ROYALTY POLICY COMMITTEE MEETING MINUTES

November 8, 2005

DENVER, COLORADO

Attendees

Bob Anderson, Bureau of Land Management William Barger, Public Representative Ronald Cattany, Western Governors' Association Michael Coney, American Petroleum Institute David Darouse, State of Louisiana Todd Druse, Ute Mountain Ute Darrell Gingerich, Petroleum Accountants Society William Hartzler, National Mining Assoc. Harold Kemp, State of Wyoming Orme Lewis, Public Representative Bob Middleton, Bureau of Indian Affairs Gary Paulson, Natural Gas Supply Association Daniel Riemer, U.S. Oil & Gas Assoc. Tom Shipps, Southern Ute Indian Tribe Pary Shofner, Western St. Land Comm. Assoc. Marvin Stewart, Crow Nation Carla Wilson, Independent Petroleum Assoc. Mtn. St. Akhtar Zaman, The Navajo Nation Francis Hodsoll, MMS/DC Lucy Querques Denett, MMS/DC Howard Chalker, MMS/DC Cathy Hamilton, MMS/DC Connie Bartram, MRM/SIO Theresa Walsh Bayani, MRM/INDCAM Pam Williams, Shell Oil Company Lora Mustoe, Kerr McGee Freddie Watson, Exxon Mobil - COPAS Ellwood Soderlind, State of Wyoming Perry Shirley, Navajo Nation	Donald Sant, MRM/AD Staff Greg Smith, MRM/RIK Philip Sykora, MRM/CAM Mary Williams, MRM/FEDCAM Nancy Messer, MRM/FEDCAM David Guzy, MRM - Indian Patrick Etchart, MMS John Hovanec, MRM Brian E. McGee, Jackson Kelly PLLC John Barder, MRM/CAM (San Juan Basin Region) Gina Dan, MMS/DAD Robert Davidoff, MMS/FEDCAM Deborah Gibbs Tschudy, MRM/DAD Robert Prael, MRM/FM Pam Rieger, MRM/RIK Roman Geissel, MRM Mary Ann O'Malley, BP John Harros, SOL/DOL Peter Schaumberg, DOI, SOL John Harpole, Mercater Energy Skip Arnold, Energy Outreach Colorado E.L. Sullivan, Peabody Greg Sopkin, Colorado PUC Kevin Murphy, Exxon Mobil Corp

Proceedings

The meeting convened at 8:30 a.m.

Welcome and Opening Remarks
The RPC Chairperson, Ron Cattany, provided opening remarks followed by introductions. He recognized that all the subcommittees had met during the last 5 months. He thanked the chairs of the subcommittees for their work. Mr. Cattany stated that it was important to ensure subcommittees, as needed, have BLM representation and that subcommittees are authorized to continue. A motion was made and approved to accept the minutes from the May 26, 2005, meeting.

Remarks by MRM Deputy Director Francis Hodsoll
Mr. Hodsoll began by stating that the Director sent her regards and regretted not being able to attend. She is very grateful for all the direction and support that this group and the subcommittees have provided. Clearly, MMS and the taxpayers benefited. Mr. Hodsoll joined the Director in thanking the subcommittees for all their hard work. The major topics of his remarks were the impact of the hurricanes on outer continental shelf (OCS) production, the Five Year Leasing Plan, and the offshore provisions in the Energy Policy Act. He discussed the provision in the Energy Policy Act that provides the Secretary with the authority to grant preference for the purpose of providing additional resources to low-income energy assistance programs. He said that the Department does not now have an answer as to what this statutory language allows; however, the Department is concerned about price increases, understands the

situation, and is working through the legal ramifications of the statutory language.
Regarding the effect of the hurricane on OCS production, he began by talking about the human suffering and emphasizing the impact of the hurricane on our colleagues from the New Orleans Office. Many lost their homes, and some temporarily relocated to Houston. He said it is important to recognize that there are many public servants who are very dedicated to their jobs. Next, he provided information about the impacts of the hurricanes on OCS production. Prior to the hurricanes, the Gulf of Mexico produced approximately 1.5 million barrels of oil per day, and 10 billion cubic feet of natural gas per day. These vital assets represent 27 percent of the oil and 20 percent of the natural gas produced in the United States. As of November 7, 2005, about 52 percent of the oil and 45 percent of the natural gas was shut in.

Among the 4,000 platforms in the Gulf of Mexico, 2,900 were in the path of the hurricanes. At times, there were gusts of 200 miles per hour, and the safety records are quite remarkable. There were 113 platforms and two drilling rigs that were destroyed. There was extensive damage to 52 platforms and 14 drilling rigs. Only one platform was destroyed that was built based on the 1988 standards. While the destruction was tremendous, these numbers need to be taken in context. Many of the destroyed platforms were small producing, older ones; and our best estimate as of about a month ago is that in the worst case, one to two percent of the oil and gas is lost, but will be replaced quickly as new facilities come on line.

In regard to the onshore and offshore recovery efforts, there is not enough equipment and trained crews to handle the massive repair operations in the United States. The Jones Act prohibits foreign crews or equipment from doing this work, and the fluctuating demand for labor in the oil business makes it difficult to attract and retain trained staff (Shadow Effect). The Department of Energy is tracking the major processing plants, and 4.6 bcf of flow pre-hurricane is shut-in because of damage to the processing plants. The average capacity utilization of the processing plants pre-hurricane was 63 percent, so there was a lot of spare capacity. If industry can find ways to reroute the gas, they have the capacity to process it.

Mr. Hodsoll continued by discussing the role of MMS. The MMS has been working closely with industry and has approved dozens of pipeline repairs and construction requests. In rare cases, limited flaring was approved to allow the oil to move. The MMS is aware that industry needs to get this infrastructure back up and running, but MMS must ensure that they do this in a safe and environmentally responsible way. No rules will be relaxed that involve safety and the environment. Mr. Hodsoll discussed EIA predictions of large increases for heating expenditures—60 percent in the Midwest and a 34 percent increase in the West. In the South, electricity used for heating is expected to increase by 9 percent. Commodity price increases will impact Americans across the board. The bottom line for our workers and for our national competitive position is more troubling in the long term. Increasing prices have caused chemical plants to close and move overseas. Chemical plants are opening in Germany because they have access to cheap gas and a trained workforce. Chemical plants are also opening in China and India. In addition to importing oil and gas, we will be importing other chemical products such as ammonia.

He outlined lessons learned from the hurricanes. The majority of the facilities were subjected to hurricane force winds and waves, and not a single life was lost. Every subsurface safety valve in the OCS worked the way it was supposed to work. There was no uncontrolled release of oil which is a significant tribute to the technology and expertise of the industry, the people in this room, and MMS folks in New Orleans. The industry has fundamentally improved its safety record over the last 30 years. He emphasized that a steady flow of energy from secure sources is a national strategic priority. President Bush recognized early in his Administration that we need to diversify supply, increase domestic energy production while conserving energy and increasing efficiency. In addition to offshore opportunities, there are five geologic basins in the Rocky Mountains that contain the second largest resource of natural gas in the country, after the Outer Continental Shelf. There is an estimated 139 trillion cubic feet of natural gas, or enough to heat 55 million homes, for almost 30 years. There are significant resources in Alaska as well. At a price per barrel of about $55, about 90 percent is economically recoverable. The National Petroleum Reserve in Alaska contains an estimated 10.6 billion barrels, and 61.4 trillion cubic feet of undiscovered resource.

He then explained the development of the 5-year leasing plan in the OCS for 2007 to 2012. The OCS Lands Act grants authority to MMS to govern this process. Some of the relevant issues that MMS addresses in the 5-year plan include: the geographical, geological, and ecological characteristics; equitable sharing of developmental benefits and environmental risks among the various regions; locations with respect to other current and anticipated uses of the sea and seabed; expressed industry interest; and the laws, goals, and policies of affected states. The MMS is also governed by the Coastal Zone Management Act which requires that the Secretary obtain a balance among potential for unknown damage, the discovery of oil and gas, and the adverse impacts on the Coastal Zone. The MMS recently closed the first comment period on the 5-year leasing plan. The MMS has received slightly less than 9,000 comments for opening additional areas of the OCS, and slightly less than 2,300 against.

