

**MINUTES OF THE
ROYALTY POLICY COMMITTEE MEETING**

May 10, 2007

Lakewood, Colorado

Proceedings

Welcome and Opening Remarks

The meeting of the Royalty Policy Committee (RPC) was held in Lakewood, Colorado, on May 10, 2007, and was called to order at 8:30 a.m. by the RPC Chairperson, Daniel Riemer. The meeting was held in accordance with the Federal Register Notice published on Tuesday April 24, 2007. The agenda for the meeting is attached. Introductions of attendees occurred after the remarks made by the Minerals Revenue Management (MRM) Associate Director.

Remarks of MMS Director Johnnie Burton

Ms. Burton began her presentation by stating that two new Deputy Assistant Secretaries were appointed to the Office of the Assistant Secretary for Land and Minerals Management (ASLM). Mr. Michael Olsen will serve as the Principal Deputy overseeing Minerals Management Service (MMS) issues. Mr. Foster Wade will serve ASLM by working primarily on strategic planning and management issues. Chris Oynes was selected as Associate Director of Offshore Minerals Management in February 2007. Ms. Burton announced that her retirement will be effective at the end of May. She briefly reflected on her 5 years as Bureau Director. She said she was privileged to serve as head of the Bureau and appreciated the professionalism of the MMS staff.

Ms. Burton outlined recent MMS accomplishments. In Fiscal Year (FY) 06, MMS collected and disbursed approximately \$12.8 billion dollars in mineral revenues. She said that the Bureau was doing a good job. She is proud of the results and thinks MMS is on the right path. She discussed that the Royalty in Kind (RIK) Program provides the Federal Government with the opportunity to have product available for strategic national needs such as filling the Strategic Petroleum Reserve (SPR). On July 1, 2007, the RIK Program will begin delivery of approximately 50,000 barrels of oil per day to the SPR until its current capacity is filled. She described the 5-year offshore leasing program that begins July 1, 2007, including the State of Virginia's request to be included in the program. She also said that a great deal of environmental work needs to be performed in Alaska before MMS could proceed with a sale. In the discussion that followed her presentation, Mr. Dan Riemer said that MMS has been criticized for use of an honor system for reporting. He reminded all that there are rules and penalties associated with false reporting.

Remarks of MRM Associate Director Lucy Querques Denett

Ms. Denett announced recent personnel changes within Minerals Revenue Management (MRM) including Deborah Gibbs Tschudy as Acting RIK Program Director and the selection of Paul Tyler as Manager of Indian Oil and Gas Compliance and Asset Management. She then stated that the MRM program-wide update to include Financial Management, Compliance and Asset Management, and Enforcement would be presented by the three responsible MRM managers. Ms. Denett presented information on MRM recent activities including completion of the assessment phase of the MRM Strategic Business Plans and outreach plans. The MRM Strategic Business Plans will chart the course and direction of MRM through 2012 to meet future program challenges and performance expectations. She also stated that the proposals submitted in response to the operations and support contract request for proposal were currently under review, and it is expected that the contract will be awarded this summer. She said that BLM and MMS published the final Geothermal Valuation and Leasing rules in the Federal Register on May 2, 2007. She discussed upcoming rulemakings including Reporting Amendments, a final rule for Indian Oil Valuation, and proposed rules for Advanced Coal Valuation and Debt Collection. Discussion followed regarding the cost benefit of audits. Ms. Denett stated that for every dollar spent on audits and compliance reviews, \$4 is recouped. Discussion ensued regarding the value of audits, their deterrent factor, and the fact that many of the major issues that previously triggered audits have been resolved. Mr. Riemer expounded on the

benefits of information-sharing, citing activities sponsored by the Rocky Mountain Mineral Law Foundation and Council of Petroleum Accountants Societies.

