

Minutes
Royalty Policy Committee
January 26, 1998

Members/Alternates Present: David Blackmon, Sandy Blackstone, Randy Bolles, Johnnie Burton, George Butler, Jack Caldwell, Wendy Daboval, Cliff Dodge, David Harrison, William Hartzler, Eddie Jacobs, Brian McGee, Gary McGee, Charles Mankin, Spencer Reid, Norma Rosner, Hugh Schaefer, Thomas Shipps, Perry Shirley, Brad Simpson, William Stone, Mary Stonecipher, Alan Taradash, and Steven Williams.

Non-Members Present: Charles Turpen, Robert Leo, Ben Dillon, Karen Tasney, Harold Kemp, Jerry Hutchinson, Lisa Burges, Rich Harpstrieth, Bill Strain, Pete Culp, Wanda Fleming, Tammy Naron, Norman Honie, Richard Wilson, Wayne Pachall, Carolita Kallaur, Lucy Querques Denett, Walter Cruickshank, Don Sant, Ken Vogel, Milt Dial, Hugh Hilliard, Bonn Macy, Vern Ingraham, Todd Mc Cutcheon, Mike Miller, Anita Gonzales-Evans, Mike Baugher, Don Gilman, Mike Fansler, Herb Wincentsen, John Hovanac, and Paul Knueven.

Welcoming and Opening Remarks - David Blackmon

UPDATES FROM CAROLITA KALLAUR(Acting Director, MMS):

We continue to expect production in the Gulf of Mexico to double by the year 2000, with daily production between 1.7 to 1.9 million barrels. According to the IPAA, the United States may reverse its domestic production decline because these increases. Also as a result, Federal revenues will increase by \$600 million annually by the turn of the century. Since MMS is the regulator of this activity, we are trying to assure industry maintains its excellent environmental and safety record. A serious accident in the Gulf would undermine public's confidence, jeopardizing the progress being made.

Very important to the MMS is reengineering. Offshore is looking at the management of lease sales, which has not changed in 40 years. The OCS Policy Committee is reviewing impact assistance, an initiative to divert some offshore revenues to States to compensate for some of the adverse impacts of offshore development. Both the Administration and Congress are interested in their report and Senator Landrew from Louisiana is hoping to introduce legislation soon.

The Royalty Management Program is focusing on three main areas: valuation, Royalty Simplification and Fairness Act (RSFA) implementation, and reengineering. Oil and gas valuation for both Federal and Indian leases is a contentious issue important not only to the Federal government, but to lease revenue recipients and industry. A number of valuation rule makings are underway with goals to simplify requirements, meet market conditions and maintain flexibility to avoid continual regulatory changes.

We're committed to meeting the time frames of RSFA in a manner that involves the stakeholders. The reengineering initiative, began before RSFA was passed, is critical to the success of our agency in the 21st century. We're committed to find ways to increase operational efficiency by analyzing core business processes, assuring computer operations supports our efficiency goals and serves recipients while reducing the burden on industry.

With the full support of the Director we at MMS want to thank the RPC for the very valuable assistance. While you're not paid to come to these meetings, you spent a lot of time on the subcommittees working through contentious issues. Several subcommittee meetings are scheduled:

- Tomorrow, the Appeals Subcommittee will hold a public discussion of the proposed appeals regulations here from 8:30 to 2 o'clock. The incorporation of both RSFA and RPC recommendations into the revised proposed rule will be discussed.
- At 2 o'clock tomorrow a meeting on Chronic Erroneous Reporting will follow-up the meeting that took place in November. We invite anyone who's interested to attend.
- The Net Receipts Sharing Subcommittee will meet tomorrow at a time and place to be announced.
- The Sodium Potassium Subcommittee will meet on Wednesday at Golden Hill starting at 8:00 a.m.

UPDATES FROM LUCY QUERQUES DENETT:

There are three main areas that we want to discuss in detail: valuation regulations, RSFA implementation, and reengineering. I will also provide an update on pending legislation.