Next Mr. Hodsoll explained the two new programmatic elements of the Energy Policy Act that relate to Offshore Minerals Management. EPAC gives MMS additional authority to grant access rights on the OCS for the development of renewable energy, and to allow for alternate uses of existing OCS facilities such as heliports and medical facilities. The MMS was granted this authority because it is best positioned to regulate the offshore and assess the balance that is required between these types of projects and the more traditional energy resources.

Coastal impact assistance is the second major programmatic element. Congress has provided $250 million per year over four years for coastal impact assistance to Alaska, California, Texas, Louisiana, Alabama and Mississippi. The states will submit plans for MMS approval based on the criteria provided by Congress. It is likely that this will be a grant program. He then presented the allocation methodology. The formula allocates funds to the states based on how much production is off their shores and how close the production is relative to the distance to neighboring states. In addition, 35 percent of the allocated amount to the state is to be distributed to the coastal political subdivisions based on population, length of coastline, and distance to production. Key issues for MMS to address include how much oversight should MMS perform, what oversight responsibilities the states will have, how do we utilize the state single audit provision for Federal funds; and how to fund our administrative costs. Mr. Hodsoll closed by summarizing the main points of his presentation. Questions, answers, and discussion followed.

Mr. John Harpole: Introduced Greg Sopkin, Chairman of the Colorado Public Utilities Commission .
Mr. Greg Sopkin: Described the impact of high energy prices on low income consumers. He stated that he was interested in the subject of royalty-in-kind as potentially benefiting low income consumers for some time and that John Harpole has been spearheading that project. He discussed the hearing of the Colorado Public Utilities Commission regarding natural gas prices which was held on November 7, 2005. Colorado customers are facing a 35 to 50-percent increase in heating costs this winter, and the level of funding from Energy Outreach Colorado is flat or declining -- leaving a need of $21 million for this year. Mr. Sopkin said the time for federal assistance is now; and if there is anyway to make that happen, he would appreciate it.
Mr. Hodsoll: Stated that the Department had not yet developed a position on how to proceed with the use of RIK revenues to assist low-income energy consumers.
Mr. Cattany: Urged Colorado folks to keep the Governor's Office in the loop about this.
Mr. John Harpole: Stated that we have had 450 bcf of gas shut-in since August 28th in the country. And, if you extrapolate the next 150 days and say there is 2 to 4 bcf of gas shut-in, we are looking at nearly a trillion cubic feet of gas that will be shut-in before March 31. He said that, based on demand construction and gas that is shut-in, we will exit the winter on March 31 with the lowest volume in storage on record. The lowest volume in the past was 600 bcf. There is some calculations that in the Northeast by the end of the winter there could be zero in storage. This is not a short-term problem. He predicted that gas cost adjustments will be made nearly on a monthly basis in January, February, and March.
Mr. Hodsoll: Said there are legal and policy issues here, and he encouraged him to stay engaged so people have their voices heard on this issue.

Associate Director's Remarks:
Ms. Lucy Querques Denett's presentation was specific to royalty issues. She provided an update on what MRM has accomplished since the Committee met last May in New Orleans. She discussed recent personnel actions. Bob Prael is the new MRM Chief of Financial Management. Ken Vogel has retired as Chief of the Office of Enforcement, and MRM is in the process of filling that vacancy. The MRM received final approval for its reorganization proposal and now has one Compliance Office. Phil Sykora is the Program Director for Compliance and Asset Management. Greg Smith is Program Director for Royalty in Kind (RIK), and RIK has moved from a pilot program to actual operations.

She distributed a handout that displayed disbursements by recipients and briefly discussed the disbursements. Other accomplishments she described included meeting the President's directive to fill the SPR to the 700 million barrel level. She provided information on the MRM study recently completed that demonstrated that RIK was more efficient than RIV, but left the details of the study for Greg Smith to present later. She informed the Committee that the RIK Program was taken off budget as the funding now comes from the revenue stream derived by the RIK Program. She outlined the accomplishments of the Financial and Compliance Programs as well. She stated that MRM has been told that it will receive a clean financial opinion with no material weaknesses for FY05. This is impressive considering that the audit standards are tighter every year. She also said that the error rate has decreased this year from 3.4 percent to 3 percent. On the compliance side, she discussed that MRM has now completed their 39 action items on the Compliance and Audit Quality Improvement Plan; the report has been sent to the IG. The MRM also received an unqualified opinion on its Audit Peer Review. She thanked the state and Tribal auditors for their contributions in the preparation of the new Audit Manual that is in compliance with GAO standards and stated that MRM has drafted a Compliance Review Manual.

Ms. Denett then distributed a handout that summarized the MRM Strategic Business Planning Initiative. The objective of the Initiative was to meet future challenges through strategic planning that emphasizes continuous improvement with integrity and strong internal controls. The expected outcome is to issue an MRM program-wide strategic business plan and a business plan for each of its mission areas including: asset management, financial management, compliance, Indian Trust, and information and resource management that will support and align with DOI and MMS Strategic Plans. Work of the RPC subcommittees will be incorporated into the plan. The State and Tribal Royalty Audit Committee has reviewed the plan, and their comments have been incorporated as appropriate. Once the business plan overview is issued in December, we will begin developing an external outreach and communication plan. She pledged to keep the RPC informed. She said that the MRM Deputy Director, Francis Hodsoll, has been very active in reviewing the MRM plan and associated activities.

Next, she discussed a potential Emergency Rule providing Royalty Reporting Relief for companies impacted by the hurricane. The rule allows that if payments can not be made due to hurricane impact, MRM would give companies until the end of the calendar year to make payments. However, amazingly enough, most of the companies -- if not all -- made their payments at the end of September, thus allowing MRM to make its disbursements. She then discussed consultations and visits she held on the Indian Oil Valuation Rule. Currently, the rule has gone through the Assistant Secretary's Office and is now with the Department for signoff. Within two weeks, MRM should have clearance, and it will go to OMB; they usually reply with questions or request briefings. Theresa Bayani will be sending out the version that is going to OMB to the tribes so that they have an advance view of the document. She also stated that there will be a Geothermal Valuation Rule and that there are a number of other rules in various stages including: Debt Collection/Privacy Act, Service of Official Correspondence, and Takes versus Entitlements Reporting. The MRM still plans on a rule for Sodium and Potassium Valuation, Prepayment of Royalty Marginal Properties, and Late and Overpayment Interest.

Ms. Denett continued by discussing the Energy Policy Act, and the new authorities it provided. She remarked that through the Director and Deputy Director's efforts, funding has been redirected to allow MRM to begin its tasks associated with the Act. She concluded her remarks by encouraging interaction between MRM senior management and RPC members.
Mr. Hodsoll: Commended Lucy and her team for their leadership regarding strategic planning. He said that MRM is in a great position to take a fundamental look at how they do business now and in the future.
Brian McGee: Asked if Ms. Denett could comment on Johnnie Burton's new assignment as acting Assistant Secretary and whether it is intended to be permanent?
Ms. Querques Denett: Stated that they cannot answer whether it is going to be permanent. Rebecca Watson resigned and will work with Hogan and Hartsell in Denver. Johnnie continues to serve as MMS Director. Johnnie indicated that the Secretary and the Secretary's Office believe that MMS was an extremely well run bureau. They had a lot of confidence in the MRM Deputies and the management team, so that they felt that she could do both jobs.
Mr. Hodsoll: Stated that Johnnie is looking to Walter Cruickshank, Deputy Director, and himself to manage the

day-to-day activities of MMS.
Mr. Zaman: *(from the Navajo Nation*) Asked if disbursement information could be separated.
Ms. Denett: Discussed FOIA and Privacy Act concerns related to the release of the information. She said we would be pleased to review that because it would be easier for MMS if we could just list the tribes.
Mr. Zaman: Asked if RIK information is included.
Ms. Denett: Said yes.
Mr. Zaman: Expressed frustration over the amount of time that it has taken to issue the Indian Oil Valuation Rule.
Ms: Denett: Told Mr. Zaman that she understands his frustration. Nonetheless, at this point, MRM was moving forward with the proposed rule, will see what the comments are, and will make a decision on how to proceed.
Mr. Zaman: Stated that the issue is that after those rules are published and finalized, there will be an appeal.
Ms. Denett: Questioned who would appeal?
Mr. Zaman: Replied: we will appeal.
Ms. Denett: Said she does not really have a good answer but appreciated his honesty and frankness -- and knew she can always count on that. She understands why the tribes are frustrated. The rule will go to OMB in the next week or two. The tribes will be getting an advance copy of this rule, and then it will be published. She told Mr. Zaman that they will have an opportunity to comment, if they so choose.
Mr. Zaman: Stated we will try.

