geographic areas having significant population of Indian mineral leases and lease owners. Locations under consideration include Anadarko, Oklahoma; Fort Duchense, Utah and Billings, Montana.

Approval of Minutes from Last Meeting:

Mr. Perry Shirley administered the review process and informed committee members that MMS had expounded more on content based on previous concerns raised by Committee members.

Mr. Brad Simpson motioned that the minutes of October 18, 2001 be approved as written. Motion seconded by Mr. Pary Shofner. Vote. 16 in favor. 0 opposing. 0 abstaining. Motion passes.

Election of Chair, Vice Chair and Parliamentarian:

Mr. Shirley explained the two-year term requirements and suggested the elections be held in an open format. Mr. George Butler asked if the chairmanship alternated between constituencies on the Committee?

Mr. Shirley: Identified the previous chairpersons as Don Hoffman and David Blackman.

Mr. Brad Simpson: I think the elections were open. I don't recall any particular rotation.

Mr. Shirley: Hearing no other questions on rotations or how we proceed I'm ready for nominations.

Mr. Shipps: Nominated Perry Shirley. Mr. David Darouse seconded the nomination. Mr. Shirley accepted. Mr. Ron Cattany closed the nominations and moved for a vote.

Vote: 15 in favor, 0 opposing, 0 abstaining. Motion carries.

Mr. Shirley: I would like to thank all of my fellow Committee members for showing your confidence in me to continue serving as the chairperson. I appreciate it. Let's move on to the selection of the vice-chair. At this point, the nominations are open.

Mr. John Clark: Nominated Ron Cattany. Mr. Simpson: second the motion. Mr. Butler: moved to close the nominations and take a vote.

Mr. Shirley: Vote. 14 in favor, 0 opposition, 1 abstaining. Motion carries.

Mr. Shirley: Now, we need to select the parliamentarian. And Mr. Schaefer is not here today. I don't know if he is

willing to serve in that capacity for another term or not. I didn't have the privilege to talk to him before the meeting. We need to make that position official. I am ready for nominations.

Mr. Cattany: Nominated Hugh Schaefer. Mr. Price seconded the motion. Mr. Spencer Reid moved to close the nominations. The vote is 14 in favor, 0 opposition, 0 abstaining. Motion carries. Mr. Shirley believed Mr. Schaefer would be more than willing to assist the Committee. If not, then we'll have to readdress that at the next meeting.

Marginal Properties Subcommittee Update:

Mr. John Clark updated the Committee on the status of the subcommittee. The subcommittee was to make recommendations to the RPC on the prepayment provisions of RSFA. Beginning with the discount rate, the term will be set by regulation and become a mathematical calculation. We'll recommend an approval based option. That option will be open to small properties that didn't want to try to use the notification base. Under that option, a producer could be as creative as they wanted to in what they wanted to request. The term could be longer than the notification based, the notification based be limited to the term of what we had posted prices for. Under either option, the states would have the ability to opt out in total, or they could even go down and opt out or in at a county level.

Our committee developed an Excel spread sheet calculation that MMS could post on their website. All a producer would have to do is plug their individual numbers in and the spreadsheet would do the entire calculation for them. I can tell you that what we will be recommending is not simple. It is rather complicated because of all the things that you have to consider. So, we couldn't make it simple, but we have come up with what we believe would be an applicable optional type solution under the law and regulations.

RPC Views on the Appeals Process:

Mr. Shirley informed Committee members that the appeals issue was added to the agenda in hopes that the MMS Director would be named so the issue could be discussed. The issue will be discussed at the next meeting. We hope to have the new Director at the next meeting to update us on how she perceives her administration to address the issue.

Mr. Cruickshank informed the Committee that trying to resolve the issues around the appeals process is a priority item for us within MMS. Appeals will be on the new Director's agenda and she will be fully briefed on it well before the next RPC meeting, so that hopefully we will be able to have progress moving along, and have something substantive to report when we get to the next meeting.

Coal Subcommittee Update:

The Coal Subcommittee has just passed its 5th anniversary. The subcommittee has continued to be involved with audit efficiency issues, policy decisions, monitoring issues under review by MMS, including waste piles, the appeals process, and minimum royalties, communication with the audit staffs on current issues in the coal industry, including online trading, and coal indexing. We also are involved with continuing to examine ways to improve the efficiency and increase the certainty in the collection and the calculation of royalties and the payment of royalties. So, it's really been I think a really good ongoing dialogue between MMS and the industry and the tribes, the states, and the federal mineral management agencies that are represented on the Committee.

Since the last RPC met, the Coal Subcommittee has met twice, and there are a couple of things that I'd like to update you on. The first is the Wyoming study project. Three years ago, the Coal Subcommittee began looking at

the merits of a simplified or indexed coal royalty rate. We felt that the current ad valorem federal coal royalty valuation regulations are complex, resulting in uncertainty, costly compliance, that often generate appeals and litigation in a deregulated environment. The Committee has narrowed its study to a simplified federal coal royalty initiative providing for calculation of payment of revenue neutral federal coal royalties on a value per million BTU instead of the current ad valorem basis.

We've looked at this as it relates to the last three to five years on coal leases in Wyoming. Wyoming was chosen because it produces 80 per cent of the federal coal. The State of Wyoming has provided the Subcommittee with statistics on federal production that include tonnage sold, millions of BTU's sold and the royalties paid on those sales. From this data estimates of cents per ton and a cents per million BTU royalty have been made for the years from 1996 through the year 2000.

The MRM folks have also provided coal quality data on federal coal production for the same time period, and that data is being used to determine if the sulfur content will affect indexed royalty estimates. The study continues to move forward with outstanding cooperation from the states and the tribes, the coal producers and the federal agencies, and we'll continue to keep you updated on its progress.

A side note is that there are six active Indian coal leases currently in production. The Indian members of the Coal Subcommittee actively participate in the Subcommittee's discussions. The majority of the Indian coal lease production is sold under long-term coal sales contracts between the coal and the electric utility companies. As a result of the Indian members, the Coal Subcommittee did not include the Indian coal leases in any alternative coal valuation methodologies, but it continues to acknowledge the uniqueness of the coal leases, and appreciates the involvement and participation of the tribe members in its discussions and presentations.