Royalty Management Subcommittee

The list of members for the Royalty Management Subcommittee was read by Mr. Riemer. The members included two former United States Senators—Mr. Bob Kerry (Nebraska), and Mr. Jake Garn (Utah). Both will serve as Co-Chairs, and Mr. David Deal will serve as Vice-Chair. Other members are Ms. Cynthia M. Lummis, Mr. Perry Shirley, Mr. Robert Wenzel, and Mr. Mario Reyes. Federal staff supporting the Royalty Management Subcommittee include Mr. Larry Finfer, Mr. Bob Anderson, Mr. Alan Rabinoff, Mr. Benjamin Simon, Ms. Alicia Kaiser, and Ms. Christian Crowley. David Deal reported on the Royalty Management Subcommittee activities to date. He stated that the Secretary and the Deputy Secretary diligently worked to get the appropriate people on the Subcommittee with balanced representation. Background information on MRM has been requested by the Federal staff supporting the Royalty Management Subcommittee. This information is being assembled and issues are being prioritized. A calendar of meeting dates is being prepared. The Subcommittee plans to report at the next RPC meeting tentatively scheduled for November. Mr. Deal emphasized that the report will be a prospective look and not investigative in nature. It will complement and supplement other reviews and reports being conducted. A discussion followed regarding subcommittee report submission procedures.

MRM Financial Management Program Overview

Mr. Bob Prael described the MRM Financial Management Program. Responsibilities of his office include reference data, royalty and production reporting, accounts receivable, billing and debt collection, distribution and disbursement, and general ledger. He outlined recent accomplishments of the MRM Financial Management Program. These included an unqualified audit opinion, successful implementation of OMB Circular A-123 requirements, reduction of error rates, and improvements in the timely disbursement rate. He stated that the Financial Management Program successfully implemented many provisions of the Energy Policy Act of 2005 including establishing direct distribution to counties, building an automated credit system, and developing accounting procedures for alternative energy.

He presented information about the Financial Management Business Plan. Areas of focus include 100 percent timely disbursement, lease rentals, system automation, lease account balance, interest an Indian over-recoupment modules, and communication and training. He also described the production reporting aspect of the MRM Resource Information Management Strategic Business Plan. A discussion followed on credits for orphaned and abandoned wells, Section 349 of the Energy Policy Act of 2005.

MRM Compliance and Audit Program Overview

Ms. Theresa Walsh Bayani presented an overview of the MRM Compliance and Audit Program. She cited Sections 202 and 205 of the Federal Oil and Gas Royalty Management Act (FOGRMA) authorizing MMS to contract with states and tribes to conduct audits of leases within their state or reservation. States and tribes are fully reimbursed for their costs. She stated that in FY 06, there were approximately 29,000 producing leases. Royalties paid for FY 06 were about \$12.8 billion. The Compliance and Asset Management (CAM) responsibilities include conducting audits, compliance reviews, and limited scope compliance reviews. CAM also provides valuation guidance, allowance approvals, state and tribal assistance, and updates regulations. She stated that the goal of CAM is to ensure reasonable compliance on an increasing percentage of revenues paid within 3 years of payment. CAM strategy focuses primarily on the largest producing properties with a more detailed strategy for Indian leases. Over the last year, MRM is developing a risk-based methodology which will be piloted to further develop and refine the identified risk factors to successfully scale the Federal and Indian compliance universe. This will complement MRM's current revenue goal.

She outlined recent CAM accomplishments. These include meeting the goal of assuring reasonable compliance on 72.5 percent of total offshore and onshore royalties paid for Calendar Year 2003, receipt of an unqualified opinion on the 2005 Peer Review, and collection of \$3.1 billion in additional royalties since 1982. Also in FY 2006, MMS resolved over 4,366 inquiries from Individual Indian Mineral Owners, and conducted 74 outreach sessions.

She described the Compliance Business Plan. The assessment phase completed in November 2006 focused on the following areas: compliance business processes; organization and human resources; information management and systems support; and performance measures and internal controls. The blueprint phase of the plan will focus on development of a risk-based strategy cost-benefit methodology for compliance. It will reengineer the compliance process to identify all properties or sources of revenue on which royalty are due, coordinate and expedite review of major companies, align and integrate MRM state and tribal processes and standards and resources, and develop comprehensive strategy for future compliance collection systems.