COAL SUBCOMMITTEE

Mr. Cattany Introduced Bill Hartzler and Bob Davidoff to report on the Coal Subcommittee.

Mr. Hartzler said the Coal Subcommittee meeting on October 19 was well attended. He discussed that Miles Weigel of Petroleum Argus made a presentation on spot pricing related to advanced royalties for coal. He predicted that there are still a couple of mines that may be impacted by advance royalties, and Argus has used some gas and oil indexing in their pricing. Mr. Hartzler said that Mr. Weigel's presentation was valuable to MMS staff and that it helped states and tribes that attended to understand that coal pricing is not quite as transparent as, say, gas and oil pricing . In coal, you have a price, and then there are other factors that affect the real price, which creates all of the advance royalty issues we have right now.

Mr. Hartzler summarized a PowerPoint presentation given by John Hovanec of MMS on the imaging process that Solid Minerals is now utilizing. The majority of the coal contracts that they have received have been scanned and can be looked up on line. Their plan for 2006 is to upgrade the system so that the various states and tribes will be able to access the information to help streamline the process. The critical issue that MMS must address in 2006 is building the firewalls within the system to provide security. He explained that this new system will result in reduced workload for industry and MMS.

He discussed the update the Coal Subcommittee had from the BLM at the meeting, regarding the issues that are likely to impact the coal industry and MMS. The final rule that was published October 7 contains cost recovery fees that will be charged for several mineral extraction activities, and for requests for advance royalties. The BLM also advised them that there were many provisions in the Energy Act that were going to require action by BLM to implement, and several of those involved MMS in a coordination process. They had already issued their interim guidance on the increases to the acreage limitations and were working on the interim guidance for the deferred lease bonus payment bonding issue and advance royalties. They were hopeful that those would be published by the end of October; but as of November 7, 2005, they had not yet been published. The BLM also told them that a final decision regarding the royalty rate that would be applicable to the continuous highwall mining operations was near. It will only impact two or three companies and three states at the present time. The BLM also gave an informative presentation detailing the process for requesting a royalty rate reduction and the operational issues that are given consideration in the processing of that application.

The question was raised about making some changes to the Sales Summary – an issue that was raised in New Orleans. The Subcommittee was informed that this initiative has been placed lower on the MMS priority list. Industry supports providing the monthly sales summary information over a larger block of time. Mr. Hartzler discussed how the MMS compliance review process and the overlapping audits created duplicate efforts on industry to provide documents. The MMS purpose in collecting monthly sales information was to enable them to meet their three-year initial compliance review stretch goals and then to be able to target issues for audit. He discussed that some in industry think that there has been a lack of coordination between MMS and STRAC on the audits. Bob Davidoff stated one of the goals in the upcoming year is to further dovetail the compliance process into the audits conducted by MMS. He plans to send the work plans for the compliance reviews that the MMS is going to be conducting to the appropriate states to enlist their assistance in this coordination. During the discussion, the representatives from Utah and Wyoming both agreed that they would try to coordinate more with MMS with the audits regarding the compliance reviews and to try to eliminate as much duplication as possible. The next Coal Subcommittee meeting is scheduled for January 24, 2006.

Mr. Davidoff: Thanked Mr. Hartzler and the members of the subcommittee for their work.
Mr. Hartzler: Thanked MMS, the states, the tribes, and BLM for meeting on a regular basis to discuss issues of mutual concern. He stated that industry is not against government doing its job; we just want to do it without an extra undue burden. They appreciate the opportunity to offer their views as decisions are being made.
Mr. Cattany: Thanked Bill and Bob and asked if there were any questions for the Coal Subcommittee.
Ms. Denett: Thanked Mr. Hartzler for bringing their concerns to her attention and stated that MMS is working to streamline the process.
Mr. Hartzler: Stated that the states and tribes want to make it a better process for everyone and hopefully the Coal Subcommittee will continue to be a positive sounding board for the Solid Minerals Group and senior management at MMS.
Mr. Cattany: Stated that he thought that for the newer members to the RPC, the Coal Subcommittee has been a forum not only to address issues, but for ongoing communication. In talking with Bill, he knew at the Colorado level they have had a lot of retirements, as a lot of other organizations have, but he wanted to make sure they continue to have someone from the State of Colorado attend the Coal Subcommittee and would certainly encourage any of the other standing subcommittees that need state input to make sure that we are getting the right folks from the states to properly address those issues as well. Within the Department of the Interior and the Minerals Management Service you have both the Royalty Policy Committee and STRAC. Those entities do not always parallel each other in terms of the issues that they look at or, quite frankly, their recommendations. So the extent to which people can be involved, both for consistency as well as information, he thinks it was a very useful thing.
Mr. Zaman: Asked Ms. Denett if electronically transferring documents to MMS required any regulation change.
Ms. Querques Denett: Conferred with Mr. Davidoff, and they both agreed that a regulation change would not be required although some system adjustments would likely have to occur. She again emphasized the importance of security, privacy, and the need for firewalls.
Mr. Cattany: Asked what will be on the agenda for the Coal Subcommittee for 2006.
Mr. Hartzler: Responded the Subcommittee will focus on the conversion to the imaging process, the access of STRAC to the system, and updates on the compliance review process. Other concerns include advanced royalty rules and information concerning BLM interim guidance on the Energy Act.

Mr. Hartzler made a motion to continue with the Coal Subcommittee and a second was made. The motion was voted and carried.

Mr. Cattany was informed that the Subcommittee had all the BLM representation that it needed.

OIL AND GAS VALUATION SUBCOMMITTEE
Mr. Cattany introduced Dan Riemer, Subcommittee Chair, who gave an update on the Oil and Gas Valuation Subcommittee. He said they had several meetings in the past year and also since the RPC met in May. They had very good attendance from the states, tribes, industry, and MMS, and have made a lot of good progress. The primary focus has not changed from when they first established their charter. He talked about the use of NYMEX and the published WTI differentials in the Oil Valuation Rule. Another item he discussed was the validity of gas index prices and exploring whether there was an index price methodology that could work for the Federal Gas Rule. The third item had to do with determining royalty value when arm's-length documentation does not exist.

Regarding the use of NYMEX and published WTI differentials, the Associations were polled and asked the following questions: Are you having problems complying with the 2004 Oil Valuation Rule? If you are, what kind of problems are you encountering? If you had the ability to use NYMEX or WTI differentials as an alternative to your actual exchange differentials, would you?

The next step was to review what the rule actually said and determine the decision process the lessees have to go through in order to decide whether they can or cannot use NYMEX and differentials, when they have to use actuals, or when they have to use a combination. After the survey and talking with industry, it was found that between the RIK Program and the use of future valuation agreements, they had somewhat reduced the requirement to calculate actual exchange differentials. He made a further point about the future valuation agreements that they may, and typically do, include the use of published WTI differentials; and they typically require a true-up or an annual review of actual exchanges versus those published differentials to ensure a revenue neutrality.

He then asked meeting attendees to refer to a consensus report that he distributed. He read the following report aloud to attendees. "During the 2004 Federal Oil Valuation rulemaking process, MMS sought comments on allowing the use of NYMEX to value oil sold at arm's length in multiple sales downstream of the lease where the lessee does not first transfer to an affiliate and where 'tracing' the production from the lease or unit to the specific sale is burdensome. MMS received positive comments from industry concerning the option to use an index-based value when a producer has numerous arm's-length sales downstream of the lease, and MMS acknowledged that allowing producers to use NYMEX prices for these transactions might alleviate some administrative burden. However, MMS reiterated its long-standing position that royalty payments should be based on actual sale prices whenever possible, and stated that under the existing regulations, producers have the option of petitioning MMS for alternative valuation procedures if they believe the administrative burden of tracing sales is excessive. The MMS further stated that it had received requests for alternative valuation approvals to alleviate the tracing burden and was in the process of finalizing the requests. Based on these facts, MMS believed the existing regulations were working and did not need to be modified."