The Subcommittee continues to wrestle with how to determine the amount due under an advance royalty request. The issue is complicated by the fact that the advance royalty provision is contained in BLM's rules. Under the current system, the advance royalty volume is determined by the BLM, and unit value is determined by the MMS under an MOU between the two agencies. If there is an appeal of an advance royalty decision involving both volume and value, the lessee is required to appeal the BLM volume decision to the IBLA and the MMS value decision to the Director of the MMS.

The Subcommittee has discussed various recommendations for the application of the current BLM regulation. However, because the current MOU between the two agencies, the Subcommittee has asked both agencies to reevaluate the MOU's process for advance royalty determinations, and the Subcommittee will determine its course of action after the reevaluation of the MOU is completed. A discussion of this issue by the Subcommittee has provided MMS with additional knowledge and insight that is useful to their current advance royalty determinations.

The Subcommittee last year requested that the MMS service make a presentation regarding records retention. Since solid minerals do not have a clear statute of limitations, the MMS no longer issues audit closure letters or record releases at the close of an audit, the issue of records retention has been raised by the industry. The industry is concerned that if they destroy their records after six years, they could be in the position of not being able to defend themselves if the MMS would assert additional royalty years later.

In August of 1997, our Committee forwarded to the Chair of the RPC a recommendation that the RPC adopt a resolution regarding coal waste piles. The recommendation was that the Minerals Management Service Director request a Department of the Interior Solicitor's opinion on the ownership of coal waste piles located on non-federal surface where the coal was originally produced on a federal lease that has been relinquished.

In 1997, the Subcommittee recommended to the RPC, and in 1998, the RPC forwarded a request to the Secretary that the Solicitor render an opinion as to certain categories of ownership related to coal waste piles in the State of Utah. At the last RPC meeting, the Solicitor's opinion was issued and discussed. We are in the process of evaluating the opinion. As part of that evaluation, BLM has requested BLM State Directors to verify and quantify coal washing waste piles.

In addition, the Coal Subcommittee has identified and is evaluating five concerns with respect to the content of the Solicitor's opinion. The first is that the original request was for an opinion that had to do with the ownership of the waste piles, not whether royalty is due under the existing regulations. The opinion appears to assume the answer to several ownership questions without providing a legal analysis. Does the United States retain ownership of severed minerals until the royalty, if any, on that material is paid? When does ownership of the material severed from the lease pass to the lessee? Has the United States abandoned any prospective interest in the waste piles?

The second question centers on the fact that the opinion does not distinguish between stock piles of coal segregated from the product being marketed to meet contractual specifications, and impurities removed through washing or other processes to place the coal in marketable condition as required by the regulations. Is this waste even coal? Should there be a distinction for royalty payment purposes?

The third issue that we've identified is that the opinion proceeds on an incorrect assumption that the lessee owns the wash plant and the waste pile where the waste pile is located on private land. Circumstances exist where a lease is still active that contributed to the content of a waste pile, and the waste pile is on private land owned by a third party having no relationship whatsoever to the current lease. What is the royalty obligation in this instance?

The fourth is that the opinion contains no analysis of what is meant by "or otherwise disposed of" in the regulation in the context of the companion requirement that nothing in this section requires payment of a royalty on coal for which a royalty has already been paid. Does this mean everything severed from the lease was placed in a marketable condition as required by the regulations? If the impurities removed from the coal were disposed of in a waste pile as having no value in the marketplace, was not royalty paid on everything severed from the lease at the time of that original sale?

And, finally, is there a distinction between the action of a lessee contemplated in the regulation that reads "coal otherwise disposed of by the lessee on or off the lease," and the regulation which reads "or otherwise finally disposed of." If the former triggers a royalty payment obligation on the value of the entire severed product at the time of disposal, does that preclude accrual of another royalty obligation at the time some of the material is finally disposed of? These and other issues are continuing to be addressed by the subcommittee as it reviews the Solicitor's opinion.

We hope actually that we can meet with MMS Director Johnnie Burton in June to brief her on some of the issues that the Subcommittee has been involved with over the last several years. We'll include this in the discussion in our meeting with her, and decide at that point whether or not we want to move a formal recommendation to the RPC. But, the bottom line is that we're not quite sure the right questions were answered, and that in coming up with the answers to the questions that were asked, some assumptions were made about the ownership of the waste piles that we still feel need to have some clarification. We are going to continue to do our homework, discuss the issue with representatives of MMS, and if it appears that there continues to be more clarification from the Solicitor's office, we'll bring that forward to the RPC.

Mr. Shipps: in terms of your proposed meeting with the new Director, I don't believe that this Committee has taken a position with respect to the opinion.

Mr. Cattany: What we want to do is outline for her what our questions are as a result of the Solicitor's opinion, and the issues that we're continuing to look at before we bring a formal recommendation to the RPC.

Mr. Shirley: Does the Committee have plans to formally pose these questions in a letter to the Solicitor's office?

Mr. Cattany: At this point, we haven't made a final decision, we're still doing our homework to determine the size of the problem. That's part of the piece that BLM is doing, because the BLM records have indications of where there are waste piles in a number of federal coal leases. And I think that part of what BLM has to do is determine the size of the problem as well.

Mr. Shirley: In light of the statute of limitations, and also in light of the Oxy decision, I think we're looking at something here that if we wait too long, we might not have a valid issue to pursue.

Mr. Cattany: The Coal Subcommittee's next scheduled meeting is on April 9th. We could certainly at that point determine whether or not we want to move something forward to the RPC. Obviously, the RPC is months away from meeting again, but we can certainly finish our homework so that you have something as soon as the RPC is ready to meet. But I think at least as a background right now, giving a copy of our report to Director Burton will certainly give her a background on what our questions are with the Solicitor's opinion, and then we can continue to frame the issues for the RPC for its next meeting.

