

MINERALS REVENUE MANAGEMENT  
ROYALTY POLICY COMMITTEE  
SUMMARY OF MEETING  
MAY 26, 2005  
SHERATON, 500 CANAL STREET  
NEW ORLEANS, LOUISIANA

The Royalty Policy Committee (RPC) of the Minerals Management Service (MMS) convened its second meeting of the fiscal year at the Sheraton Hotel, 500 Canal Street, New Orleans, Louisiana on May 26, 2005. In accordance with Public Law 92-463, the meeting was open to the public.

Members/Alternates Present

Johnnie Burton, MMS Director,  
Lucy Querques Denett, AD/MRM  
George Triebisch, AD/PMI  
William Benham, Natural Gas Supply  
Ronald Cattany, Western Governors Association  
Michael Coney, American Petroleum Institute  
Lisa Crothers, Independent Petroleum Association  
David Darouse, State of Louisiana  
Todd Druse, Ute Mountain Tribe  
Darrell Gingerich, Council of Petroleum Accountants Society  
William Hartzler, National Mining Association  
Eddie Jacobs, Oklahoma Indian Mineral Owners Association  
Harold Kemp, State of Wyoming  
Orme Lewis, Public Representative  
Thomas Lonnie, BLM  
Bob Middleton, BIA  
Daniel Riemer, U.S. Oil and Gas Association  
Thomas Shipps, Southern Ute Indian Tribe  
Pary Shofner, Western State Land Commission Association  
Carla Wilson, Independent Petroleum Association of Mountain States  
Akhtar Zaman, The Navajo Nation  
Freddie Watson, COPAS

## Other Attendees

Shirley Conway, MMS  
Anita Gonzales-Evans, MMS  
Theresa Walsh Bayani, MMS  
Herb Black, MMS  
Robert Davidoff, MMS  
Gary Fields, MMS  
Deborah Gibbs Tschudy, MMS  
Pam Inmann, Western Governors Association  
Lonnie Kimball, MMS  
Mary Ann O'Malley, BP  
Phillip Sykora, MMS  
Ken Vogel, MMS  
Mary Williams, MMS  
Pam Williams, Shell Oil Company

## Welcoming and Opening Remarks

The meeting convened at 8:30 a.m. The RPC Chairperson Ron Cattany provided welcoming remarks and had all members present introduce themselves. The Chairperson made a Motion to Approve the Minutes from the previous RPC Meeting held in Lakewood, Colorado on October 28, 2004. The Motion was deferred until after lunch. Mr. Cattany stated that his interest in the Royalty Policy Committee was two-fold. His first interest is to encourage simplification in the methodologies and valuations of energy producing minerals. His second interest is to encourage the streamlining of the collection process. He handed out educational materials from the State of Colorado.

## Director's Remarks

Ms. Burton began her opening remarks by thanking Shell for a tour of their facilities on Wednesday, May 25, 2005. She continued with a discussion of open access to the Outer Continental Shelf (OCS) and domestic production from the OCS. Currently, 10 percent of the total OCS is open for access. Only two-thirds of the Gulf and North Slope of Alaska are open for access to the OCS. The amount of investment to find the resources for exploration and production is incredible. The largest production platform in the world, which was put onsite last month in the Gulf approximately 150 miles offshore from Louisiana, cost several billion dollars. One of the major companies is reported to have committed \$15 billion to the Gulf of Mexico in this decade.

The MMS keeps track of production on all public lands, whether they are submerged or onshore. That equates to tracking about 26,000 leases onshore, which includes both Federal and Indian leases, and about 8,000 leases offshore. Approximately 3,600 of the offshore leases are nonproductive. Current figures show that 30 percent of domestic oil production and 23 percent of domestic gas production comes from offshore; whereas 5 percent of domestic oil production and 11 percent of domestic gas production comes from onshore. These figures show the importance of offshore production and the amount of money needed to run the operation.

From a revenue standpoint, Minerals Revenue Management (MRM) is collecting an enormous amount of money. Last year, MRM collected \$8 billion in royalties, bonuses and rents. Again, the vast majority of this revenue came from offshore. The U.S. currently imports 58 percent of all oil consumed in this country. We are doing much better with natural gas. We currently import approximately 15 percent -- with most imports coming from Canada given the existing pipeline system. A small portion of natural gas comes from LNG, but not in significant quantities. LNG is one of the ways that we are going to use to increase gas supply. We do not expect LNG to take care of the entire supply, so we need to increase domestic production as well.