Ms. Bayani outlined the Indian Trust Business Plan. The objectives are: achieve most effective business model for delivery of Indian mineral revenue trust services in partnership with Bureau of Land Management, Bureau of Indian Affairs, and Office of the Special Trustee; provide trust management and mineral revenue services to Individual Indian Mineral Owners in a timely and effective manner; promote Indian tribal engagement in the royalty management process; and manage and protect Indian trust records. Focus areas include: assure effectiveness of current business processes; evaluate potential of processes to meet MRM strategic business goals and objectives; evaluate organization and human resources; assess adequacy of information management and systems support; address performance measures and internal controls; and examine reports and communication.

She concluded her presentation by presenting information about the 2006 Office of Inspector General (OIG) Audit Report on the compliance review process and the MRM Action Plan in response to the report.

Luncheon Presentation

The luncheon speaker was Mr. Frank Macchiarola from the Senate Energy and Natural Resources Committee. He presented an update about legislation of interest to MMS under consideration by the Senate Energy and Natural Resources Committee.

Office of Enforcement Overview

Mr. John Price began with a description of Alternative Dispute Resolution (ADR). The legislative foundation for ADR is the Alternative Dispute Resolution Act of 1990. MMS established its ADR program within the Office of Enforcement (OE) in 1992 (backlog at that time of 1,500 appeal cases). The Federal Oil and Gas Royalty Management Act, as amended in 1996, mandated at least one consultation in any appeal. ADR facilitates negotiations to resolve issues that are referred for settlement after demand by other MRM offices. The negotiation team consists of representatives from MMS, the affected state or tribe, and the Office of the Solicitor. They assess the risk of MMS positions and review precedents. This has proved to be a useful process for everyone involved.

Mr. Price presented an overview of enforcement operations. It consists of actions to compel current compliance with minerals revenue laws and regulations and deter future violations. Enforcement often begins when orders or verbal requests to make such corrections are not obeyed. Cases arise from employee referrals, outside allegation, or OE's own efforts. Violation types include reporting failures, unresolved variances, payment violations, information refusal, and false information. Pertinent statistics for Enforcement Operations include 334 cases opened since FY 2000, 287 cases closed, and 206 were

closed with compliance achieved. Penalties totaling approximately \$23.8 million have been collected since FY 2000.

Mr. Price described the litigation support function including providing the Department of Justice with responses to requests for production of documents, responding to answers to interrogatories, preparing privilege logs, coordinating bankruptcies and filing proofs of claim, referring MRM debt to the Department of the Treasury, and maintaining adequate surety instruments. He outlined the discovery process. FY 2007 workload includes 60 litigation cases, 1 filed bankruptcy proof of claim, 266 debts referred to Treasury, and 103 surety instruments for appeal issues.

Oil and Gas Valuation Subcommittee Update

Mr. Scott Miller presented a subcommittee status report regarding whether published gas index prices are a viable measure of value for Federal gas royalties not sold at arm's length. He provided a description of the sources of published gas index prices and stated that the confidence level with respect to transparency of the indices is high and that most markets have adequate liquidity. Mr. Miller stated that contracts are written utilizing index prices as the basis for valuation, but some subcommittee members felt that index prices cannot be used in isolation to value production at the lease and that other factors in the valuation equation should include transportation and processing adjustments. He discussed the differing viewpoints regarding the use of index valuation among industry, states, and tribes. Industry has long advocated the use of index valuation, but states and tribes do not support the use of the index-pricing methodology. One state has a concern about a zone-pricing approach with an index-pricing basis, as the gas within the state can flow to different markets with different demand structures. The prices do not move in tandem and vary widely from month to month. Another state believes that the arm's-length gross proceeds of the producer or its affiliate is preferable to index pricing, as there is too much of a disconnect between the Rocky Mountain index prices versus NYMEX that is not transportation related. The State of Louisiana proposed that when index pricing is used to value non-arm's length sales, that the index price should be no less than the high end of the averaged daily or month-forward pricing index range as published for each liquid market index point for volume flowing to each such index point from the producer/seller and affiliate. Industry is opposed to the use of the high-end range.

