

**Royalty Policy Committee
Minutes
September 22, 1998**

Members/Alternates Present: David Blackmon, Sandy Blackstone, Jack Caldwell, Gary Carlson, Wendy Daboval, David Harrison, William Hartzler, Brian McGee, Dave Loomis, Spencer Reid, Stephen Reynolds, Norma Rosner, Hugh Schaefer, Thomas Shipps, Perry Shirley, Brad Simpson, William Stone, Mary Stonecipher, and Steven Williams.

Non-Members Present: Sherry Barnett, Paul Bodenberger, Jeanne McCibbin, Del Fortner, Bill Strain, Wanda Fleming, Robert Leo, Tammy Naron, Sue Hamm, Mary Robyn, Richard Wilson, Akhtar Zaman, Cynthia Quarterman, Lucy Querques Denett, Walter Cruickshank, Don Sant, Ken Vogel, Milt Dial, Bonn Macy, Vern Ingraham, Mike Miller, Debbie Gibbs Tschudy, Connie Bartram, Barb Desiderio, Greg Smith, Anita Gonzales-Evans, Mike Baugher, Don Gilman, Herb Wincentsen, John Hovanac, Barb Lynham, Boh Walker, Dennis Johnson, Jan Therkildsen, Bob Prael, Dennis Jones, Pat Milano, and Paul Knueven.

Welcoming and Opening Remarks - David Blackmon

UPDATES FROM CYNTHIA QUARTERMAN (Director, MMS):

Since the Federal Advisory Committee Act requires that the RPC must be re-chartered, a review of the Committee's accomplishments during the past two years and its future should be considered. RPC should be commended for their work. Recommendations not implemented immediately are being considered in our reengineering efforts.

Legislation requiring the Government to take Royalty-in-Kind consumed much of our time recently, to analyze the proposal and respond to inquiries. The General Accounting Office also reported agreement with our analysis that enactment would reduce revenues. At this time the Congressional Budget Office is analyzing the bill's revenue effect, but time is running out in this particular Congress. On our own, we are working on several RIK pilots: Wyoming starting October 1, for which we received bids, a Gulf of Mexico natural gas pilot, and one with the State of Texas.

The oil valuation regulations are prevented from being finalized by a rider placed on a supplemental appropriations bill for fiscal 1998. The Department is working to ensure the fiscal 1999 appropriations are free from such riders.

Several accomplishments can be reported with our efforts to increase electronic reporting. We published a proposed rule which, when finalized, will require electronic reporting and payments by the beginning of 1999, except in hardship cases. And electronic reporting is currently up to 78 per cent on royalty reporting, 54 per cent for production reporting, and 92 per cent of payments.

We continue to move forward with innovations, with an announcement today of the electronic imaging of over 100,000 solid mineral and logical mining unit documents. With electronic retrieval, documents will be easily accessible to everyone. As required by the Royalty Simplification and Fairness Act, we resolved 50,000 exceptions and collected more than \$54 million in royalties by reinventing the process of volume data comparisons. As a result, royalties are paid to States, Tribes and others faster and companies know sooner what amounts are due.

UPDATES FROM LUCY QUERQUES DENETT:

Program Reengineering

Reengineering has entered a critical phase. We issued the preliminary design concept in March 1998 which defined the new RMP organization with new business processes implemented. We also started pilots and initiated a systems prototype to explore technology needs. The pilots for on-shore and off-shore oil and gas are completed while the prototype continues. The Integrated Project Team (IPT), formed to manage contracts and funding needs, includes the MMS's Procurement, Information Technology and Budget Directors; RMP's Systems Management Division Chief, and PRO Team member Ken Madsen. IPT will report on reengineering to the Office of Management and Budget by the end of the month.

We are focusing on the Compliance and Asset Management functions with three operational models: off-shore, on-shore and solid minerals, to be managed by John Russo, Jim Detlefs, and Debbie Gibbs Tschudy, respectively. The first to be activated will be off-shore. Rather than parallel operations, these models will involve new compliance initiatives and reengineered processes. To help guide the implementation process, the PRO Team will issue a road map to the 21st century soon. This will identify action items to be completed during the next three years, responsible offices and time frames.

Royalty Simplification and Fairness Act (RSFA) Implementation

Last year we issued the RSFA delegations rule that required States to audit all Federal leases within their state boundaries if they elected to do audits. Some states have now raised the issue that, given their legislative requirements it is difficult to obtain funding approval, even though the Federal Government provides the funds. To alleviate the problem we will publish a proposed amended rule, probably in November.

The Marginal Properties rule for Federal leases, developed with you in many workshops and other forums, required modifying our accounting systems. The rule provides for six types of relief; three require only that you notify us; the other three require prior MMS approval after State consultations. Publication is expect in December 1998.

The interest and the OCSLA Section 10 repeal rule should be issued in early 1999. MMS has already modified its systems to calculate and pay interest, and accept payors' reports of interest

calculations. Since inception \$8.7 million has been paid on payors' overpayments. To assist in the interest calculations MMS's web page includes interest tables, formulas and explanations.