One of the problems LNG is encountering is the “not in my backyard” syndrome. We only have four LNG terminals onshore that can receive the liquefied gas, regassify it, and put it into the network of pipeline in this country for delivery. There have been permits issued to increase the capacity of these four plants, but we still need more terminals to process the gas. Siting for any proposed new terminals is extremely difficult because of population issues. The majority of the population in this country lives within 100 miles of the coasts, all around the country. Companies have found that it may be easier to site terminals offshore. Currently, we have received about 7 or 8 applications. Three of these applications are at the stage of receiving permits.

Offshore siting of LNG terminals creates environmental concerns with marine life. The regassification of liquefied gas would use a considerable amount of ocean water, and during the process it would heat the water. The Governor of Louisiana recently announced that she would not agree to the use of open rack vaporizers in any Louisiana plant. This is a big issue because any alternative method of regassification is more expensive.

We still have an obligation to do more domestically. Coal bed methane is a bright spot, and there is a lot that BLM is doing to help develop gas in various basins in the West. When you look at natural gas resources all over the country, about 40 percent are offshore and 60 percent are onshore.

The MMS has an entire suite of incentives to attract industry and increase production. Energy production is a global issue and companies are acting as global companies. They will decide where to invest their money and we need to make it attractive from a fiscal, regulation, and valuation standpoint to invest their money in this country. It is our role to ensure that the public gets back what it should and that we are doing everything possible to ensure that production of energy keeps growing in this country as opposed to increasing imports. These issues are not always easy to resolve. The MMS and BLM play a key role in managing mineral and energy production on public lands, and industry is the advisor to us on how to treat those resources in terms of valuation and management.

In addition to financial incentives, MMS is trying to streamline the rules, and MRM has taken a look at three major rules. The Federal Oil Valuation Rule was revised and became effective last summer, and the Federal Gas Valuation Rule will become effective June 1, 2005. Current work on the Indian Oil Valuation Rule will have to start all over again. The Associate Director for MRM and her staff are holding some workshops and will be seeking further consultation with the tribes over the next few months. We hope to have a proposed rule drafted sometime by the end of Summer 2005, and a final rule out by next year.

The Royalty in Kind (RIK) Program is doing quite well. We have begun implementation of our five year business plan. Current figures show 80 percent of oil royalties from the OCS are paid in-kind and 25 percent of gas royalties are paid in-kind. This last year, our metrics indicate we collected \$18 million more in revenue than if royalty had been collected in value. We continue to fine tune aspects of the program and are getting set up for long-term practice. Additionally, the program has allowed us to continue to fill the Strategic Petroleum Reserve (SPR) to capacity by the end of Summer 2005. Currently, we are planning to market and sell the oil and gas taken in kind since we have the systems in place to handle it. Once we do this, we will incur different costs. We are currently in partnership with the Department of Energy (DOE) who has compensated us for administrative costs involved in refilling the SPR. Once we have completed filling the petroleum reserve, DOE will no longer be involved; and they will no longer compensate us for administrative costs. This does have an impact on our budget; but we are getting ready for it, and it is working well.

The Fiscal Year 2006 Budget has been passed by the House. We were treated fairly reasonably in the House; however, there have been budget cuts. The President has recognized that we need a certain level of money to run our program and fulfill our mission so there has been a transfer of where the money comes from. Instead of having all the funds we need appropriated to us, they have been cut and we were authorized to recover those funds if we could figure out a way to increase our offsetting collection. Since there is not much excess in our organization, we have to impose \$19 million in fees to stay at our current budget level. The approved Budget for MMS is \$290 million. We have a proposed rule that increases the existing fees that industry pays today, and there will be some new fees. Additionally there is a group of fees that benefit the person asking; and a group of fees that benefit drilling and production plans, which apply particularly to offshore.

The role of MMS is getting more critical because production of energy not only has a tremendous impact on the role of the economy in our country, but it also has a big impact on the security and safety of our citizens. The less we rely on other countries for production of energy and the more energy we produce domestically, the better off we are.

Questions, Answers, and Discussion Followed:

Ron Cattany (Q) Is net receipts sharing being considered to recover the \$19 million?