Mr. Miller discussed the recently published Federal Energy Regulatory Commission notice of proposed rulemaking to facilitate price transparency in natural gas markets. He stated that the information required to be reported will get MMS closer to constructing meaningful location differentials for federal gas production. Mr. Miller stated that currently the subcommittee cannot reach a consensus. He discussed the possibility of developing a rule on a regional basis. He asked that MMS provide information on non-arm's-length transactions versus arm's-length transactions to assist in defining the scope of the Federal gas valuation challenge.

Oil and Gas Royalty Reporting Subcommittee

Ms. Marvynette Ponder presented an update on the activities of the Royalty Reporting Subcommittee. The subcommittee met to discuss the priority of proposed projects. One proposed project is to review production reporting including timeliness and accuracy, data requirements, and streamlined reporting. Another project involves the review of rent reporting and payment alternatives, and outreach opportunities. An additional proposed project is to determine ways to close the gap in information processing time in data exchanged between BLM, MRM, and BIA. Areas of focus include Notices of 1st production, unit participating area and communitization agreement approval, well data, and terminable rents. Another proposed project involves reviewing Coalbed Methane reporting including the 2014, unbundling of rates, allowances, estimates of rates, and prior-period adjustments. Ms. Ponder stated that the subcommittee will meet in early June to finalize their priority list.

Coal Subcommittee Update

Mr. Ed Sullivan updated the RPC on the activities of the Coal Subcommittee. The Coal Subcommittee met once since the last RPC meeting. The meeting was well attended by representatives from the MMS, BLM, The Navajo Nation, states, and industry. At the meeting, BLM and MMS provided progress reports regarding the implementation of the Energy Policy Act of 2005. The BLM and MMS staffs anticipate that the Advanced Royalties for Coal Valuation proposed rule will be published by September 2007. The royalty rate applicable to continuous high-wall mining operations will be part of the proposed rule.

Mr. Sullivan discussed the Solid Minerals and Geothermal Compliance Asset Management (SM&G CAM) upgrade of their document imaging system to allow STRAC electronic access to valuation decisions, lease information, project files, sales contracts and sales summary information. The Coal Subcommittee views the completion of this project as critical to improving the MMS compliance and audit efforts, as it will result in the reduction of duplicate information requirements. The SM&G CAM provided the subcommittee with an overview of an effort that began in August 2006 to reduce the open receivables balance for solid minerals to comply with the Debt Collection Act. The cooperation between industry and SM&G CAM reduced the over 180-day open receivable balance from \$55 million to \$1.5 million in 3 months. Industry believes if they had the ability to access production and royalty data submitted through the BRIO portal, it would accelerate the process of researching open receivables and eliminate much of the current SM&G CAM time required to resolve open receivables balances.

The SM&G CAM provided the subcommittee with a briefing on the various compliance tools used to meet the MMS compliance program goals. The SM&G CAM also discussed several future enhancements to the SM&G Compliance Program to address concerns raised in the OIG Audit Report.

The Coal Subcommittee requested that SM&G CAM analyze the recently completed coal audits to identify the issues that resulted in the assessment of additional Federal royalties. Industry representatives on the Coal Subcommittee asked if there was any information available regarding adherence to Agency policy of the resolution of coal appeals within 33 months. A discussion followed regarding the importance of the coal regulations to The Navajo Nation and the need to consult with them before the regulations are finalized.

Indian Oil Valuation Subcommittee

Mr. Perry Shirley stated that the Indian Oil Valuation Subcommittee had not been active due to the situation with respect to the Indian Oil Valuation final rule. A discussion followed regarding the possibility of the subcommittee pursuing other issues of concern to them. The decision was made to not pursue other issues until the Indian Oil Valuation Rule is final.

Committee Roundtable

Possible agenda topics and potential dates and locations for the next RPC meeting were discussed. Recommended topics included United States refining capacity, national security issues related to the SPR, ASLM vision for energy production, Trans-Alaska pipeline, tar sands and oil shale update. Discussion followed regarding whether the time required at the next meeting for the status report of the Royalty Management Subcommittee would allow much time for other topics. The next meeting of the RPC is tentatively scheduled for Thursday November 8, 2007, in Denver, Colorado.

The meeting was adjourned at 3:55 p.m.