Other RSFA rules for 1999 publication include Takes versus Entitlements, Chronic Erroneous Reporting, and Prepayment of Revenues. Dialogue on the related issues included many ongoing meetings and conferences with affected parties.

Small Refiner Royalty-in-Kind Program

The RPC recommended that we study this operation and make appropriate changes in the responsibilities of both the refiner and the producer. After several reviews, we initiated a pilot with the small refiners, with a final report targeted of March 1999. If there is a continual need for the program, we will publish a Federal Register notice to start the process.

Farmington Indian Minerals Office

In 1992 the Bureau of Land Management (BLM), the Bureau of Indian Affairs (BIA) and the MMS established an office in the Farmington area to provide one-stop services to Navajo individual Indian mineral owners. Four years later a National Performance Review study recommended a pilot be established to test joint management under the oversight of the Indian Minerals Steering Committee (IMSC). This committee, established by an interagency agreement between MMS, BLM and BIA, consist of senior managers from these three agencies and the Office of the Secretary, the Office of Surface Mining, and the Office of Special Trustee. The pilot began two years ago with the IMSC selection of an office director. During this time FIMO has improved the communication between the owners and the Department, and enhanced our ability to met legal trust responsibilities.

To encourage leasing of Indian lands, FIMO conducted a lease sale in July 1997 involving unique leasing terms. Rather than the usual 16 2/3 per cent royalty rate, this sale involved two-step rates of 12 1/2 in the initial term with an increase to 20 per cent. We received about 250 bids, which BIA is in the process of approving. The innovative lease terms demonstrated a positive approach to enhance business activity.

The IMSC is evaluating the pilot to determine if the one-stop approach will be continued or expanded into other areas. We'll be reporting back on that issue at the next RPC meeting.

Indian Self-Governance

Tribes can elect to assume a range of royalty management functions, from audit to the entire program under self-governance contracts. To date Tribes have only requested to perform audit functions. The likely candidates for expanded self-governance are the 12 out of 41 Tribes that receive over a million dollars annually. We continue to encourage all tribes to participate in these opportunities.

The Department is working on finalizing a February 1998 proposed self-governance rule through

a negotiated rule making committee of Interior and Tribal representatives. There are a number of significant issues to be considered during the next meeting this November, including:

- The definition of inherently federal functions.
- The discretion Tribes have in assuming non BIA Indian programs.
- Investments of Federal funds controlled by Tribes in non-guaranteed instruments.
- Tribal conflict of interest standards.

Office of Indian Royalty Assistance

Supporting self-governance are the educational programs of RMP's Office of Indian Royalty Assistance (OIRA). In the intern program, Tribal representatives work with RMP to gain knowledge of royalty issues through hands on experience. For example, a Crow Nation representative is working on coal valuation during the first year, and is scheduled to work on coal audits during the second.

The OIRA, developing a more creative strategy, is staffing booths at Indian fairs and other gatherings to disseminate royalty information. Also scheduled is an IMSC listening conference in October, to improve the accessibility of northern region Tribes.

Year 2000 Compliance

The Department has a goal of achieving year 2000 compliance with its computer systems by March 1999. RMP is ahead of schedule for our major systems, and our support systems will meet the goal. Our external data partners were notified by letter during May 1998 that our systems will be able to review and modify data to assure compliance. Questions regarding this issue can be addressed to our web site established for this purpose at Y2K.mail@mms.gov.

Information Requests

The Department has a strategic goal that by September 1999, frequently requested information be made available electronically. We will have the systems in place to begin making this data available on the Internet in the near future. Hopefully, this will reduce the number of Freedom of Information Act requests we receive for the same data and make the information more readily available.

Pending Legislation

In addition to the legislation mentioned by the Director, we were asked to comment on three bills: the small refiner forgiveness legislation, the Royalty Protection Act of 1998, and a bill to dissolve the Minerals Management Service. The small refiner forgiveness legislation would forgive the billing obligations of small refiners for royalty oil take as part of the Department's current RIK program. We support the concept with a few additions. One is that the language in

the bill needs to make clear that the Federal Government can pursue payments from those producers who knowingly provided false reports concerning the proper value of crude oil being supplied. Second, if a small refiner sold the production rather than using it forgiveness would not be provided. The Federal Oil Royalty Protection Act of 1998 proposes to repeal the prohibition of issuing the Federal oil valuation rule and implements additional measures that prospectively would raise royalty collections by as much as \$76.4 million annually. While the agency supports the prohibition repeal, the position on the second is still being considered within the Department and OMB. The bill to dissolve MMS has no co-sponsors and probably will not see any action this Congress.

APPROVAL OF THE JANUARY 26, 1998 MINUTES

Motion was made that the minutes be accepted as drafted.

Motion seconded.

Vote: 17 votes in favor, none opposed.

Motion carried.