Johnnie Burton (A) We don't intend to reopen net receipts sharing; \$1.2 billion paid to states last year with \$600 million to Wyoming, \$350 million to New Mexico, and so on.

Don Riemer (Q) Oil is \$50 and Gas is \$7 for industry, and it is the same for the Federal Government, so much more royalty revenue is being collected. So, why can't this additional revenue be used to offset costs instead of a fee increase on industry?

Johnnie Burton (A) The extra revenue is being used to reduce the nation's debt.

Don Riemer (Q) What is the status of the Policy and Management Improvement Group reviewing MMS oversight of offshore pipelines?

Johnnie Burton (A) It is an agenda item for discussion later.

Orme Lewis (Q) Can someone speak to the lack of refinery capacity in this country, and how it will disrupt the availability of product into our system, thus moving more of the crude to sources that are nonbeneficial to us?

Johnnie Burton (A) That is beyond what we do.

Orme Lewis (Q) As a public representative, I'm very sensitive to this.

Johnnie Burton (A) I agree, and I know it's a big issue, if I could defer to Bob Middleton on this issue.

Bob Middleton No new refineries built in this country since late 70's or early 80's and we need to increase refinery capacity. The President is looking at base closures for possible locations; 3 tribes in northern area looking at new refinery in the distant future.

Tom Shipps (Q) What is the annual total cost of the RIK Program?

Johnnie Burton (A) About \$10 million per year

Lucy Querques Denett	Talked about RIK/RIV cost comparison study
Aktar Zaman (Q)	Since it looks like there is no increase in the future budget, is it possible to make states responsible to pay back the U.S.?
Johnnie Burton (A)	I don't think it will happen.
Lucy Querques Denett (A)	Discussed devolution, competitive sourcing, RSFA delegations, states prefer to just do audits, tribal self-governance; self-determination
Ron Cattany (A)	Discussed issues with consistency across states if everything delegated to states
Tom Shipps (A)	Agrees with Ron; lack of consistency a problem
Mike Coney (Q)	Are there any plans to publish any rules for RIK?
Johnnie Burton (A)	No, authorized by legislation; we have our business plan and rules are not necessary

#### Associate Director's Remarks

Ms. Denett announced recent MRM personnel selections. Phil Sykora has been selected as the Senior Executive, Compliance and Asset Management (CAM); and Greg Smith has been selected as the Senior Executive, Royalty in Kind. We currently have two advertised GS-15 positions. We are in the process of paneling a selection committee for the position vacated by Phil Sykora in Financial Management, and we have selected Pam Rieger for the RIK Deputy Program Director. Lonnie Kimball was selected as the Manager for the Houston Business Center which will also have an RIK office. Allen McDaniel is the Manager for the Dallas Office. Our reorganization package is moving through DOI which includes one senior executive position over compliance for both offshore and onshore which will be managed by Phil Sykora. The RIK program will also be shown as a separate box in the organization. In the past, it has not been shown at all.

Ms. Denett discussed the recent completion of the Federal Oil and Gas Rules and the current work on the Indian Oil Valuation Rule. Other rules in process include Reporting Amendments, Debt Collection, etc., scheduled for completion by the end of Summer 2005; Takes vs. Entitlements, ANPR, proposed for July 2005; and the Sodium/Potassium Rule, proposed to be issued by the end of the year.

We had a task group led by Connie Bartram, which included members of STRAC and our auditors to update our Audit Procedures Manual. They did a wonderful job. Connie is also heading up a team to update the compliance review and procedures manuals, and we will have some auditors and STRAC members on that team as well.

As a result of an OIG report and a peer review of our audit program, there were a number of recommendations that were made for improvements we needed to make. Compliance personnel put together an Audit Improvement Plan with 39 action items. The action items included tasks we need to complete to ensure all of our procedures are in place. We have a few more action items to be completed by the end of the month at which time. Lucy will be receiving a report from Phil for review by her, the Director, and the OIG, respectively. We have asked for another peer review of the audit program in July. The audit program must receive a peer review every three years.

We have met our Government Performance and Results Act (GPRA) goals in the compliance area for FY 2004, and we are comfortable with what we need in FY 2005. Things are working well on the financial side. We are looking forward to having a new manager for that office. Deborah Gibbs Tschudy is acting for Financial Management at this time. She is an expert in compliance, and now she will be an expert in financial management and valuation as well. She is doing a wonderful job.