Mr. Simpson: We asked the question a year or so before we got the Subcommittee to write the letter to the Solicitor, and then it took them three years, so this thing has been going on for over five years. I'm concerned how this issue relates to other solid leases that have by-products. Ten years down the road when this started we were thinking they're waste piles, and now there's third parties actually coming back in and recovering a lot of this natural resource from our commodity that the federal government and the state owned.

Mr. Cattany: I think that there's a broader issue that Brad is talking about. I think it is important as you look at waste piles in general as technology changes over time, and yesterday's waste may actually have a market tomorrow. But in this particular case, as I understand it, a lot of the activity right now is a result of the Section 29 tax credits. So, there's sort of an artificial economy that's been created to begin with for this commodity. It may be limited right now to the coal waste piles, but it doesn't preclude technology changes over time that allow waste to have some market in the future as well.

Sodium/Potassium Subcommittee:

Mr. Harold Kemp updated the Committee on the status of the subcommittee. I think this Committee was looking for consensus within the issue related to the draft rules that have been circulated for Sodium/Potassium. There was essentially one issue in the context of what we're doing, and that was the definition of primary product as it related to certain manufactured products. And that issue was the sodium bicarbonate recovery, and how that stood vis-a-vis primary product. We are going to attempt to work for another 60 days. We will meet again sometime in April and come back to this Committee with an explanation of the draft rules, an explanation of what we've done, and answer this Committee's questions.

Records Management Discussion:

Mr. Mark Ferguson, Director, Records Division, National Archives and Records Administration (NARA) Rocky Mountain Region briefed the Committee and provided a PowerPoint handout. Mr. Ferguson discussed the work that NARA is providing to MMS regarding the retention of electronic records. Most Federal records are temporary and destroyed when no longer needed. However, a small percentage will be kept permanently, will go to the

national archives and will never be destroyed. And if the agency knows litigation or audits are open or may begin, the related records are frozen – maintained indefinitely until the litigation or audit is completed.

Federal laws and regulations mandate that agencies periodically inventory its records and assure records schedules that describe the records and state the retention periods. Because agencies change the way they operate over time their schedules must change. Records that have never been scheduled cannot legally be destroyed. Retention periods define how long records are kept after being closed. A small percentage of records, 5 to 10 per cent, have secondary values, and are kept permanently for historians and researchers.

In response to Mr. Shirley question regarding Native Americans records being permanent, Mr. Knueven explained that this it a proposed changed. As a result of 30 or more years of Indian trust litigation these records have had indefinite retention period. Rather than continuing to leave them in this limbo status we are proposing to make these permanent.

We are also proposing to extend the retention periods for Federal records from 7 to 12 to 15 years. This is due to the statute of limitations for the False Claims Act is ten years, and there may be more than a year from the time that such a claim is filed before MMS knows about it, because those claims are sealed. So, we're considering the minimum time for keeping federal records as twelve years. We are not changing the retention periods for policy development documents, which are currently permanent.

Mr. Ferguson explained the process under which a schedule is finalized which includes a public comment period. If we get comments, we will analyze those comments and address them. Some of those comments may need to be addressed by the agency as well. If all the concerns are settled the schedule will be sent to the Archivist of the United States for approval.

As part of the presentation, MRM requested the RPC's input in determining retention periods. After extended discussion Mr. Cattany motioned that the Coal Subcommittee continued to follow records issues and request MRM to provide a records briefing sometime in June 2002, the exact date to be coordinated with the members who want to attend. Mr. Butler seconded the motion.

Vote: 15 in favor, 0 opposing, 0 abstaining. Motion carries.

Status of MMS Internet Shut Down:

Mr. Sant provided the Committee with an update on the status of our systems shutdown, the effects on business relationships, and system recovery plans. On December 5, 2001, the U.S. District Court for the District of Columbia issued a temporary restraining order in the Cobell v Norton litigation. This order required the DOI, including MMS, to immediately disconnect all its systems from the Internet. To comply the MMS shutdown its new Financial Management system and disconnected from the Internet.

As far as reporting impacts MMS normally receives about 250,000 lines of 2014 data from 1800 payors each month. Currently MMS has about three-quarters of a million lines to process once the system is brought back up. We anticipate this to take seven to eight workdays. As far as impacts on reporters, companies have not been able to submit their 2014 information and we have not been accepting production reporting since August. Thirty-six companies that are reporting the X-12 format under EDI have been able to continue to submit reports. Not all systems issues have been identified. MMS had only one month of processing experience (11/01) before the system was shutdown. Impacts on the system core functionality and user ability to effectively process and research data remain outstanding.

Error rates. The error rate in the first month of the new financial system was 18 per cent. Normally it's less than 5 per cent. The error rates probably will stay higher for the shutdown months because of MMS not being able to

work with reporters to help them improve reporting. We believe many of the errors are a result of misunderstanding about the new reporting formats and some lease and agreement formatting issues. The MMS will continue to have MMS company representatives work with reporters to resolve problems and answer questions regarding reports and payments.

The system assigns the date reports are received as the receipt date. Documents received prior to the shutdown will have been given the correct receipt date. Paper documents, because they are stamped in, will also have the correct receipt date. The X-12 EDI documents have a date built into their file so we should not have any receipt date problems. Electronic reports sent to Peregrine, either the pro-client or the web based, will have incorrect receipt dates when the system is turned back on.

If a payor submits an estimated payment, that document will reject because the estimate that applies to an earlier month won't be received until March. As a result, interest won't be calculated correctly. If you report an estimated payment, and your actual payment is larger than your estimate that you have on file, we calculate interest for the difference between the estimate and the actual for one month. But it's calculated from the receipt of the document and not from the receipt of the revenue.

Late interest for states won't be calculated correctly because we need the documents processed to determine how much is owed. We are not sure what's going to happen with Indian over recoupments. In the current system involving tribal payments, you can't recoup more than what's due for a lease in any month, and you can't credit any recoupments against other leases. For allotted lands, you're limited to recoup 50 per cent of the payment that you're making that month on allotted lands. But when we have multiple months they're going to be all rolled up into one. If you have reporting problems with some leases the roll up may cause a higher amount of rejected lines.