"Concerning adjustments for the differences in location and quality between the market center and Cushing, MMS proposed to use actual arm's-length exchange agreements, which are the market's valuation of the difference. When lessees do not actually exchange oil to Cushing at arm's length, MMS proposed to allow the use of published differentials between the market center and Cushing, but MMS does not believe that it would be best to allow lessees to use WTI differentials in lieu of calculating their own location and quality differentials when they have significant arm's-length exchanges. If arm's-length data is available, MMS believes actual data is preferable to using a published differential and more accurately represents the actual value of the lessee's oil."

Third paragraph: "The Oil and Gas Valuation Subcommittee solicited comments from lessees about their ability to comply with the existing regulations. Responses varied from 'extremely difficult' to 'not a problem', and items like system changes, alternative valuation procedures, and the Federal RIK Program were cited as factors which enabled compliance. The option of petitioning MMS for an alternative valuation procedure has proven to be an effective means of mitigating the tracing burden, but annual reviews to confirm revenue neutrality require administrative effort on the part of lessees and MMS auditors. The cost/benefit of expanding the use of NYMEX and WTI differentials per MMS approved publications as an alternative to actual exchange differentials should be revisited during the next rulemaking process."

He was pleased to say that he agreed with what MMS said during the rulemaking process, "We think the 2000 rule is working, basically, the way it was written." He stated that industry was concerned about the timeliness of responses, but MMS compliance staff have done a super job of working through these agreements. At some time next year, the Subcommittee will issue a final report on what was presented today.

He then discussed the Subcommittee's second charge--gas valuation. The first task is to compile a list of issues/concerns with the gas indices. Another item was to review the Indian Gas Rule; specifically the index zone method. The next step will be to compile issues and concerns that the states/industry have, start looking at some index methodology, and developing recommendations. He stated that the work of the Subcommittee needs to continue next year.

Mr. Riemer made a motion to continue with the Oil and Gas Valuation Subcommittee, and a second was made. The motion was voted on and the motion carried.

Mr. Riemer's last item had to do with how to determine royalty value when arm's-length documentation does not exist. He stated that MMS is working directly with the individual from the state that posed this question trying to reach a consensus; and at the next meeting, they will report back to the Subcommittee. Ms. Mary Williams and Mr. Dan Riemer requested that the Director be informed that the consensus is that the oil rule is working.

Mr. Cattany asked about BLM representation on the Committee, and it was agreed that none was needed. Mr. Riemer said it would be helpful to have gas marketers on their Subcommittee. Mr. Cattany advised that there are no restrictions on committee members, and actually non-RPC members can be on the subcommittees. When there is either technical expertise or other issues out there that are not encompassed by the membership of this group, they are encouraged to have others participate. Mr. Cattany thanked the subcommittee for a job well done.

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OIL AND GAS REPORTING SUBCOMMITTEE

Mr. Cattany introduced Mr. Darrell Gingerich, Chair of the Oil and Reporting Subcommittee, and asked him to make a presentation. Mr. Gingerich stated that the scope and objectives of the Oil and Gas Royalty Reporting Subcommittee were to explore opportunities to streamline royalty reporting. The primary focus was to determine how to streamline the royalty reporting of the retroactive calculation on non-arm's-length processing and transportation cost allowances. The Subcommittee held six effective meetings via teleconference.

He discussed the current method which is called "back out and replace." That means that in 2005 we are paying royalty payments and reporting on estimated costs, and we will continue to do that until about March 2006. Then industry will calculate an actual rate based on a cost methodology allowed on plants and facilities that are non-arm's length. Once that new rate is established, they are required to back out all of the original entries, use the new rate, and put them all back in at a monthly basis, per month, and per property. This method impacts payments and may result in interest or a refund. He presented an example to demonstrate this.

Mr. Gingerich stated that the Subcommittee reviewed four options:

- Option 1 was termed a roll forward. This means you calculate the difference between the estimate and actual; it is a relatively small difference and would be rolled into the future rate. In March 2006, the delta difference would be included in the new rate for 2006 and that would be used in the future. This option eliminates any adjustments including retroactive adjustments.
- Option 2 takes the difference between the estimate and the actual; in March 2006 when it is calculated, you take the difference, whether a payment or refund, and collapse all 12 months into one month and make one net entry for each property. Option 2 would result in a savings of about 90 percent of the total lines required for the back-out and the replacement.
- Option 3 was to take last year's rate—once it is calculated in March 2006--and use that rate and replace it for all the rest of 2006 and for the first 3 months or so of 2007. That rate is rolled forward into the future. Option 3 requires no adjustments.
- Option 4 is a modification of the current method. You take a net adjustment for each month, and only report the net adjustment.

The MMS assisted the Subcommittee to compile the impact and to maintain confidentiality. Six companies volunteered to submit their information. The allowances made up about 43 percent of the total Form MMS-2014 lines, a significant amount. The allowances permitted are payments and refunds, or about 5 percent of the total royalty payment due. He stated that the Subcommittee goal was to reach consensus and that the Industry recommendation is to use Option 3 as the first option, with Option 1 selected as the first alternative. He stated that industry does not believe that Options 2 and 4 will benefit them and also questioned whether it would benefit MMS. The benefits of Options 1 and 3 are the reduction of administrative effort in the number of lines to report which he believes would help industry and MMS and would simplify cost allocation. They thought that Options 1 and 3 would provide revenue neutrality as you allocate cost over time.

Ms. Tschudy: Stated that the actual allowance cost calculation is based on the undepreciated capital and as the asset--the pipeline or the processing plant--is depreciated, the allowance should be going down over time. She then asked Fred Watson from Exxon Mobil to comment.

Mr. Watson: Stated that the case studies that were done reflected that while production is not all going straight down, there's enough decline in production that when you are calculating these cost rates, it offsets this decline in the

cost dollars. And, thus, the cost rates themselves may be escalating slightly. And if that occurs, Options 1 and 3 would result in slightly incremental payments to the MMS or the Federal Government.
Mr. Hodsoll: Commenting on Option 3, he stated that he is a believer in having the right incentives in regulation, and this brings up this allowance adjustment, one quarter of one percent, issue. It was not surprising to him that as long as there is no bias, and nobody is trying to game the system. He stated that over a large number of payments it should balance out; you are just looking at the average. It does not mean that any one company may not have--and he was sure you probably saw that in the data--that not everybody was grouped around that mean in terms of allowance adjustments. Is that correct?
Mr. Gingerich: Stated that actually, the MMS was the only one that saw the individual companies' data.
Mr. Hodsoll: Commented that Option 3 might actually create some interesting incentives that he thought needed to be thought about. He understood potential benefits but was concerned about incentives created in Option 3 from Industry's perspective.
Mr. Gingerich: Stated that in Option 3, actually, they would be using last year's rate as the actual rate that was calculated. And they would simply continue to use that in 2006. So there shouldn't be a way there to game the system, because you are using last year's rate. You are just going to continue to use that forward. You are kind of lagging that actual rate of 2005, which you would actually use into 2006 until your new rate came along.
Mr. Hodsoll: He understood how it worked, and they have to audit the rate, also.
Mr. Gingerich: Yes.
Mr. Hodsoll: So we would have to go back and audit the rate?
Mr. Gingerich: Right.
Mr. Hodsoll Thought it to be a concern.
Mr. Lewis: Orme Lewis questioned the order of magnitude that was being discussed in light of revenue neutrality.
Mr. Cattany: Questioned whether revenue neutrality was looked at in examining the different options.
Ms. Tschudy: The magnitude of oil and gas allowances is approximately 5 percent of $7-8 billion (coal royalties excluded) or $350-$400 million.