Valuation Regulations

On December 16, 1997 we published in the Federal Register a final rule that clarifies natural gas transportation cost deductions. As a result of FERC's Order 636 regulatory guidance was needed to identify deductible allowance costs. The rule identifies firm demand charges, commodity charges, wheeling costs and other FERC instituted charges as allowable; not allowable are long-term storage, aggregator fees and intra-hub title transfer fees. The rule is effective February 1, 1998.

The Federal oil valuation rule was the subject of nine workshops and extensive written comments. We are issuing a further notice to proposed rule making in early February to incorporate these

responses. The proposed rule is currently under OMB review, who requested that a few additional clarifications be added. The purpose of this rulemaking is to decrease the reliance on oil posted prices, require fair market value be used to calculate royalties, and assure certainty and as much simplicity as possible to reduce administrative costs. We would like to publish a final rule this spring.

Other valuation rules of interest include:

- For the proposed Indian gas rule, we completed an economic impact analysis and a review of the revenue effect on recipients. Our target is Spring of '98, to issue an interim final rule.
- The Indian oil rule is currently under OMB review. This review will probably require two or so months before the rule is published in the Federal Register.
- With the emphasis on the Federal oil rule we haven't focused as much on federal gas as we would have liked to. This will change this spring when we will be asking you to work with us in some workshops.

RSFA Implementation.

We've made a lot of progress implementing time dated requirements of RSFA, and working other regulations such as takes and entitlements, chronic erroneous reporting and marginal properties. The input and the dialogue has helped us. It's moving us further along, and you'll see some rules this year on these areas. Various constituencies, including industry, States and Indian representatives, specifically requested we not to issue anything during the holiday season, because of the burden to review those with staff vacations. They wanted the opportunity to review and develop substantive comments. The same type of problems occurred with us. We've had so many things ongoing and are trying to establish more realistic time frames. Accordingly, all regulatory target dates will be reevaluated and posted on the Internet under the regulation section in about 30 days.

The three rules scheduled for publication later in 1998 under RSFA are Marginal Properties Accounting and Auditing Relief, Interest/OCS Section 10 repeal, and self-bonding. Not related to RSFA is the final liability rule for Non-RSFA Indian and solid mineral leases. We published a proposed rule on that in June of 1995 which we will finalize. We will also publish a separate proposed liability rule for RSFA leases. Before finalizing the interim final rule on the lessee-designee issue, we would like to receive RPC recommendations.

Some internal statistics:

- As of last week, we had only 5,430 of the original 14,300 pre-August 1996 takes vs. Entitlement exceptions remaining, including Indian leases. The RSFA

mandated the Federal exceptions be resolved by August 1998.

- Since May of '97, we've paid \$3.3 million in interest on overpayments, 95 per cent of which was a result of estimates. To reduce interest payments we are working with payors to reduce these balances, particularly those on properties for which they are no longer reporting. We also implemented IRS Form 1099 software to report interest paid.

Reengineering.

The reengineering team will present a preliminary design of business processes to RMP senior managers for discussions through February. We intend to do some prototyping as we move toward implementation. More details will be provided in a later presentation. Several specific groups contribute to our success so far:

- The STRAC contributed two staff members to the reengineering team, providing important feedback.
- The RPC Subcommittee on coal closely reviewed coal reengineering and contribute comments.
- The COPAS group has been invaluable in answering questions, responding to proposed scenarios and providing feedback.

Pending Legislation

There were two legislative proposals introduced last year by Representative Carolyn Maloney from New York. One was HR-1106, amending FOGDRA to require that any ADR settlement for \$2 million or more be approved by the Secretary of the Interior. The other bill, HR-1107, would transfer oil and gas royalty auditing and reconciliation activities from Interior to Treasury. Both bills were introduced to the House Resources Subcommittee, and referred to the House Subcommittee for Energy and Minerals. To date, there has been no action taken on these bills. Later Bernie Dillon will walk us through an RIK legislative proposal that the industry has developed, which will be the subject of a hearing next month.

APPROVAL OF THE SEPTEMBER 25, 1997 MINUTES

Mr. Schaefer moved that the minutes as presented be accepted.

Motion seconded.

Vote: 16 votes in favor, none opposed.

Motion carried.