There isn't any issue on late payment payor interest if a payor pays late, because the interest for late payments is created from the receipt of the money and not from the document. We know what you have paid by month. Initially we had hoped the shutdown would only last a short period of time. But at three months we have some work to do to minimize the number of documents that might have some problems.

Ms. Naron: If I send my file to Peregrine on a Wednesday, and they don't get it transferred to you until Thursday, your receipt date is Thursday?

Mr. Sant: Correct. The system assigns the date that it's processed into the system.

Ms. Naron: But that's not when I sent it to your agent, I sent it on Wednesday. My original thought was that Peregrine has the receipt dates. They knew the date that we transferred the file to them. They could go through their system and electronically change the receipt dates of all those transactions that are on our files.

Mr. Sant: Peregrine does not maintain that data.

Ms. Naron: You'd better put that on your list of issues, receipt date by the MMS as opposed to the receipt date by Peregrine, if they're different.

Historically, we've received approximately \$500 million a month in mineral revenues. Last year, the monthly average of revenues received by MMS was a little over \$800 million. In November, December, January and February, the monthly receipts went down to about \$400 million. We are researching the difference. We do know that the receipts that have been identified as being RIK wire transfers to MMS have been accounted for in the \$400 million figure. To minimize impacts on people who are getting the revenues we decided to give estimated payments to the state governments.

Mr. Simpson: What are those estimates based on?

Mr. Sant: The December payment was based upon an average of the August, September and October 2001 payments to the states. We took an average of those 3 months. In December, we sent out \$59 million to 16 states. We did not make a disbursement to any state that would have received less than \$100,000, because we are working on a reconciliation process.

Mr. Simpson: Most of the states distribute down to the county and city level. If you're overpaying us now are you going to come back and ask for money back? We would have to go back to the cities and counties and ask for money back? That's going to be a real problem if that happens.

Mr. Sant: We will recoup it in the following months like we've always done.

Mr. Simpson: So, you'll just zero us out. I'm just asking the process. You're doing 100 per cent of distribution based on the three previous months?

Mr. Sant: The number was 90 per cent of the average of August, September, and October for the December payment. The January payment was an average of September, October and November. In February we took the average of what we distributed out last year.

Mr. Simpson: Have you told the states how the money was distributed?

Mr. Sant: Yes.

Mr. Cattany: That raises two points. One is the information about what's happening now. But also whether or not there should be multiple month reconciliation once the system is up as opposed to reconciling it all in one month. I think it would be useful for you to take this back to MMS and have some dialogue with the states as to what that reconciliation time frame ought to be.

Mr. Sant: We want to reconcile December, January and February, and if we have to, make an estimate for March. MMS would reconcile all four months before we do anything to reduce payments to any of the states.

Mr. Shipps: What time periods were the allottee estimates made?

Mr. Sant: My understanding is that they were the average of October and November of last year.

Mr. Shipps: Those averages were intended to take care of production periods for the same months?

Mr. Sant: No, it would have been for December, at least a down payment on December, January and February.

Mr. Shipps: Are the allottees still defined with respect to receipt of payments?

Mr. Sant: Yes. Payment was made for only one month because we have been down for three months. And just for information, the Navajo Nation made some payments to the allottees on the Navajo Reservation. They had a threshold and sent checks of \$200 to people that were below a threshold, and then checks for \$800 for people above that threshold.

Mr. Shirley: You mentioned that there was a percentage of reduction in the receipts for December. Do you know if there's been any analysis on the impact of royalty receipts for the lock box accounts for the various Indian tribes?

Mr. Sant: It didn't appear that the reduction on mineral leases on Indian lands is down as much as it was on federal lands. They're down a little bit, but not nearly as much as for the 50 per cent reduction from the average of last year.

Mr. Shirley: Do you think some of that might be attributable to some of the payors thinking that since the system is down they don't have to report their royalties?

Mr. Sant: That's a possibility. But we will have to wait and see what our research tells us.

Mr. Shirley: Was a Dear Payor letter that was sent out to advise the payors that their royalty payments are still due?

Mr. Sant: We've been telling people to continue to remit revenue payments.

Ms. Naron: Can MMS determine which companies are not sending in payments?

Mr. Sant: We continue to analyze the situation.

Moving to Compliance impacts. MMS has an Indian gas rule that calculates major portion prices. You can report your initial value until MMS publishes this major portion price. Interest on the difference is not due between the major portion value and what you reported. It's only if you're 30 days or longer to pay the value under the major portion that MMS has calculated. We used to post the index that was required under the Indian gas rule. We have not been able to do that.

Mr. Clark: We report using the EDI value added network. We were told not to report because MMS couldn't bring it in. Are you now telling me that if we're doing an EDI transmission, we should be reporting?

Mr. Sant: Yes. I'll take it back for clarification.

We've had some notices of non-compliance identified before the shutdown. We certainly will give grace periods before people have to start reporting again, and we won't impose penalties on the notices of non-compliance until after there's a grace period to get your data back in.

Mr. Cattany: In the case where you underpaid a state and do the reconciliation will the balance of that account and the check be interest bearing? Because I assume all this money is in an interest bearing account at the federal government level right now.

Mr. Sant: No.

Mr. Shipps: Does that same practice hold true with the allottees?

Mr. Sant: They will get the interest that their payments have been earning in OTFM's account. OTFM does invest the revenues and when they do get caught up the allottees will receive whatever interest rate the OTFM is receiving.

Moving on to the restart of the system. The first 24 hours will be used to get the system ready for users. We'll turn on the systems. We'll do some initial tests. We will reestablish the connections to Peregrine. We will complete a full backup of the system, and also we'll assign new passwords to all users of the financial system, so that we will have the security that we need that only people with the ability to use it will have access to it. We will provide

notification to all reporters through press releases, Dear Reporter letters, notices to trade associations, and the MRM website.