We were really happy to receive an unqualified audit opinion in November 2004, and we have started the audit for FY 2005. It is critical that we get another unqualified opinion.

We have an ongoing major records project to ensure our documents are filed properly and meet the requirements of NARA. That is going extremely well. It has taken a lot of time and resources, but we are on target. Completion of this project will allow us to do our jobs more efficiently.

Alaska is a new member of STRAC. They have one person working with us who joined us at the last meeting. We have had over 20 years of partnership with the states and tribes and have grown older together. We are getting a lot done and are appreciative of that. It is working well.

Questions, Answers, and Discussion Followed:

- Darrell Gingerich (Q) Is Audit Procedures Manual available to the public?  
Lucy Querques Denett (A) No  
Mike Coney (Q) Should we expect major shifts as result of the Audit Improvement?  
Lucy Querques Denett (A) No

Status of Open and Nondiscriminatory Access – Proposed Rule

George Triebsch walked through handout – Power Point presentation

Questions, Answers, and Discussion Followed:

- George Triebsch (A) Refers to Dan Reimer’s question earlier “What is the status of the Policy and Management Approval Group reviewing MMS oversight of offshore pipelines?

We are drafting a rule to implement and fill the Secretary’s responsibilities for the OCSLA. The FERC recognized there may be some issues with FERC Order 636 issued in 1992 which requires companies that transport gas on the OCS to submit rates and contract term information. The U.S. Appeals Court for D.C. found that the FERC did not have the authority to require the companies to provide pricing, service structure information, or to establish open access regime on the OCS under the OCSLA. The Court implied that the authority was vested with the Secretary of the Interior. The MMS established a team to look at the issues. In April 2004, we issued an advance notice of proposed rulemaking and received comments from many of you. After researching and reviewing all comments, we drafted a proposed rule. The next step is to move forward with formal DOI review and surnaming of the proposed rule. We hope to publish the proposed rule in July.



BREAK

## Coal Subcommittee Update

Bill Hartzler, Chair, provided an update on the Coal Subcommittee.

The Subcommittee has been effective in educating constituents. Sulfur credits are a big issue – more specifically the premium in quality adjustments. The Subcommittee and the new Subcommittee members reviewed prior issues which included non-arm's-length valuation issues, advanced royalty, deference to appeals, and the changes in the Energy Bill that may affect this issue.

The San Juan Coal Company gave a presentation on continuous high-wall mining, underground vs. surface mining, and the priority in BLM to make a decision. Royalty rates or tax rates differ depending on the type of mining for each of the agencies. The issue is currently cutting across a lot of agency lines. Different state offices in BLM and OSM have made different determinations as to whether it is considered surface mining or underground mining.

Tom Lonnie commented that the only office that has implied that CHWM is underground is the Farmington Field Office. Additionally, he stated that one mine in New Mexico is paying 8 percent and one mine in Wyoming is paying 12.5 percent under protest.

Bill Hartzler spoke about the presentation that Nola Freeman, MRM Records Officer, gave at their last meeting. At that time, Nola spoke concerning proposed changes to the MMS records retention schedule. The NARA has not approved some of the proposed revisions because of a mix of Federal and Indian records. One major change from the June 2002 proposal is a reduction in retention of non-Indian records from 20 years to 10 years.

There is a time delay on lease account status approvals which deals with the reassignment of leases. The reason this is a big deal for solid minerals is because we do not have a statute of limitations. We currently have a director who says it will be seven years; however, if a new director comes in, we could be operating again without a statute of limitations. We are requesting that MMS and BLM work together to correct the problem.

The Subcommittee has established a working group to help examine monthly sales summary information. The MMS would like to standardize these summaries in a way that will be supportive to the industry.