RPC Member Attendees

Andrew Bremner, Independent Petroleum Association of Mountain States
Bob Anderson, BLM
Bob Middleton, Office of the Assistant Secretary of Indian Affairs
Daniel Riemer, US Oil & Gas Association
David Deal, Public Representative
Harold Kemp, State of Wyoming
Edward Sullivan, National Mining Association
Joanna Prukop, State of New Mexico
Johnnie Burton, MMS
Patrick Lyons, Western States Land Commissioners Association
Lisa Crothers, Independent Petroleum Association of America
Lucy Querques Denett, MMS
Marcella Giles, Oklahoma Indian Land/Mineral Owners of Associated Nations
Marvinette Ponder, Council of Petroleum Accountants Societies
Orme Lewis, Public Representative
Laura Nelson, Western Governors' Association
Scott Miller, State of Louisiana
William Barger, Public Representative
William Johnson, Ute Mountain Ute Tribe
Akhtar Zaman, The Navajo Nation

Additional Attendees

MMS: Deborah Gibbs Tschudy, Donald Sant, Theresa Walsh Bayani, Richard Adamski, Robert Prael, Connie Bartram, John Price, Pam Rieger, Lonnie Kimball, John Hovanec, Paul Tyler, Robert Smith, Patrick Etchart, Nancy Messer, Jim Morris, Shirley Conway, Diane Dundee, Gina Dan, Lorraine Corona, and Peter Christnacht.

Other: Perry Shirley, Presenter; Frank Macchiarola, Presenter; Alan Rabinoff, BLM; Mary Ann O'Malley, BP; Pam Williams, Shell Oil Company; Ron Belak, GAO; William Hartzler, Foundation Coal Corp.; Glenn Fischer, GAO; and Amy Jimenez, Stacey Crouser, Pete Brand, and Tim Musil, OIG.

Meeting Documents

Documents presented or distributed at the RPC meeting included:

- MRM Financial Management Program Overview
- MRM Audit and Compliance Program Overview
- MRM Enforcement Program Overview
- Oil and Gas Valuation Subcommittee Status Report
- Oil and Gas Royalty Reporting Subcommittee Update
- Coal Subcommittee Report
- Department of Interior, Minerals Management Service, Geothermal Royalty Payments, Direct Use Fees, and Royalty Valuation; Final Rule
- Department of Interior, Bureau of Land Management, Geothermal Resource Leasing and Geothermal Resources Unit Agreement; Final Rule

I certify that the above minutes are an accurate caption of the May 10, 2007, Royalty Policy Committee proceedings. The minutes may be released to RPC members and made available for the public inspection.



Date 6/18/07

Daniel F. Riemer
Chairman, Royalty Policy Committee
Minerals Management Service

**Royalty Policy Committee
Agenda
Denver, Colorado
May 10, 2007**

Welcome and Opening Remarks	8:30 - 8:45	Dan Riemer
Director's Remarks	8:45 - 9:15	Johnnie Burton
MRM Associate Director's Remarks	9:15 - 9:45	Lucy Querques Denett
<i>Morning Break</i>	9:45 - 10:00	
Royalty Management Subcommittee Update	10:00 - 11:00	David Deal
MRM Financial Management Program Overview	11:00 - 11:30	Robert Prael
MRM Audit and Compliance Program Overview	11:30 - 12:00	Theresa Walsh Bayani
<i>Working Lunch - Legislative Update - Senate Energy & Natural Resources Committee</i>	12:00 - 1:30	Frank Macchiarola
MRM Enforcement Program Overview	1:30 - 2:00	John Price
Oil & Gas Valuation Subcommittee Update	2:00 - 2:20	Scott Miller Peter Christnacht
Oil & Gas Royalty Reporting Subcommittee Update	2:20 - 2:40	Marvinette Ponder Robert Prael
<i>Afternoon Break</i>	2:40 - 3:00	
Coal Subcommittee Update	3:00 - 3:15	Edward Sullivan John Hovanec
Indian Oil Valuation Subcommittee Update	3:15 - 3:30	Perry Shirley
Public Remarks	3:30 - 3:45	
Committee Roundtable	3:45 - 4:15	Committee
Schedule Next Meeting/Adjourn	4:15 - 4:30	Chairperson

Attachment