We can process 150,000 lines a day. Given the high error rate we made a decision also to re-validate the data every night. Accenture is working on some system improvements to the production environment so that we can start getting the production reporting and exception processing improvements implemented.

We want to minimize impacts on states and tribes. That's why we made some estimated payments to them. We also want to minimize impacts on reporters by not enforcing certain orders and notices of non-compliance that were out there before the system shut down. As far as other impacts, we have not been sending out courtesy notices for rental payments. We typically send out a courtesy notice a month before the rental payment is due. But that has not been happening.

Ms. Naron: Did you tell companies that you were not going to send them that anymore? Because I know a lot of companies depend on that notice to determine if rental is due.

Mr. Price: Some companies do have in their operating procedures that when they get the statement they make the payment on the delay rentals. And they do rely on those courtesy statements. What's at risk is losing potentially exploratory leases that you're getting ready to drill. Has there been any thought in looking at a grace period if you are late on a delay rental payment?

Mr. Sant: We haven't run our program to determine if anybody is late in paying rental payment. But, we would need to coordinate with the BLM before any decisions are made.

Ms. Naron: I'm going to tell companies in my organization to start checking their own rentals because the MMS is not sending courtesy notices.

Mr. Shirley: MMS needs to think about who is responsible for payment of the rental. Is it the government's responsibility to notify the companies that rentals are due, or is it a responsibility of the company, the lessee, to know when their rental payments are due, and to submit the payments as such?

Mr. Shipps: Are courtesy notices issued to holders of allottee leases as well as federal leases?

Mr. Sant: Any lease that has annual rental payment gets a courtesy notice.

Mr. Shipps: With respect to the allottees it may create a very harsh situation, but it may be one that you can't correct without the consent of the allottees.

We don't have a crystal ball, but we think it's probably going to take nine to twelve months after we get back up to clear out all of the backlogs. We need to reconcile the manual distribution that we've made to the states and work on the process to get the system fully operational. We want to bring on production reporting, and that's estimated to take maybe four to six more weeks. We don't have the exception process in, which looks at the financial terms of leases and does the interest calculations. That wasn't completed when we got shut down. When will we be caught up? As I've previously said, we think maybe within nine to twelve months. When will everyone be paid? That's probably going to take several months also. And when will reengineering be completed? Well, we hope by three or four months after we come back up, but we will be doing continual improvements. Some of the items in the compliance group were not finished but gradually it will all be completed.

Strategic Petroleum Reserve Initiative:

Mr. Greg Smith updated the Committee on the strategic petroleum reserve (SPR) project. He talked about President Bush's directive and associated authorities and the approach MMS has adopted with the Department of Energy (DOE) who we're collaborating with on this project, as well as, the scope and management of the supply side of the project.

On November 13th of last year, President Bush directed that the existing capacity of the SPR be filled with royalty-in-kind oil. Lots of discussions worked up to that announcement at the highest levels in response to 911 and to increase the energy security of the country.

Thought was given to appropriating monies to pay for the oil to replenish the SPR. But the decision ultimately was to go with the royalty-in-kind oil source for the replenishment. The associated authorities for the Department of Interior is the OCS Lands Act, which gives us the authority to transfer royalty commodity within the federal government at no cost, and on DOE's side, the Energy Policy and Conservation Act, which provides the authority to fill the SPR basically. We have developed a memorandum of understanding with DOE governing what each agency's respective roles and responsibilities are on this project. MMS will be managing the supply side, logistics and exchanges from the offshore lease platforms to the onshore market centers in the Gulf of Mexico. DOE is going to manage exchanges of that crude for either the same crude or different types of crude to move right into three of the SPR sites in Louisiana and in Texas.

This project is very large. 700 million barrels is the capacity of the SPR. Right now, it's standing at about 592 million barrels. We're looking at about 108 million barrels of oil into the strategic petroleum reserve. We think it will take about three years to do this. At \$25 crude price, that equals somewhere close to \$3 billion dollars in foregone royalties.

On the DOI side we want to adopt commercial practices and mimic a working interest role on the lease like the other producers and go out and market it to bidders and exchange partners who engage the oil and gas industry. Jointly, we don't believe that the monitoring of volume imbalances and volume reconciliation with producers is solely our responsibility, or solely the oil and gas industry's responsibility. It's a joint responsibility. The royalty obligation is satisfied when the correct volume is transferred to the lessor. We want to work together with the oil and gas industry to jointly and timely, within 90 to 120 days, resolve all of our volume issues.

Where is the oil coming from? Gulf of Mexico royalty oil exclusively at this point, and we don't see any reason to change. No 8-G volumes are at all caught up in this. We are adopting a phased ramp-up of volumes so we know our procedures with respect to producers and volumes are working. At steady-state, probably next springtime, we're looking at the potential of a couple hundred royalty meters, 500 properties in the Gulf, virtually all of the pipelines in the Gulf of Mexico, and all of the seven or so crude types that are in the Gulf of Mexico. The small refiner program will continue with about 50,000 barrels a day. Even though that program has been overhauled and is working much more efficiently we've started to think of adopting the same sort of exchange agreements that we're utilizing in the SPR to actually move small refiner barrels to onshore market centers. Next spring were looking at around 80 per cent of our royalty production in the Gulf of Mexico being in kind. That amounts to about 180,000 barrels a day out of our royalty position in the Gulf.

In previous SPR fills and previous royalty-in-kind crude programs in the Gulf, we had leaned on our lease term right to direct the producers and the operators of the leases to move the royalty oil onshore. For a whole variety of reasons, that just doesn't work very well, lots of imbalances, and the like. So, our exchange partners are going to receive the royalty oil at the lease, and in return for that, deliver exchange oil to DOE, really their marketing agent, or their exchange partner, at each of the four major liquid pricing points or market centers in the Gulf of Mexico.