AMENDED ROYALTY POLICY COMMITTEE PROCEDURES

Mr. Blackmon presented amended operating rules made for clarification and to incorporate the changes due to the election of a parliamentarian at the last meeting.

Ms. Blackstone moved to accept the revised Operating Committee procedures.

Motion was seconded.

Vote: 16 in favor, none opposed.

Motion carried.

OTHER LEASABLE SOLID MINERALS SUBCOMMITTEE INTERIM REPORT

Ms. Burton reported that the Subcommittee met in December to begin the process of identify issues of interest to the Subcommittee as MMS started redrafting the rule. We organized with the intention of having a representative from the five states that have some leasable potassium and sodium. Of those, Utah decided not to participate and California's representative past away three days before the meeting. While California has yet to name a replacement, our next meeting is here at the Embassy Suites, on Wednesday. We will start at 8 o'clock. These are public meetings, so anybody interested is more than welcome to attend.

NET RECEIPT SHARING SUBCOMMITTEE INTERIM REPORT

At our next meeting tomorrow, Ms. Burton stated the NRS Subcommittee plans to finalize their report for consideration at the next RPC meeting. Today, two Subcommittee members are meeting with OIG staff to review their report for tomorrow's discussions.

COAL SUBCOMMITTEE INTERIM REPORT

Mr. Hartzler reported that the Coal Subcommittee met three times since the last RPC meeting, addressing a list of 59 issues. The Subcommittee reached a consensus in December and finalized its report on audit for RPC consideration.

While the report was mailed to all members, additional copies were not available for review and the issue was tabled by the Chairman.

After all members received copies of the report, Mr. Hartzler explained that the Coal Subcommittee reviewed the oil and gas report and modify it to fit coal.

Mr. McGee motioned that the recommendation of the Coal Subcommittee for improved Coal Royalty Audits be approved by the RPC.

Motion was seconded.

Vote: 18 in favor, none opposed.

Motion carried.

LESSEE-DESIGNEE SUBCOMMITTEE INTERIM REPORT

Ms. Stonecipher reported that while the Subcommittee has not met as a group ten to twelve state and industry representatives have volunteered to participate, with MMS and BLM representatives. It appears to both Ms. Stonecipher and Mr. Simpson that MMS has decided on a course of action and the purpose of the subcommittee is not understood.

After a lengthy discussion between committee members, MMS representatives and others, it was agreed that the actions of the Subcommittee would be worked out in continued dialog.

APPEALS RULE UPDATE BY HUGH HILLIARD

The MMS assembled a team of employees to draft an appeals rule which would largely put into place the recommendations of the Royalty Policy Committee reports, with some changes and clarifications. It's been meeting regularly recently and developed a first draft of the rule for discussion purposes, that was sent to Committee members. Tomorrow we will hold a public workshop to discuss it. We also plan to hold some consultations in the Indian community to make sure that we're fulfilling our trust responsibilities under Secretarial Order 3175.

Mr. Vogel added that this draft explicitly recognizes the rights of lessees and designees both, or separately, to file appeals. It's something that wasn't in the RPC Subcommittee report.

ROYALTY-IN-KIND PRESENTATION BY BONN MACY

Mr. Macy referred to a handout which was made available to all members. He then discussed it in detail, which was followed by a question and answer session.

INDUSTRY'S ROYALTY-IN-KIND PROPOSAL PRESENTATION BY BEN DILLION

Mr. Dillion referred to a handout which was made available to all members. He then discussed it in detail, which was followed by a question and answer session.

PROGRAM REENGINEERING PRESENTATION BY MILT DIAL

Mr. Dial referred to a handout on the RPM reengineering initiative which was made available to all members. He then discussed the subject in detail, which was followed by a question and answer session.

SOLID MINERALS REENGINEERING PRESENTATION BY JOHN HOVANEK

Mr. Hovanec referred to a handout on the solid minerals reengineering initiative which was made available to all members. He then discussed the subject in detail, which was followed by a

question and answer session.

NEXT RPC MEETING

Mr. Blackmon stated he would schedule a date during May 1998 for the next meeting, contingent on the subcommittee work products.