Discussion Followed:

- Bob Davidoff Spoke about the sales summary issue and how standardization of these summaries will help the compliance process, lessen the burden on industry by developing tools for them to tap into, and assist STRAC in their work by reducing the amount of sales summaries that industry will have to report. It will also put a lot of the data up front instead of having to wait for it.
- Bill Hartzler Discussed reengineering, companies agreed to submit their own information, monthly basis does not work, how does new reporting fit in with compliance strategy and with audit strategy
- Lucy Querques Denett Agreed with Bill that goal of compliance strategy was to be more efficient, goal was to better target our audits, agency needs to consider whether they want to change reporting requirements
- Aktar Zaman Next door neighbor to San Juan Coal, decision may impact Indian leases
- Tom Lonnie Decision on CHWM being given careful consideration, BLM aware of revenue impacts

Geothermal Valuation Subcommittee

Orme Lewis, Chair, gave a PowerPoint presentation update on the Geothermal Valuation Subcommittee.

The Assistant Secretary Watson's letter to us states that she wants to make royalty valuations more efficient and effective for the government, as well as ensuring that government receives fair market value; however, the goal is not to discourage geothermal development, including direct use on federal lands. It is a continuing endeavor we face. This is a resource generating \$11 million in royalties at this point. The Geyser Field, which is the world's largest geothermal production field, accounts for 61 percent of the royalties, flash plants account for 35 percent, and direct use binary account for 3.5 percent. Current MMS valuation methods are grouped by usage and disposition of the resources. Sales, valuations, and netback valuations have been reviewed. The Assistant Secretary's letter addressed the complexity of the netback valuation method. I would like you to review the report from the Subcommittee, and I ask that the recommendations in the report be considered so we can move forward with a recommendation for a rulemaking change. At that outset, the goal of our Subcommittee was to stay within the structure of the steam act through rulemaking rather than legislation.

Questions, Answers, and Discussion Followed:

- Aktar Zaman (Q) Is netback more complex and complicated?
- Theresa Walsh Bayani (A) Explained the netback process
- Johnnie Burton (Q) Asked Theresa Walsh Bayani to explain the difference between direct use today and subcommittee recommendations
- Theresa Walsh Bayani (A) Current: Arm's-Length Situations = gross proceeds under arm's-length contracts
- Non-Arm's-Length Situations = First applicable of the three benchmarks
- Proposed: New Lease: First five years = minimum royalty
- \$2/acre Existing Lease: Royalty Schedule Published. Measure at inlet of facility & not at the outlet. Schedule based on assumed outlet temperature. Value based on Powder River Basin (PRB) coal spot prices. Explained rationale.
- Johnnie Burton (Q) Are royalty rates the same all over the country and do the states have a severance tax in addition to the royalty rate?
- Theresa Walsh Bayani (A) Generally, most leases are 10 percent royalty rate with a few exceptions. Additional state taxes vary from state to state.
- Johnnie Burton (Q) Asked about rose grower and his support of subcommittee recommendations
- Johnnie Burton Subcommittee recommendations still complicated
- Aktar Zaman (Q) Why is PRB coal cheapest in country -- \$2/acre less than rental
- Theresa Walsh Bayani (A) We asked BLM to perform a study, and we reviewed the binary plant values across the country and compared the results of this binary plant study to the value of energy for direct use.

MOTION:

RPC to favorably forward report and recommendations of the Geothermal Subcommittee to, Director, MMS for action

Orme Lewis	Made Motion
Carla Wilson	Seconded Motion

Motion carried unanimously (16 in favor, 0 opposing, 0 abstaining)

Oil and Gas Valuation Subcommittee

Dan Riemer, Chair, gave an update on the Oil and Gas Valuation Subcommittee.

The Subcommittee has met three times since it was first formed. In the initial meeting, we spent time on the charter and ground rules. We met by teleconference the first two times and at our third meeting we met in person. There was great participation from the states, tribes, and industry. The preliminary focus so far has been the expanded use of published WTI differentials and the validity of published gas index prices. We need to determine the effectiveness of these index prices relative to actual market prices. We also discussed how to determine royalty value when arm's-length documentation does not exist. This is an issue brought forward by several of the states in dealing with their audits.

The August 2004 oil rule preserved the use of actual exchange differentials and only permitted use of published WTI differentials. Industry is having some concerns with the prior publishing of the final rule. The RIK program and MMS approved tendering programs have somewhat reduced the requirement to calculate actual exchange differentials and several companies have ventured forward pursuant to the rule. Proposed future valuation agreements with MMS which include the use of published WTI differentials, typically require a periodic review of the actual exchanges versus the published differentials.