Net value difference between what the oil is worth offshore versus onshore is the only departure from a commercial exchange agreement that would be paid in barrels rather than in cash. Therefore, the 108 million barrels that are going into the SPR, we're actually going to have to take more than that amount of barrels at the lease to pay for the cost of exchanging it to the onshore market centers. The key is to market this thing to each of the major shippers, major exchange partners, facilitators, brokers, aggregators out there so that we are identifying the best transport rate and using the best transport rate implicit in the exchange agreements. Compete it so that we will have multiple six month and one year exchange contracts out there to take advantage of all of those companies that have good niche transportation agreements on these lines.

On the market side or the SPR side, DOE again is managing that part. Our exchange bidding contracting has to be coordinated with theirs. Their contractor is going to accept deliveries from our exchange partner at the market center, and then deliver oil, whether it's domestic, foreign or some combination thereof, into the SPR sites. In mid-February we awarded our first batch of crude oil to go into the SPR at about 60,000 barrels a day. Four companies were the high bidders involving seven packages and receipt points. If we were to go to 100,000 barrels a day, we would have to go to 19 receipt points or meters. To get up to 130,000 we would have to go to over 200 meters.

So, we're clearly starting with the properties that have the most volume, and it's easy enough for us all to get our arms around it to start. And six of these seven packages were already a commercial royalty-in-kind program. So there's not a huge amount of disturbance out there right now with respect to these properties. DOE went ahead and awarded a single contract to Aqueva for all of the 60,000 to move it into the SPR.

In the future we are going to continue to engage the industry. We have almost weekly conferences with DOE and the public to continue to inform and get input on this program and continue the ramp-up. At steady-state, when we get up to the highest volumes there's going to be some resource, reallocations within MRM to effect this. One of the great parts of RIK is that you have the ability to monitor, assess, retool and remain flexible to changes. Another reason we want to do six month and one year contracts rather than three year contracts is tariffs change, players change, pipelines change. So, we want to remain flexible and agile with respect to, again, trying to expend the least amount of barrels to get the primary amount of the barrels into the SPR and fill it up as quick as we can.

Mr. Cattany: On the royalty-in-kind side how do the states' shares of royalty, if cash had been paid as opposed to royalty-in-kind, handled by MMS?

Mr. Smith: If this were an onshore program, like our program in Wyoming, it gets handled the same way as any other receipts would be coming in. We invoice our purchasers. We fill out the 2014s going in to the system, and it gets allocated just like the lease gets allocated to different fund codes. If one lease is halfway into Trona County and the other is halfway in Campbell County, it gets split out according to the database and the percentages that are in there. It really gets handled like any other cash transaction.

Strategic Planning Initiative:

Mr. George Triebisch updated the Committee on the Department's strategic planning initiatives.

The Department's goal is to manage and measure. We want to be accountable for those things that we measure on a continual basis at all parts through the organization, not just the top but all the way down through the programs. This is going to be a big change for us. We want to talk about new approaches. We want to talk about tradeoffs of our work. If we produce more, what does that mean to the environment? And if we protect the environment, what does that mean toward oil and gas production? What does it mean toward fair market value? All those things have to be part of the equation, and they all have to be balanced to some degree.

In the past, we've not had one DOI plan. Each of the Bureaus within the Department has had their own plan with a management piece at the top. That's going to change. This is going to be a top down plan, where DOI is going to have priorities. Each of the Bureaus are going to contribute to those priorities and then it's going to be Bureau specific in implementation. It starts with a results oriented organization and agency. It flows down, mission, Departmental goals, the outcomes, and the strategies. We're going to align the programs. After we've done that, we're going to have activities that we're going to budget to, and also we're going to cost to at some point through activity based costing. We will know what things cost on a per unit basis and be able to make better decisions by managing for results and measuring performance.

We've engaged the Performance Institute out of Washington, D.C. as our contractor. They have provided us with a model. The end outcomes are the Department's contributions to societal goals. The strategies, the intermediate outcomes are more strategies the Bureaus would pursue to contribute to the end outcomes. The outputs are the outputs of the programs that go down through the Bureau to line managers. And then the inputs, the FTE that we use, the full-time equipment, the people, resources, budget resources, IT investment, that type of thing would go to the inputs. We really don't anticipate the overall mission for the Department to change.

What we've accomplished to date with the DOI plan is to form theme teams of employees from all the Bureaus. These teams have been working from December 2001 to the present to develop the end outcomes and intermediate outcomes. We have also formed a senior career team to review what the theme teams have developed and providing advice. We're currently at the point where the theme teams and senior career teams have combined concepts to present to the political leadership.

The next steps are to finalize our end and immediate outcomes so we can start to develop the MMS strategic plan that is scheduled to be in place by September of this year. This information will be used to align the program outputs and the performance measures for the FY 2004 budget. My plan is for MMS to distribute final DOI outcomes and strategies to the Advisory Committees for review. We would like some feedback from the Advisory Committees on what you think are the right priorities and strategies. This Committee's thoughts on what you see the working world looking like in five years. What are the trends? What are the things that are really going to affect the energy business. I think that's critical, and we would really rely on the advisory groups to help us.

Mr. Shirley: Where is the proposal to go forward with the new Indian trust office? Also, related to royalty management issues is there something planned that would be drastically different than the way things are currently operating now as opposed to what you see in the future?

Mr. Triebisch: We're not there right now. I don't see a tremendous change in what we do. I think there's more opportunity in being more efficient, more communicative, and working along those lines. There's a debate right now on how to capture the Indian issues in this plan. If you recall on the house diagram the four areas: recreation, use, serving communities, and protection. There has been a lot of discussion on how to capture the Indian issues in those.

President's Management Reform Initiative:

Mr. Cruickshank updated the Committee on some of the management improvements proposed by this administration and the current energy legislation.

The President's vision for government is highlighted by three principles. The government should be citizen centered, providing efficient services to the citizens of this country. It should be results oriented, and the government should be market based, actively promoting innovation through competition. To put this into practice, the President has created a Management Reform Agenda that contains five goals to be instituted government wide.

The five goals are meant to address problems that the administration sees as being systemic across federal government.