Todd Druse, spoke on behalf of the Ute Mountain Ute Tribe and on behalf of the state and Tribal members of the Subcommittee. The first priority of the states and tribes is to maintain revenue neutrality. He said we are willing to make changes to the reporting process if it does not affect the net receipts to the state or Tribe. Most of his comments were focused on Tribal effects. He stated that the possibility that an asset may change hands might have a great effect on how the allowances are calculated. The big concern he heard from the states was that their responsibility is to ensure that the revenues are collected properly and that nothing would change the expected revenues that they're going to receive in the future. The concern from the Tribal perspective is that any changes other than Option 4 would affect the dual accounting and major portion calculations. Major portion and dual accounting are part of the contracts that the tribes enter into with the producing company that protects the interests of the Tribe so that they are receiving market value for the production from the reservation. As you move actual costs from a non-arm's-length plan or transportation facility, if you move them into a time period outside the actual production, it is very difficult to calculate a major portion or dual accounting accurately. And that is the basis for the argument against any of these changes other than Option 4 from the Tribal perspective. And, as Darrell mentioned, Option 4 really has little advantage to industry. He stated that they were at a point here where they do not think we are going to reach consensus on any of these options. He asked if Mr. Gingerich concurred, and Mr. Gingerich responded yes.

Mr. Hodsoll: Asked that if the concerns about major portion were addressed, would that help them get to consensus, or are there still other issues?
Mr. Druse: Said it could be done; but it would be a huge data issue for MMS to place the actual costs into the proper month so that those could be calculated, and he was not sure that MMS is willing to take on that sort of activity.
Mr. Coney: Asked if the Subcommittee explored the possibility of instead of redoing all of these lines perhaps just adding a quarter of a percent on to value. I don't know if that's a viable business plan.
Mr. Druse: Responded that he did not believe the quarter percent was seen as an amount that was lost. It was just the change in the overall reporting.
Mr. Coney: Replied it opened the possibility of underreporting. Wasn't the Indian concern that it allowed for a

discrepancy of a one-quarter percent swing in the allowance?
Mr. Druse: Stated that this is one concern. The way that major portion is calculated, that difference for the company who has a non-arm's-length processing or transportation within a basin is actually going to affect every other producer that is in that same major portion calculation. So it is not just that individual company that would be affected on a major portion basis. It could be something more than a quarter of a percent.
Mr. Cattany: Asked Mr. Druse whether the terms royalty neutral and revenue neutral, are interchangeable?
Mr. Druse: Said he would use those interchangeably.
Mr. Kemp: Asked Mr. Druse whether Option 4 would provide at least a 33-percent reduction or a reduction of a third of the amount of lines, as industry had requested or required, and if this was a goal in terms of cutting back some of the level of their activity in making those adjustments?
Mr. Druse: Responded that many of the companies said that the savings of 33 percent of the lines for these particular properties would not compensate for the cost that they would incur in re-engineering their systems; they currently have set up two entries, one to back out and one to put in the new line, that a net entry would not really provide any savings.
Mr. Shipps: Said that he thought that when Mr. Gingerich was describing Option 2, he indicated that there would be a savings of 90 percent of the lines. Yet when he referred to the recommendations, Option 2 was unacceptable; so his assumption was that even saving 90 percent of the lines was not an adequate solution.
Mr. Gingerich: Responded that Option 2 does not save anything in terms of system processing and did not think that MMS or the states would benefit either. Option 2 was the one they worked on the longest, because they thought they might be able to come to consensus but it did not get them anywhere.
Mr. Kemp: Agreed with Mr. Gingerich’s assessment.
Mr. Druse: Said that there was some major opposition to Option 2 because of the interest issue, coming from one of the major producing states.
Mr. Hartzler: Requested clarification on whether it was actual cost per month or a fixed cost problem that created the change at the end of the year.
Mr. Gingerich: Asked Mr. Watson to comment.
Mr. Watson: Offered clarification that the costs that are being used today are being accumulated on a year's basis and then developed into a rate and that same rate is applied for a full year. The actual costs are being determined a year later when all of the cost information--not just the fixed but also the variable cost--is available. So the answer to that question is that it is both.
Mr. Hartzler: Stated that it seemed that if you can capture actual costs on a monthly basis, you can deduct the actual variable on a monthly basis. Then, if your depreciation and return on investment are the fixed cost that is going to fluctuate from month-to-month, instead of doing a 20-year depreciation, you look at doing some sort of units of production and say, this is what it is going to be. He asked whether you could apply your ROI and add that amount to the actual, if it would not get you away from some of this. If you can capture your actual costs monthly, deduct those on a monthly basis, and then add on your "depreciation" which gets affected by the number of MCFs or barrels shipped to that number, and calculate that using units of production over a 20-year life.
Mr. Cattany: Asked if the Subcommittee had looked at that.
Mr. Gingerich: Responded no, since you would have a difficult time getting the actual cost in time to report 60 days later.
Mr. Riemer: Discussed the limitations to trying to capture that data on a monthly basis.
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Mr. Hodsoll: Asked if they capture the actual cost—are they allowed to do it, or do they always have to use this rate to calculate, and is it an option currently in MMS regulations to capture actuals?
Ms. Tschudy: Responded that they are required to pay or to calculate their transportation and processing allowances based on actual costs, but the way the regulations are currently written, they calculate their costs annually at the end of the year. They determine what their actual operating costs were, what their depreciation was, and their return on undepreciated capital; and then they determine that rate. It is a cents-per-barrel.
Mr. Hodsoll: Stated that we might want to explore whether to give the companies the option.
Ms. Tschudy: Responded they could talk about it with the Subcommittee.
Mr. Hartzler: Questioned whether the interest calculation was an issue with the tribes.
Mr. Druse: Responded that interest was a small concern for the tribes. It was of greater concern for the states and that the ability to properly calculate a major portion and its affect on all of the producers in that field or region is a bigger issue for tribes.

Mr. Hartzler: Stated that the regulations now say you have to do an annual calculation and a rate. He questioned if the regulations were adjusted to monthly; and if you reported your actual costs, you knew to do that adjustment; and then as you learned of additional costs, you rolled them into the month you learned of them, would that address the problem? You are going to wind up with the actual cost eventually, and you will be understating your adjustment in the prior month; so you are always over-reporting, catching up as you learn the additional costs on a monthly basis, and the companies could deal with it how they wanted to, if it was a big enough accounting issue.
Mr. Coney: Commented on data disclosure and stated that he thought there were FERC restrictions on disclosures of data.
Mr. Druse: Said it referred to non-arm's-length processing and transportation, so it is intra-company; it is not between companies at all. So there should not be a data disclosure problem.
Mr. Zaman: Questioned why Option 4 would not benefit industry.
Mr. Druse: Responded that once you got your systems changed then you might start achieving some benefit in that you are going to have less lines. He questioned whether MMS would benefit from being able to process just the one line instead of the back-out and replace.
Mr. Cattany: Asked what the Subcommittee's next steps were.
Mr. Gingerich: Stated that the Subcommittee will prepare a draft report, send it to the Subcommittee one last time and make sure it is exactly what they want and bring it to the next RPC meeting.
Mr. Cattany: Suggested one more teleconference to include Mr. Hartzler and Mr. Hodsoll to see if any further progress could be made before they issued the final report.
Mr. Gingerich: Agreed to one more discussion and suggested that the issues around the Tribal concerns could be pulled out if Tribal properties were excluded, but the preference would be to apply it to both onshore and offshore properties.
Mr. Cattany: Recommended that as you schedule this call, to copy all the RPC members. That way if there is anybody that wants to participate in the call besides Messrs. Hartzler and Hodsoll, they would have the option.