I have made attempts to poll the industry, since things have changed since the rule was published. I sent out a survey two weeks ago. We are attempting to gather industry input on concerns with the applicability of WTI differentials. Our Subcommittee has an action item to develop a decision tree which shows the decisions a lessee goes through in order to determine whether WTI differentials and the government's index pricing applies. Hopefully, we can submit a report and a possible recommendation by Fall 2005.

The MMS sponsored a workshop in Houston to bring together some of the leading experts in gas markets to provide information helpful in answering the question, "Do the published natural gas price indices in the United States now have sufficient liquidity, transparency, and accuracy to truly represent the value of natural gas commodities in today's marketplace?" The MMS has received several comments from the states and industry; and as a result, there will be further review.

## Oil and Gas Royalty Reporting Subcommittee

Darrell Gingerich, Chair, gave an update on the Oil and Gas Royalty Reporting Subcommittee.

We have been holding our meetings by teleconference and it has been very effective. Ultimately, we may get together in person to work through details. We are currently working on the goal to reporting, and it is associated with the retroactive calculation on non-arm's-length processing and transportation cost allowances. Current regulations require industry to pay on an estimated basis on each property in a detailed level throughout the year. When the year is over, they then have to do an actual cost calculation or allowance and take the difference between the estimate and actual, and make an adjustment. The adjustment requires you to reverse the original estimate and plug in your new rate. So, in essence, you are adjusting each property every month for a total of 24 times to adjust the annual rate. With an established objective of the Subcommittee to remain revenue neutral, we looked at how we continue to do these adjustments. Option 1 is an industry proposal called a roll forward adjustment to the current year. This means after you calculate the difference, you would roll that into the current year rate. In order to keep the revenue neutral, we would need to compound interest into that; so you would need to calculate some additional figures into the adjustment. Option 2 is called the lump sum adjustment. This has the most support among Subcommittee members. In this option, instead of reversing the original estimate and plugging in a new rate, you would take the net adjustment for each property and report it for the previous year one time only.

Todd Druse, Vice Chair, gave a report on the feedback from STRAC.

Option 1 has been virtually eliminated from the state and tribal viewpoint due to the fact that it is very difficult to audit adjustments made for the year, other than the actual production year. Option 2 had very little negative feedback. The majority of comments dealt with interest that would be due to the state or tribe. On the tribal side, there are some major problems with calculations of major portion and dual accounting. John Barder, MMS, suggested that if this option were allowed, MMS would have to develop a way to allocate that adjustment to individual months to properly calculate the major portion or dual accounting.

Deborah Gibbs Tschudy gave an update on regulatory changes required by the options being considered. Based on our initial research and the effect on our regulations, Option 2 would require a rule change. At our next meeting, we are going to look more closely at the framework so we can figure out what provisions of the rule would have to be changed.

Questions, Answers, and Discussion Followed:

Bill Hartzler (Q)                      Would there be any impact to reporting for solid minerals once you resolve this?

Deborah Gibbs Tschudy (A) If there is a benefit to industry and MMS, it is something we can consider.

BREAK FOR LUNCH 12:00 P.M.

RECONVENE 1:15 P.M.

Ron Cattany, Chairman, RPC

Discussed oil shale activities as it relates to the Senate energy bill. Copies of the testimony of his Executive Director before the Senate Energy and Natural Resources Committee were provided for those interested.

#### MOTION

To accept minutes from the October 2004 RPC meeting with an amendment to add Perry to the list of attendees.

Dan Riemer	Made Motion
Thomas Shipp	Seconded Motion

Motion unanimously carried (16 in favor, 0 opposing, 0 abstaining)

#### Indian Oil Valuation Subcommittee

Thomas Shipp gave an overview of the Indian Oil Valuation Subcommittee.

Perry Shirley, our Chair, could not be here today. There is not much for us to do at the present time since the proposed oil rule that had been circulated was initially proposed about seven years prior to the formation of our Subcommittee, and subsequent to the formation of the Subcommittee, the proposed rule has been withdrawn.

The first issue we have deals with whether or not there is some substitute index or NYMEX price that could be used as a standard for determining value when there are not arm's length sales. No consensus was reached on this. Almost all sales of Indian oil are at arm's length. The second issue is computing allowable transportation costs with respect to non-arm's length Indian oil sales. We are asking whether MMS should apply a 1.3 times the Standard and Poor's BBB rate as the rate of return on undepreciated capital investment as reflected in the federal crude oil valuation rule, or should there be a higher or lower rate applied? There was no consensus on this issue.