This agenda is not meant to replace other sorts of management reforms that have been started in the past and are ongoing. It is to be done in conjunction with them, or in some cases, in advance of, but certainly not to stop the other sorts of reforms that have been underway. First item is the strategic management of human capital. This arises from the fact that over the past ten years, the federal government has reduced the number of employees by some 325,000. Much of this reduction was done through across the board reductions in personnel, or through hiring freezes and attrition, but without a lot of planning. This agenda item is trying to do strategic management now by trying to figure out what skills your work force will need for the future.

Each agency is supposed to prepare a five-year restructuring plan based on its future workload analysis. This plan is to result in putting more employees on the front lines dealing with customers and citizens on a day to day basis thereby reducing the number of managers and organizational layers. These human capital strategies are to be linked to our performance mission. In addition, the administration is pursuing legislation to try and grant managers additional flexibility to recruit, retrain and reward employees and develop a high performing work force. As part of this effort, agencies will be trying to determine their core competencies, those core skills they need going into the future, and to try and build that capacity either internally or through contracting out. In short, strategic management of human capital means the ability to attract and retain the right people, and have them in the right places at the right time.

Within the Department of Interior, there are a couple of things that we're doing to try and get this in motion. We are undergoing a work force planning exercise, as this agenda item calls for, trying to put together training programs for the future, and to try and improve our management tools for managing the work force. In addition, the Department is taking a close look at how we're organized on a lot of the Department-wide sorts of functions. We're very de-centralized now in support services, things like Human Resources, Information Technology, and Procurement.

The second item is competitive sourcing. This arises from the realization that nearly half of all federal employees perform tasks that are readily available in the commercial sector.

The Department of Defense has been doing competitive sourcing for a number of years, and they've done about 550 studies for competitive sourcing over time. Their process has resulted on average in about a 34 per cent reduction in costs. In addition to recognizing that a lot of what the government does is also done in the private sector, there is a realization that if you go through and try and determine the best way to get this job done, you can make the government more efficient as well.

I want to point out that competitive sourcing is not outsourcing, it is not contracting out necessarily. The idea behind competitive sourcing is for an agency to focus on what it's supposed to be doing, determine its performance measures, what its benchmarks are for determining certain functions, and then try to define its own maximum efficient organization. The performance measures are what the private sector bids on. The bids are compared with your own public sector costs of doing that same job. If the private sector has the low bid, they would win the job. But if your own maximum efficient organization is the cheapest way of going about the job, then the function would stay in the public sector with government employees. But, to the extent you already haven't done so, you are then committed to instituting your maximum efficient organization. So, whether or not you end up contracting out to the private sector or keeping the function in house, the expectation is there will be some change in how you do your business, and some reduced costs as a result.

Ms. Naron: Are you going through now and determining which ones of these functions we want to get competitive bids on?

Mr. Cruickshank: We are starting that process. Under FAIR Act every agency is supposed to do is take an inventory of all its jobs, and determine which are inherently governmental and which are potentially commercial. And as part of that inventory, then you have this set of potentially commercial jobs out there, and administration has set goals to what percentage of those commercial activities need to be competed in each year.

Right now, we're working off older inventories that were done two or three years ago. In 2002, we are to either competitively source or if we prefer, directly convert to the private sector about 5 per cent of our commercial inventory of jobs. For MMS, in 2002, that means 27 positions, and we've already made the decision that those are all going to be in the Information Technology area.

In 2003 we are to compete an additional 10 per cent or competitively sourcing 54 jobs. We have not made a final decision on just what those jobs would be. But one of the main things we're doing right now is putting together our new inventory of positions as to what is inherently governmental and what is commercial. This will be the first time that's been done under the current administration to make sure there's consistency across agencies on the types of functions that are identified as commercial, and not. This inventory will drive what we would put up for competitive sourcing in 2004, and beyond.

The goal of this administration is that by the end of the administration, up to 50 per cent of the commercial jobs would have been competitively sourced.

Improved financial performance. This arises out of the realization that a lot of federal agencies don't have their financial house in order. Inherent in the management goals of the administration is that managers need accurate and timely financial information to manage their programs. The goal here is to fix these problems by creating new financial systems and processes that will routinely produce information in a timely manner that is useful to managers.

Expanded electronic government is another major area that we hope to be working on again soon. It's tough to spell government without an "e", but that's where we are right now. The problem is that the federal government is the world's largest single consumer of information technology. But while IT is viewed as contributing to about 40 per cent of the increase in private sector productivity growth over the past several years, no one has been able to document similar sorts of gains in the public sector. And some of the reasons for this include that a lot of agencies are not ensuring their IT systems communicate with each other. This is an example within the Department of Interior. We have at least three different e-mail systems, none of which communicate very well with each other. In addition, often when agencies automate, they go to information technology simply to automate their existing process, and they don't actually step back and take a look at trying to reengineer their process and automate a new, more efficient process.

And, finally, you find that there's a lot of commonality among the needs of agency systems on things like finance, payroll, and procurement. Each agency tends to go out and procure their own system that works for them, but develops it separately when a single system would serve these functions for everybody.

What the administration has done in the e-gov area is to try and focus on a handful of high profile projects that it believes will deliver significant productivity and performance gains across government. It's tried to identify types of projects that are applicable government-wide. It has initiatives in e-procurement, in e-grants, in e-regulation to try and form a common electronic basis for types of programs that we found in many agencies.

In addition, there's a focus on trying to create single points of access to government services and information. To reduce reporting burden on businesses by reusing data that may have already been submitted and sharing that data among different agencies and make use of standard commercial electronic transaction protocols instead of special

ones created just for the government.

With respect to MMS, our e-gov is well along. We did reengineer our processes to do our business more efficiently. We are just starting that process on our offshore side. Last year, there was a study completed to take a look at an approach to implementing e-government in the offshore program. Additional planning is going on this year, as well as some pilot programs, and the President's 2003 budget includes money to start transforming the offshore program into a more web based and paperless program.

On budget and performance integration the idea is to allocate federal resources to programs that deliver results. What the administration is doing here is to try and better link program goals to budget decisions. They are trying to also create the budget data and the cost data that will be available to program managers to make better decisions, and try and be more efficient in meeting performance goals.