Based on a discussion regarding dual accounting and major portion applicability, Ms. Tschudy agreed that the Subcommittee would analyze the dual accounting issue.
Mr. Shipps: Questioned whether the concern that was raised by Todd with respect to the Tribal issues as it relates to dual accounting is not unique to tribes or is it also a Federal issue?
Mr. Riemer: Made one more clarifying point relative to data and information. Even though, as Todd said, this only applies to non-arm's-length, it is not a matter of just intra-company. Many of the pipeline systems and many of the plants have multiple owners. If I as a lessee--if my affiliate is not the operator--number one: availability of data is an issue as well as access, because utilities have to be very careful about either. They cannot discriminate against people, nor can they show preferential treatment. And, they will not make information available in many cases, because then they subject themselves to having to treat everybody the same way; and anybody that asks for that information could have access to it. And we are talking about financial books of a company that are not public information.
Mr. Cattany: Stated that the other suggestion for follow-up discussion is to look at the Coal Subcommittee work on alternative valuation strategies as their recommendations would not necessarily apply to the Indian leases.
Mr. Gingerich: Stated that their agenda for 2006 will include looking at unit expansion, the process for any expansion approvals, and determine how the reporting is done. He expressed the need for BLM representation. A discussion followed whereupon it was agreed that a BLM representative from the New Mexico State Office would be appropriate.

Mr. Gingerich made a motion to continue with the Oil and Gas Royalty Reporting Subcommittee, and a second was made. The motion was voted on and the motion carried.

INDIAN OIL VALUATION SUBMITTEE

Mr. Cattany introduced Mr. Perry Shirley and Ms. Theresa Bayani representing the Indian Oil Valuation Subcommittee.
Ms. Bayani provided a short update as follows. In New Orleans the Subcommittee provided a position paper on the proposed Indian Oil Valuation Rule, and a discussion was held. Since that time the Subcommittee has not met; however, MMS has held three public workshops and five consultation sessions. The proposed rule is currently

moving through the Department; and as soon as it goes through OMB, she will be sending the tribes a copy. It will be published in the Federal Register no later than January 2006.

Perry Shirley commented that it was decided by the Subcommittee in a teleconference last April that absent any formal draft oil rule, they should withhold any further discussions. He said they have been waiting 6 years for the rule. Mr. Shirley followed with questions for the Associate Director. These included whether OMB was concerned about any additional reporting burdens as result of the new rule, and whether there was any revenue impact to the Indian Tribes. He also asked if there were any additional reporting burdens as a result of any new rule. His question to MMS was: Anticipating those questions that may be raised from OMB, has the MMS done anything related to those two issues?
Ms. Denett: Said there will be additional reporting burden in order to do some of the calculations that MMS needs to do. If OMB asks for an explanation on why more data is needed to perform these calculations, MMS has that information; and it is explained in the preamble.
Mr. Perry: Followed up by asking about the royalty revenue point of view.
Ms. Denett: Said there is an increase for the tribes, but it is not a large amount. And there is an added burden on industry to pay additional royalties. There are some areas where there are some additional allowances that can be obtained by the industry; but when you balance them out, there are still additional royalties that will be paid.
Mr. Shirley: Reminded everyone that with respect to reporting requirements that exempting the Indian leases from any changes is always an option.

Mr. Orme Lewis made a motion to continue with the Indian Oil Valuation Subcommittee, and a second was made. The motion was voted on and the motion carried.

Afternoon Session

<u>GEOTHERMAL VALUATION SUBCOMMITTEE</u>
Phil Sykora, the MMS Program Director for Compliance, opened the afternoon session with an update on the Geothermal Valuation Subcommittee, focusing on the status of recommendations made by the Subcommittee. The Subcommittee report was accepted unanimously at the last meeting of the RPC. The Department was pleased with the report and recommendations and was prepared to move those forward even before the Energy Act was passed in August. The recommendations offered by the Subcommittee were compatible with, but not identical to, the Energy Act. He thanked the Subcommittee for their thorough and timely report. He distributed a handout comparing the current Geothermal Valuation Rules, the RPC Subcommittee recommendations, the Energy Policy Act, and MMS action. He discussed two main areas--direct use and electrical generation.

With respect to direct use on non-arm's-length sales, the RPC recommended a fee schedule that was based on thermal content, with one meter at the wellhead. This recommendation fits within the Act, which specified that the Secretary would implement a fee schedule based on thermal content, volume, or both. For electrical generation, RPC recommended a royalty based on gross proceeds from electricity sales. The Act took the same approach with a different calculation methodology, although the effect is almost identical. For both direct use and electrical generation, the Act did not cover arms'-length sales. MMS will pursue the methodology proposed by the RPC whereby valuation is based on gross proceeds.

The MMS is expediting rulemaking, with a preliminary target date of December 2006 for a final rule. This is an optimistic schedule, but it is based on the desire of the Department to expedite the rule. There is also a slim possibility that the fee schedule could be added to a piece of legislation, which would allow MMS to implement the fee schedule before the rulemaking process.

Mr. Barger made a motion to continue with the Geothermal Subcommittee, and a second was made. The motion was voted on and the motion carried.

<u>ENERGY POLICY ACT</u>
Mr. Cattany introduced Ms. Tschudy who gave a presentation on the provisions of the Energy Policy Act for which

MRM has responsibility. She began by stating that MRM has responsibility for implementing all or a portion of 29 sections of the Act. The MRM has formed an implementation team made up of key experts in the program. Phil Sykora is the MRM lead for geothermal, and Bob Prael has the lead on financial accounting and system modifications. The MRM is utilizing a detailed project implementation plan, and many of the provisions require coordination with other agencies. She focused her presentation on 12 sections where MRM has major responsibilities. She went chronologically through the Act. Section 223 deals with direct use and requires MRM to establish a schedule of fees in lieu of royalty for direct use in no-sales situation, and that fee actually can be based on either the quantity or the thermal content of the resources or both. Section 224 is titled "Geothermal Royalties and Near Term Production Incentives." It establishes new lease royalty rates, the values of which are based on a percentage of the proceeds which range from one to 2-1/2 percent for the first 10 years and from 2 to 5 percent thereafter.

Another major provision that she discussed allows the Secretary to accept Royalty-in-Kind for the value of electricity under a contract with a state or county government entitled to royalties. A lessee can sell electricity of a certain value to the county to fund such things as county buildings; and for the value of that electricity, they can get a credit against royalties that they owe. She stated that this requires a major system change for the MRM current PeopleSoft financial system. She then provided information on a number of geothermal provisions. One such provision requires that for geothermal leases, MRM send 25 percent of the royalty to the Federal Government, 50 percent to the state, and 25 percent directly to the county where the producing lease is located. Now MRM will be paying the counties directly for their share of the geothermal royalties. Another key provision of the geothermal portion of the Act is that for producing leases, the rentals can now be credited against future royalty payments. This is something that was not in effect before for geothermal; it is something very common and already in effect for oil and gas, so not a major change. The MRM's existing processes and instructions given to the oil and gas payors can be applied to the geothermal payors for this provision of the Act. In order to implement the geothermal provisions of the Act, MRM needs to modify our system to account for royalty credits, to disburse royalties to the county level, and to account for and track the direct use fees and advance royalties in lieu of production. An additional system change will be required to implement the provision that allows geothermal producers a 45-day grace period if they do not pay their rentals timely. The MRM needs to issue regulations that address royalty credits, the process for approving the lessee and the state or county contract for the sale of electricity, and the process for allowing existing lessees to modify their lease terms. A discussion ensued regarding the logic behind the geothermal provisions in the Act. Ms. Tschudy stated that the royalty portions of geothermal have been governed by the Geothermal Steam Act of 1970, so that some of the provisions of the Energy Policy Act were designed to bring geothermal forward to where oil and gas are.

Ms. Tschudy spoke next of the transfer of the Naval Petroleum Reserve #2 from the Department of Energy to the Department of the Interior. The MRM has obtained copies of all of the leases, has contacted all of the payors to inform them how to report and pay, and has requested that an account be established by Treasury to be used for environmental improvements on the NPR at a rate of $500,000 a year--not to exceed $3million. Once the environmental improvements are completed, the money will go fully to the United States Treasury. Ms. Tschudy continued her presentation by talking about Federal low-income energy assistance. She said the law requires that MRM submit a report within 3 years of the Act, assessing the effectiveness and providing a recommendation for continuation of the provision that allows the Secretary to grant RIK oil and gas to any person, state, or government for Federal low-income energy assistance.