The third issue concerns the sale of transportation facilities utilized with respect to non-arm's-length sales of Indian oil and how new owners of such facilities can reset depreciation at the new sales price in computing transportation allowance. We have no consensus on this issue. The fourth issue concerns whether MMS should revise the requirements for major portion analysis in the Indian Oil Valuation Rule so that reported values relate to a newly identified geographic area as set forth under the current rule. No consensus on this issue was reached.

The fifth issue is should a new Indian Oil Valuation Rule prescribe that, in conducting major portion analysis, the comparative price is the 75<sup>th</sup> percentile, as contained in the formerly proposed Indian Oil Valuation Rule, or the 50<sup>th</sup> percentile plus one of arrayed arm's-length prices, as contained in the current Indian Oil Valuation Rule? No consensus on this issue was reached. The sixth issue is should MMS collect information to use in major portion calculations to distinguish the quality and production location of the oil? There is consensus in the group that there is insufficient information reported to effectively perform major portion analysis or to sustain a challenge to a major portion analysis if one were completed.

#### Questions, Answers, and Discussion Followed:

- Theresa Walsh Bayani      In our analysis of the proposed rule, we are looking at the impacts of the oil major portion analysis and the economics as well. Additionally, we are looking at arm's-length prices in the major portion array and the results.
- Dan Reimer      The issue is that in the major portion analysis, only arm's-length transactions are used in that analysis. However, the major portion analysis is to be performed on every property and lease.
- Tom Shipps (Q)      Is this actually performed, and if so, at what frequency? I know there are some methodological difficulties to completing major portion. Do we actually see this as a viable tool for measurement?
- Theresa Walsh Bayani (A)      Current regulations require that we array only arm's-length prices. As of 2001, we are getting information on the Form MMS-2014 related to the sales for both arm's-length and non-arm's-length sales. Prior to that, we were not obtaining that type of information on the Form MMS 2014.
- Eddie Jacobs (Q)      Some of the older leases do not require major portion analysis. Why would there be a differentiation in pricing of \$3-4 for instance?
- Lucy Querques Denett (A)      Eddie, would you mind sharing the documents with Theresa so we can take a look at it? We will follow up on it.

**\*ACTION ITEM:**

Follow-up on question from Eddie Jacobs on pricing discrepancy (Theresa Walsh Bayani)

**BLM's Oil and Gas Program**

Tom Lonnie gave a PowerPoint presentation on BLM's Oil and Gas Program.

I will summarize what has happened between 1997 and 2000 and 2001 and 2004. Acres leased has been flat in terms of new leases and total acreage. The year 2004 showed a downturn in total leases and acreage onshore. There has been a 74 percent increase in permits approved during both of these periods. We currently have eight field offices onshore that handle about 80 percent of the oil and gas activity. We have a 17 percent increase in gas production, mostly with coal bed natural gas. Oil production has declined; however, we have had a major discovery around Richfield, Utah. Some other areas of activity are also picking up. There is about an 80 percent increase in royalty income, mostly due to price.

We are encountering a significant amount of protests on the sale of parcels. Most of these protests deal with the National Environment Protection Act (NEPA) and allegations that we are not complying with our planning rules and consultation requirements. Generally, we are going forward with the sale; however, most bids are tied up until we resolve the protest. This creates a problem with the requirement under the Mineral Leasing Act to issue a lease within 60 days of sale.

Currently, the total leases in effect are about 45,000 acres and total acreage is about 35 million. Approximately 7 million acres are in some form of production, whether it is actual or allocated. The decline in 2004 is attributed to leases still tied up in protest. At BLM, we do not lease Indian lands. The BIA leases Indian lands; however, we do handle operations.

We are improving processes in multiple well development and contract development. Industry pays for all the projects for Cultural Resource Service on both private surface and federal surface, or federal leases. Anytime you have to move a power line or setup of the location has to be adjusted, you have to do a cultural survey. We are trying to encourage block surveys so there are no delays. Another thing we have to consider is NEPA analysis and environmental assessments. Some of the problems we face are air quality, whether it is dust or oxidations from compressors which becomes a limiting factor in terms of activity. Clearing, venting and completion techniques are also a big issue.