Within Interior, we have a couple of major initiatives. One is the strategic planning effort you just heard about, which would lay out the goals for the Department and what our performance goals should be and how we're going to measure our performance. And those performance goals and measures will be used in putting together the next budget request for 2004, and will also then trickle down to the various Bureaus as they put together their plans and budget requests.

In addition to this sort of budgeting approach, we're going to activity based costing. In activity based costing you are linking each of the activities you do in a Bureau to the specific performance goals and the strategic plan. And for each activity, you will have the information, or will develop the information for what it costs for you to do that activity, so you'll know what it costs to meet the performance goals of your organization. Activity based costing is only in place in one part of the Department of Interior, and that's the Bureau of Land Management that implemented this a couple years back. But by October 1st of this year, MMS and OSM will also have activity based costing in place for our programs, and the rest of the Department will be following along in a couple of years. That in a nutshell is the President's Management Reform agenda, and what we're doing at the Department. I want to speak briefly about how the Department is organizing itself to accomplish these goals. The Secretary's management reform strategy is based on four key principles. First is customer value, wanting to ensure that all of our activities in the Department add value to the citizens and ensure effective use of our resources. Accountability; by establishing clear performance measures and holding all of our managers and employees accountable to achieve performance. Modernization, using technology to work smarter and provide single points of access to our services. And integration, identifying opportunities to avoid duplication, and achieve economies in providing services and information to our customers.

The Secretary has established a Management Excellence Council to provide leadership and direction to the Department. That council consists of the Secretary, the Deputy Secretary, the Assistant Secretaries and Bureau Directors, and will provide overall guidance to all of these activities within the Department. Below that is something called a Management Initiatives Team, which consists of primarily the Deputy Directors of all the Bureaus, or other senior career executives. And this team is to act as the interface between the political appointees and the rest of the Department in trying to implement these reform items. And out of this Management Initiatives Team hub are several spokes with teams of senior managers within each Bureau, one team focused on each of the management reform agenda items in the President's agenda. And these various teams are meant to put together the plans for the Department, as well as provide some leadership and guidance in implementing management reform agenda items.

Finally, the Department has created a new position, a Deputy Assistant Secretary for Performance and Management, and hired a fellow by the name of Scott Cameron to fill that position. He will be the person responsible for trying to make this organization work and making sure that the management reform agenda work's

their way through the Department and implementation.

Energy Legislation:

The House did pass their legislation HR-4 last year, and there are a half dozen or so provisions that are of direct interest to MMS. The most prominent is royalty-in-kind. In our royalty-in-kind program, we have for the past couple of years been able to pay for transportation and for natural gas processing out of the proceeds of our RIK sales, something analogous to the deductions taken by payors when they pay royalties in cash. We have this authority through the appropriations bills, and we get it on a year by year basis.

One of the main things the RIK provision of HR-4 would do would be to grant us this authority through 2006. It would allow us to use this authority only when the Secretary has determined that RIK will provide net benefits over a comparable royalty in value program. And it also provides that we report annually to Congress on what we're doing in RIK, including developing performance benchmarks for the program.

The provision would also codify a number of our current practices with respect to RIK including that we consult with states before we do any RIK onshore. Lessees are responsible for placing production in marketable condition and that the delivery of the right volume and quality of production will fulfill the royalty obligation. It also retains our current authority with respect to the small refiner program and for transferring RIK to the Department of Energy and Department of Defense. Finally, it would create an additional discretionary preference for the Secretary in selling RIK to purchasers who would provide additional resources to low income and energy assistance programs. There are also provisions for royalty credits for NEPA analyses. In the onshore program, quite often companies need to do some of the analyses and studies and reports for the NEPA documentation required to bring a lease into production. Where a company has undergone such expenses, they would be able to take a credit against royalty payments due on that lease.

With respect to geothermal leases it would reduce the royalty rates for geothermal leases prospectively to a maximum royalty rate of 8 per cent. The Geothermal Steam Act now calls for royalties between 10 and 15 per cent. It would also create a 3-year royalty holiday for new projects, including certain expansions of existing projects, as long as production came on stream within five years of enactment. It would do away with royalties for low temperature projects, though there would be annual fees of something between \$100 or \$1000, based on the schedule to be determined by the Secretary. And, finally, HR-4 includes a provision for coal leases where the amount of time that advance royalties can hold the lease would be doubled to 20 years.

Turning to the Senate bill the major issues include the Arctic National Wildlife Refuge, the fuel economy standards for automobiles and light trucks, renewable fuels, particularly the use of ethanol, electricity restructuring, climate change, and offsets for the various tax provisions in the energy bill.

There are a few items in the bill relevant to MMS. One deals with fiscal policies for setting taxes and royalties. The Senate bill proposes the DOE do a study in conjunction with the Departments of Interior, Commerce, Treasury, and with tribal governments, the Interstate Oil and Gas Compact Commission, to evaluate the full slate of federal and state tax and royalty policies and how they impact resource development and revenues.

They would be asked within six months to come up with recommendations for tax and royalty policies for all levels of government, as well as guidance for private landowners on the types of royalty policies they ought to have in place. In addition, the Senate bill would require that we fill the Strategic Petroleum Reserve using royalty oil, something that we are already doing. It also has a sub-salt lease extension provision similar to that in HR-4 that we are doing administratively. It also has a proposal for ultra-deep water and unconventional exploration and production technologies, but unlike HR-4, it does not fund it out of oil and gas lease revenues. It simply is appropriations out of the general fund.

As for the next steps, the Senate will continue debating energy for a while. If they don't seem to be making any progress, then Senator Daschle has said he would pull it off the floor so they can return to campaign finance reform. But nevertheless, Senator Daschle's goal is for both of those issues to be voted on before the Senate goes into recess at the end of the month.

Scheduling of Next Meeting/Adjourn:

After discussion the workable dates for the next RPC meeting are September 4th or 5th, or the 16th or 17th of October. Meeting adjourned at 4:43p.m.