NET RECEIPT SHARING (NRS) SUBCOMMITTEE REPORT

Mr. Reynolds, who recently assumed the position of Chairman of the Subcommittee on Net Receipts Sharing, presented the final report (All members received a copy more than 30 days before the meeting.). For technical analysis, it referred to a Department of Interior, Office of Inspector General's audit report of October, 1997. In response to questions, Ms. Querques-Denett stated:

- MMS didn't agree with everything in the report, especially methodology issues.
- In regards to refund to the States for NRS overcharges, MMS has requested the Office of the Solicitor to provide an opinion if the agency has the authority to issue such a refund.
- For fiscal year 1997, including BLM, MMS and Forest Service, the NRS deduction was \$.0329 for each dollar the States received.

After extensive debate, an amended motion was presented to the RPC that this report be forwarded without action by the whole committee to the three agencies for consideration on its own merit, with a request that the agencies respond to the legal and accounting issues which have been raised. Accompanying the report will be a statement that the RPC supports full, fair disclosure of all costs that are charged back to the States.

Motion seconded.

Vote: 18 in favor, none opposed.

Motion carried.

LESSEE-DESIGNEE SUBCOMMITTEE REPORT

Ms. Stonecipher Mr. Simpson presented results of the subcommittee work. The subcommittee was formed to resolve the problem of the MMS knowing who to notify when collecting payments that are due and that were not paid initially. As a result of the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996, effective for production after September 1, 1996, only lessees are responsible for the royalty and related payments. But lessees may designate a person to make all or part of the payments due under a lease on the lessee's behalf with notification of MMS. The subcommittee charge was to determine how the MMS would know who to notify in the event of underpayment, since the Government's systems are payor based. (The Subcommittee provided a proposed Data Management Plan for the RPC's review.)

Mr. Blackmon explained that since the RPC did not receive the report at least 30 days before the meeting as required by the RPC's Procedures, the committee would first have to waive that rule on a two-thirds vote. The Parliamentarian, Mr. Schaefer Agreed.

Motion was made to waive the 30 day requirement for consideration of this report.

Motion seconded.

Vote: 19 in favor, none opposed.

Motion carried.

An amended motion was made to approve the committee's report and forward it to the proper authorities within the Department, with a transmittal letter recommending that the MMS consider the benefits of adding Indian leases to this process. An additional clarification will be included in the transmittal letter that the report applies only to oil and gas leases.

Motion seconded.

Vote: 17 in favor, one opposed.

Motion carried.

OTHER LEASABLE SOLID MINERALS SUBCOMMITTEE INTERIM REPORT

Mr. Reynolds, chairman of the subcommittee, explained that they met four times since the spring, making progress in developing consensus for the framework on developing the royalty valuation rules and regulations. Accordingly, MMS facilitators are drafting a rule for the subcommittee to review on November 9, 1998, and possibly one additional meeting to complete the review and submit a report to the Royalty Policy Committee in the beginning of 1999.

COAL SUBCOMMITTEE INTERIM REPORT

Mr. Loomis explained that the coal subcommittee has evolved to more of a standing committee than an ad hoc committee, functioning to identify and discuss mutual topics and clarify related issues. The committee has been examining whether non-arm's length valuation benchmarks should be revised. While consensus has been reached on the new benchmark, recommendations will be incorporated in a comprehensive report in the future. Issues currently being studied and/or discussed include:

- Rail cost adjustment factors.
- Flat rate investigation by the state, which MMS is addressing.
- Summary of valuation methods for state severance taxes and foreign valuation methods.
- Sales to joint ventures affiliates, which will be addressed in an MMS policy decision shortly.
- First sale of electricity, which will be addressed in a MMS briefing paper.
- RSFA for coal and the potential of the industry pushing for a RSFA of their own.
- Electric utility deregulation and the effects on industry.
- Option payments, stranded costs and contract termination payments.

Questions outstanding with the MMS is the audit recommendations, a June 15, 1998 letter from the MMS Director Quarterman, and the waste stockpile legal opinion.

PROGRAM REENGINEERING PRESENTATION BY MILT DIAL

Mr. Dial referred to a preliminary design concepts report that came out in March and a hard copy of the presentation slides which was made available to all members. He then discussed the subject

in detail, which was followed by a question and answer session.

APPEALS RULE UPDATE BY WALTER CRUICKSHANK

Mr. Cruickshank provided a background and current status of the pending appeals rule. This was followed by a question and answer session.

ROYALTY-IN-KIND PRESENTATION BY BONN MACY

Mr. Macy discussed in detail the current status of the three RIK pilots, Wyoming, the Texas 8-G and the Larger Gulf of Mexico pilot. He also referred to the MMS internet address, www.rmp.mms.gov, "What's new" where there's information on the Wyoming pilot, including a list of all the properties, winning bidders, and background information. Mr. Macy's presentation was followed a question and answer session.

NEXT RPC MEETING

Mr. Blackmon stated he would schedule a date during January 1999 for the next meeting.