The next major provision she discussed impacts both BLM and MRM and establishes a program for lessees to remediate, reclaim, or close orphaned, abandoned, or idled wells. The money they spend reclaiming an orphaned or abandoned well can be used as a credit in the MRM system to be applied to royalties due on other leases whether the leases are located on Federal or private lands. She stated that there are a number of questions associated with how the credits will work. The Mineral Leasing Act works, if the company takes a credit for 50 percent of the royalties and pays MRM in cash for the other half. We are going to have to disburse 50 percent to the state, 40 percent to Reclamation, and 10 percent to Treasury. Thus, the state is only going to get 25 percent. So, a technical correction may be needed. A discussion followed, and Mr. Bob Anderson from BLM stated that new lessees would not be responsible for actions undertaken by previous owners with regard to improperly abandoned wells.

Another provision in the Act discussed by Ms. Tschudy allows for reinstatement of terminated leases for failure to pay from the period September 1, 2001, through June 30, 2004, and that is mainly to remedy a situation we had during the time that our systems were shut down as a result of a court order. The law provides that as long as the lessee files a petition within 120 days of the Act, the lease can be reinstated. The law says that they have to certify that they did not receive notification 13 months before the termination date. The language should have read 13 months after the termination date, and BLM has issued an instructional memorandum for implementation to clarify this.

She stated that through this Act, Congress is attempting to resolve an obligation that the Federal Government incurred back in the 1980's for draining some State of Louisiana leases. What the law says is that the obligation that is due would be set by a report that was written in 1988 and that, as of October 2006, is $44 million. The affected offshore lessee may withhold from their royalties for as long as it takes to recoup the $44 million--they can recoup that amount of money every month from their existing royalty payments until they reach that $44 million as long as they give 44 cents of it for every dollar withheld to the State of Louisiana. The MMS is seeking the Department's and appropriators' approval to use the Environmental Improvement Restoration Authority for payment of that obligation in October 2006 as a lump sum payment to the State of Louisiana. The MMS estimates that if it can use these funds and pay off this obligation to the lessee and to the state, next October the taxpayer will save a little over $12 million.

The next provision that Ms. Tschudy discussed concerned advanced royalties. The Act requires that the value of the advance royalties for coal be based on the average spot prices for sales of comparable coal, or in the absence of a spot market, use a comparable method established by the Secretary. The MMS is working with the Bureau of Land Management to develop revised regulations for implementing this provision of the Act. The MMS proposal is that MMS issue those regulations related to the valuation as part of the 30 CFR regulations, and then the remainder would be part of 43 CFR regulations; but again, MMS is working closely with BLM in implementing those provisions. A discussion followed regarding this point.

In summary, Ms. Tschudy said the Act requires MRM to issue new regulations for the geothermal provisions, royalty credits, and advance royalties for coal leases; modify its financial system, and establish a number of new Treasury accounts with several more in the future, so MMS is designing a fairly robust royalty credit tracking system.

Mr. Cattany introduced Mr. Bob Anderson, from BLM, who provided a presentation on the BLM implementation of the Energy Policy Act. The BLM has about 60 sections to implement. Mr. Anderson stated that the number one priority for BLM is the implementation of pilot offices to streamline oil and gas permitting. The BLM has 7 offices accounting for about for about 65 percent of the production from Federal lands in seven western states that have been designated to improve Federal permit coordination. To give some perspective BLM issued 4,000 applications for permit to drill in 2001; and it is projected that there will be 10,000 this year. The BLM is in the process of hiring additional personnel to support these offices, working to eliminate duplication among Federal agencies in an effort to reduce the processing time for permits.

The BLM must approve APDs in 30 days or provide a schedule with timeframes to complete the APD. With the establishment of the pilot offices and the one-stop-shop approach, Mr. Anderson said that he was hopeful that BLM can meet this requirement. Mr. Anderson went on to discuss another provision of the Act that limited NEPA review for certain oil and gas activities -- Categorical Exclusions (CXs). In order to obtain a Categorical Exclusion, the following criteria must be met: an individual surface disturbance must be less than 5 acres and the total surface disturbance must be less than 150 acres; the drilling of the oil and gas well must be at a location or well pad site at which drilling occurred within the last 5 years; and the drilling was on a developed field with an approved land use plan or NEPA document that analyzed such drilling under what we call a "reasonable foreseeable development" prepared within the last five years. There are the other two statutory CXs: Placement of a pipeline in an approved right-of-way corridor when the corridor was approved within the last 5 years, and minor maintenance activities other than construction or major renovation of a building or structure. With respect to Right of Way Corridors, the Departments of the Interior, Agriculture, Energy, Defense, and Commerce must designate corridors in the western states. The BLM has been working on this for a number of years. There are about six different options that are currently being discussed in meetings around the West, and one of the meetings was in Denver a few weeks ago. The DOE is leading the effort and is developing an MOU with the different agencies to coordinate the applicable Federal authorizations and environmental reviews.

Mr. Anderson relayed that the Act requires lands to be made available within one year of the Act for leasing oil shale research and development. The BLM has 20 nominations for leases in Colorado, Utah, and Wyoming; and a panel of experts from the different agencies and representatives of the Governor's Office from those three states, is evaluating them for selection. BLM is also preparing an EIS to cover both oil shale and tar sands at the same time. The Act also requires a report analyzing oil shale for commercial development and to update the resource information by conducting a National Oil Shale Assessment. A discussion ensued on the technology for extracting oil from shale. Mr. Anderson stated that Shell has an in situ process where they are putting down wells and heating the ground--very closely spaced wells, and it appears to be working. Shell has submitted a few nominations.

Mr. Cattany: Discussed that Shell is working on a freeze wall, and what is still requiring work is determining how to avoid ground water contamination. He thinks that one of the reasons they may want to move on to a Federal tract is so they can continue to do their R&D, and work on their technology.
Mr. Paulson: Asked if there was a deadline for submission of the National Oil Shale and Tar Sands Assessment Report. (No deadline for this report in the Energy Policy Act.)

Mr. Paulson: Said that the military is really interested in shale oil because it is conducive to jet fuels, and that probably will be the number one use.
Mr. Cattany: Expressed his concern regarding the short time frames that were given to the State for reviewing lease applications. He stated that the time frames may be difficult to meet because of the tremendous amount of energy activity in Colorado.

Mr. Anderson continued by stating that through research and development, BLM will be able to lease what is out on the street right now; but for long-term beyond the R&D, BLM will have to develop regulations for long-term oil shale use. The BLM has been leasing in the NPRA in Alaska since 1999. The BLM has 2.8 million acres leased, 19 wells have been drilled, and 2 wells with discoveries. He talked about marginal wells next. Until recently there were royalty reductions for marginal wells--wells that produced 15 barrels or less per day. There were also provisions for royalty reduction for heavy oil, and that mostly applied to Bakersfield. Those royalty reductions will be suspended for 6 months.

Mr. Anderson described that Section 354 of the Act authorizes grants for carbon dioxide injection and requires coordination with MMS. Section 361 requires DOI and the Department of Agriculture (DOA) to perform an internal review of current Federal Oil and Gas leasing and permitting practices, and Section 362 requires DOI and DOA to improve administration of Federal Oil and Gas leasing, permitting, and I& E programs. Section 363 requires BLM and the Forest Service to establish an MOU to improve coordination and to establish a joint data retrieval and GIS mapping system. He briefly discussed Sections 432 through 437. Mr. Anderson went on to discuss some of the studies that BLM has to complete and stated that some of them are controversial. He responded to a question by Mr. Paulson by saying that the studies had not yet been prioritized or funded. He concluded his presentation by stating there was a BLM contact person for each of the 60 sections for which they have responsibility and by briefly discussing funding.

Mr. Shipps: Asked about the right-of-way compensation on Indian lands and its relationship to sovereignty of tribes and whether it was consistent with public policy and whether BLM was going to be involved in the study.
Mr. Anderson: Responded yes because BLM needs to involve the Indian Community in rights-of-way borders, but that BIA would be the oversight Agency. A discussion followed concerning DOE and DOI study on national policy on energy development. There are four components to the study, two of which are data collection, historical rates of compensation and what policies are currently in place for compensation for rights-of-way across public lands. Two sections deal with recommendations that the Secretary will make on what may be a fair return for that right-of-way.
Mr. Stewart: Discussed the problem that he was having getting information from BIA and BLM.
Mr. Anderson: Suggested that he go to the closest BLM office and /or the original BIA office to get the information that he needed.