Questions, Answers, and Discussion Followed:

- Eddie Jacobs (Q)                      What is your rate for a standard lease agreement for federal land?
- Tom Lonnie (A)                        It is 12 ½ percent. Some leases have sliding scales if you produce over a certain amount.
- Dan Riemer (Q)                        Since you have received a thousand more permits than you had last year at this time, are you approving them as they come in or do you have a backlog?
- Tom Lonnie (A)                        We have a backlog that we are dealing with. Three years ago, I never would have expected the activity we have right now.

Legislative Update

Anita Gonzales gave a Legislative Update.

The 108<sup>th</sup> Congress adjourned last December without passing a comprehensive Energy Bill. The 109<sup>th</sup> Congress has taken up the legislation.

The 108<sup>th</sup> Congress passed a conference report, HR-6, the Energy Policy Act of 2003. The Senate introduced a bill called Energy Light. Neither bill has been passed through legislation. The Methyl Tertiary-Butyl Ether (MBTE) is one of the biggest issues.

The 109<sup>th</sup> Congress convened January 4, 2005. They put energy legislation on the fast track and passed an Energy Bill on April 21 by a vote of 249 to 183. The House bill has 25 titles and about 1000 pages.

This is the fourth attempt Congress has taken to pass energy legislation. There are three Legislative proposals related to MMS that are both included in HR-6 and the Senate Committee draft. The first proposal is RIK. This provision gives the Secretary of the Interior permanent authority to use in-kind revenue to cover transportation and processing costs and is an annual appropriations process. The second proposal in the legislation is the Alaska offshore incentive for existing and nonexisting producing leases. This proposal expands the Secretary's current authority in the GOM to offer royalty relief to nonproducing leases in Alaska. The third proposal is alternative energy uses on the OCS. This provision amends the OCS Lands Act and gives DOI authority to act as the lead agency to facilitate a permitting process for alternative energy projects like wind, solar, and renewable energy. There are some marginal propositions on coal, geothermal.

The Administration strongly supports HR6 and wants it completed by the August recess. Senator Landrieu from Louisiana plans to offer an amendment on the floor which will allow states to comment and decide if they want to drill off their coastlines.

BREAK

Indian Energy Resource Development Office (IERDO)

Bob Middleton gave an update on the Indian Energy Resource Development Office.

On April 14, 2005, Secretary Norton signed a Secretarial Order forming this office, placing it under the Deputy Assistant Secretary for Policy Development. Additionally, it moved the Division of Energy and Mineral Resources in Denver, Colorado, underneath my office. There will be some offices that focus on economic development formed underneath my office as well. This will give us an opportunity to focus on energy development on Indian lands and remove some impediments to energy development in Indian country. Currently, Indian lands have 20 percent of the natural gas, oil, and coal that is being developed onshore in the United States.

We are taking the opportunity to bring more focus to the Indian Minerals Steering Committee and have renamed it the Indian Energy and Minerals Steering Committee to add focus to renewable energy resources on Indian lands as well.

We will be forming a partnership between BIA and Colorado School of Mines to reinvigorate the Native American Minerals Institute, which faded away in the 1990s. We will be setting up individual courses to provide educational benefit to tribal leaders and mineral specialists.

Questions, Answers, and Discussion Followed:

Eddie Jacobs (Q)                      How is taxation affecting individual Indian allottees?

Bob Middleton (A)                      I will research this and get back with you.

Aktar Zaman                              There should be participation from the tribes on the Steering Committee.

Bob Middleton                            You are right, and we are looking at a way to do that effectively. We are also looking at an initiative to work across Government to include DOE, HUD, USDA, Rural Services, Indian Health Services, etc.

Orme Lewis                                A single policy for Indians does not work – you must be flexible because of the different traditions and personalities of each tribe.

Tom Shipps                                I agree that tribes are incredibly distinct.

Public Remarks

None

Committee Roundtable

None

Proposed Date/Time and Location for Next Meetings:

November 8, 2005, 8:30 a.m., Denver, Colorado

MOTION

To Adjourn

Orme Lewis	Made Motion
Pary Shofner	Section Motion

Motion unanimously carried (16 in favor, 0 opposing, 0 abstaining)

The Meeting was adjourned at 4:05 p.m.