Mr. Anderson--based on a question from Brian McGee of Jackson Kelly--agreed to go back and to determine a method to ensure that the regulated community was aware of Interim Guidance that BLM has issued.

ROYALTY IN KIND PROGRAM

Mr. Cattany introduced Mr. Greg Smith, RIK Program Director, who gave a presentation on the RIK program. He began by saying that the message that MRM wanted to present is that the MRM asset management strategy is now being validated by new data on performance that is just emerging. He described MMS's asset management approach. The MRM has been doing RIK for 7 years now and has concluded that RIK is a valuable asset management tool, not to be used everywhere, but only where the situation dictates. The asset management approach is the selective use of both RIK and Royalty-in-Value (RIV) where they make sense. And the choice of the method really depends upon both efficiencies and economics, administrative costs and revenue impacts. The GAO noted what MRM had known for a number of years -- that better measurement of revenue and cost of the RIK program was needed. The questions were: Does RIK cost more than it brings in, and is RIK a good deal for the taxpayers? So MRM set about to try to answer those questions with both administrative cost and revenue performance measurement.

Another benefit of RIK that Mr. Smith discussed was related to Hurricanes Rita and Katrina. The staff in New Orleans who subsequently relocated to Houston after the first hurricane, knew the platforms, the pipelines, the infrastructure, and the like; and DOE had data on the infrastructure from the downstream retail markets. But there was not anyone in the government that knew a lot about where those two infrastructure grids meet--that is right along the beach, right along the onshore so that data could be provided to decision makers that needed to know the effects of the hurricane. He relayed that RIK staff knew about the marketplace, having business relationships with the gas plants, oil terminals, compressor stations, pumping stations, all those with infrastructure right at the intersection of offshore and onshore; and RIK was able to provide the needed information to the decision makers.

Mr. Smith stated that the early promises of RIK are being confirmed. RIK is providing cost efficiencies, knowledge of the value chain, and increasing revenues for the Treasury. Administrative costs have been reduced as a result of both RIK and Compliance Reengineering. The FTE numbers in MRM were reduced by 51 in a 4-year period which is more than 10 percent. Appeals were also reduced; and of 120 current appeals, none were RIK. Previously in a 4-year period, there were 250 appeals; only 3 of which were RIK. He then discussed a comparative cost analysis of RIK and RIV, which demonstrated about a third less cost for RIK than the RIV method. Another important metric is that 85 percent of account periods for Fiscal Year 2004 were closed within 6 months. In both Fiscal Years 2004 and 2005, there was no bad debt.

The efficiency gains--the 26 to 36 percent lesser cost amounts to a cost avoidance of about $1.6 million. The MMS is responding to questions that GAO and others had asked in their audits, and GAO is closing out those particular recommendations, saying that MMS has realized a measurement environment to answer these questions. He then said a little over $18 million was brought in for FY04. This amounts to a one to two percent, incremental revenue gain. RIK rewards are constrained by its risk profile and a conservative business model. This is appropriate for the Federal Government. He then discussed a detailed revenue performance chart.

Mr. Hodsoll: Stated that it was important to recognize that there are cost reductions, as a result of RIK, that benefit the taxpayer and industry. Mr. Hodsoll and Mr. Smith said that inasmuch as there are risks associated with the RIK program, that there may be times when the performance may not be as positive.

Mr. Smith went on to talk about the Five Year RIK Business Plan that was published in May 2004 and the RIK risk management policy that was developed and approved last year. He introduced Pam Rieger as the new Deputy RIK Program Director. Next he talked about the provision in the Energy Policy Act which provided permanent authority to pay for transportation, processing and other administrative costs, including salaries from the RIK revenue stream. He explained that RIK oil was used to fill the SPR, and those royalty volumes that supported the SPR fill have been converted to a Royalty-in-Kind commercial program. He went on to say that the RIK program is focused on the Gulf of Mexico. He said there is strong competition in the gas marketplace which leads to fair market value. The market with respect to oil is growing as they are starting to move crude oil from offshore to onshore to try to increase the numbers and the diversity of crude oil counterparties.

Mr. Hodsoll: Acknowledged the value of the market knowledge brought to the Federal Government by the RIK program.
Mr. Smith followed with a summary of how the RIK program works. He detailed recent organizational and human resource actions. RIK established a front, mid, and back office structure for internal controls resulting in a complete separation of duties. The business plan called for a slight expansion of the business model, moving product to onshore, scheduling, diversifying our markets, and the like. So, MRM recognized the need to make its bench a little bit deeper with respect to human resource skill sets. The MRM is trying to recruit some of these skill sets, and he announced that MRM hired Diane Dundee as the MRM Gas Front Office Manager in Houston.

The MRM concluded a feasibility study of Wyoming gas RIK feasibility, and did a status report which will be given to Congress in the near future. The risk management policy was approved by the MMS Executive Committee, and signed by the Director in September 2005. The policy sets transactional boundaries and limits. He discussed the newest project, an 8-month study, which concluded that RIK does have the potential to lead to increased revenues for Wyoming's largest producing natural gas properties. The Wyoming State Land Board voted to support the gas pilot. The MRM plans to start this project in Spring 2006.

Mr. Riemer: Asked if the State of Wyoming will participate in this project.
Mr. Kemp: Stated that Wyoming will not participate at this time and the vote of support means that there is no protest in terms of the Federal Government establishing an RIK program in Wyoming.
Ms. Denett: Further clarified that MMS has a policy that it will not take Federal production in kind within the state boundary unless that state is okay with it.
Ms. Denett: Clarified for Mr. Zaman that if an Indian Tribe wanted to participate in the RIK program, they would have to contact MMS. A determination would be made based on whether it made good business sense for MMS and for the Tribe. .
Mr. Hodsoll: Commented that there would be significant discussions about the MMS trust responsibility with respect to this matter.

Mr. Smith said that RIK in the future has some significant but manageable challenges in regard to organization and staffing. To implement the RIK risk management policy this year, they will use a matrix that measures quantitatively what their exposures are, as well as some of the uncertainties with respect to its portfolio of contracts. He said that we are in a high commodity price environment; and although that is a very good thing for a seller of a valuable commodity--people like to buy it, it is a seller's market--but with that comes some challenges, too. With high absolute prices comes high volatility. With high volatility comes a very changeable basis environment, the basis being the widening difference between prices at two points and being much more unpredictable than at lower prices. And, of course, credit issues. He stated that this winter there will be some price spikes on gas especially, and the credit people will likely need to closely examine the credit worthiness of counterparties.

Committee Roundtable

Mr. Cattany stated that Mr. Gary Paulson had taken a new job within his company and is working overseas now, and this is his last RPC meeting. Mr. Paulson also served on the RPC prior to enactment of the new charter. He said it was great to have him here and asked Mr. Paulson to tell the group about his new job.
Mr. Paulson: Stated that he was with BP as an attorney. He explained that he has taken a job with the company working in the Caspian area, in Baku, Azerbaijan--enormous oil and gas reserves offshore in the Caspian. He said there are interesting transportation issues, and he is also performing some fascinating work in other places--Egypt, Angola, offshore, Pakistan and Abudabi .-. He commented about his RPC experience. “This has been a terrific experience. I think by anybody's measure, the hallmark of good government is an honest desire to seek input on governmental measures as they are drafted and a willingness to provide a forum for interested parties to debate and discuss important issues. By those standards, the RPC really represents the finest traditions of good government, and it's been a real honor to serve on it--a great pleasure. And I'd like to thank the members of the committee for the opportunity to work with you over the years.”

Mr. Cattany: Mr. Cattany and Mr. Paulson discussed the need for a successor to Mr. Paulson and his alternate who is also no longer available to serve.

Ms. Denett and Mr. Cattany held a discussion on when and where to hold the next meeting of the RPC. Locations proposed included Lakewood, New Orleans, Santa Fe, and Houston. A tentative decision was made to have the next RPC meeting in Houston late April -- the day after the MMS Industry Award Program.
Mr. Cattany: Thanked Mr. Hodsoll for his attendance and his active engagement in the meeting.

The meeting was adjourned at 4:30 p.m.

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