

**Minutes
Royalty Policy Committee
September 25, 1997**

Members/Alternates Present: Kenneth Carfine, Johnnie Burton, David Darouse, Ron Cattany, Brad Simpson, Gary Carlson, Spencer Reid, Eddie Jacobs, David Harrison, Perry Shirley, Thomas Shipps, Wendy Daboval, David Blackmon, Gary McGee, William Stone, Mary Stonecipher, Fred Hagemeyer, Hugh Schaefer, Steven Williams, William Hartzler, John Sharp, and Sandy Blackstone.

Non-Members Present: Cynthia Quarterman, Lucy Querques Denett, Bob Brown, Don Sant, Ken Vogel, Frank Salwerowicz, Terry Holman, Connie Bartram, Milt Dial, Hugh Hilliard, Vern Ingraham, Todd Mc Cutcheon, Mike Miller, Herb Wincentsen, Mike Throckmorton, John Hovanac, Scott Ford and Paul Knueven.

Welcoming and Opening Remarks - David Backmon

UPDATES FROM CYNTHIA QUARTERMAN:

The western Gulf lease sale held during August 1997 was the fourth in a row of a series of record-breaking lease sales. We received 1224 bids on 804 tracts, high bids of more than \$600 million. This compares to last year western Gulf sale which generated about \$350 million. We are projecting a minimum 70 percent increase in oil production in the Gulf of Mexico by the year 2000.

Update for rule makings in process:

- Indian gas valuation proposed rule was published in September 1996, the comment period ended in December, and reopened in March 1997. Presently, we are discussing the revenue effects with our Indian constituents and conducting an economic impact analysis. We plan to publish the final rule before the end of this year.
- While the Federal gas valuation negotiated rule making was withdrawn, we decided to proceed with request for comments on two additional options for valuing federal gas; one an index based formula and the other patterned after Norway's royalty evaluation system for crude oil; or other options. the comment period closed September 22, 1997. These comments are now being reviewed.
- The January 1997 proposed crude oil valuation was the topic of workshops in April 1997, with a revised proposed rule issued July 1997. Workshops on the rule have been scheduled. Crude oil valuation review in California continues with bills for more than \$345 million issued to date. On a nation wide basis we also

continue to audit the most recent six years for any crude oil valuation issues, implementing the June 1996 valuation guidance.

- A proposed rule for Indian oil valuation is scheduled for year end publication. It will create a new form for collecting value differential data, decrease our reliance on posted prices, and increase consistency with Indian leases terms.
- A rule making to separate cost for gas transportation required by FERC Order 636 is also in process. Issuance of a final rule will occur soon.
- To lower costs we will propose a rule before the end of the year that would require electronic reporting except in hardship cases by the end of 1999. Electronic reporting holds the promise of reducing both industry's and MMS's costs. With less than a one percent error rate, error correction costs for electronic reporting have proven to be much less than manual reporting with an error rate exceeding six percent.

Our Internet homepage includes much of the information that will be presented today. This includes status reports on RSFA implementation, Program Reengineering, valuation regulations, as well as news releases and lease sale information. In addition, we have a document that celebrates the achievements made in MMS's first 15 years.

In 1995 we began implementing innovations to do business better and more efficiently. Over the past two years we have verified 21 different initiatives, for which Vice President Gore recognized employees with his Hammer Award. The reengineering effort within RMP is an important effort that will help streamline our reporting. Conversely, looking at ways to improve our business functions is something I support wholeheartedly, and invite you to participate in with us.

UPDATES FROM LUCY QUERQUES DENETT:

Four main areas will be included in this update: RSFA, the Royalty In Kind Programs, with the two studies recently completed, reengineering, and status update on RPC recommendations. The later included:

- Eliminating the reporting of drilling wells on the MMS 3160 and the Oil and Gas Operations Report, to save reporting time for operators.
- Eliminating the unnecessary data fields on the payor information form. Changes will probably will be implemented with RSFA changes.
- Extending the due date by 10 days for production reports that are submitted electronically.

- Eliminating unnecessary status codes from the production report.
- Studying Federal reporting for royalty oil taken in kind for the current crude oil small refinery program.

For RSFA implementation, we've accomplished a number of actions. We began paying interest to companies who overpay on royalties by February 13, 1997. In October, companies will be able to calculate their interest on overpayments and take credits against royalty payments. We also repealed section 10, OCSLA, and issued an interim final rule regarding designation of payment responsibility. And finally, we issued the final rule on State delegations. System changes to facilitate additional State delegations will not proceed until we know more about their interest.

Thanks to all industry and State representatives that met with us on numerous occasions to help work through RSFA implementation. The next RSFA implementation meeting on November 5, 1997 from 1:00 to 5:00 followed by a full day session the next day at Building 85. Discussion topics include rule making for interest on overpayments, the 10 percent excessive overpayment issue, chronic erroneous reporting, take versus entitlements, and accounting relief for marginal properties.

A Self-bonding proposed rule should be issued this fall. While RSFA applies to federal oil and gas only, self-bonding will be expanded to solid mineral and geothermal leases.

The proposed appeals rule was placed on hold as a result of the RPC's recommendations. Another proposed rule will be worked on this fall, incorporating the recommendations accepted by the Secretary. Additional proposed rules will be developed on prepayment of future revenue streams, statute of limitations, and payment liability.

Royalty In Kind involves two separate issues: the current RIK program for small refineries and an expanded program to replace part or all of the existing royalty in value. In 1995 MMS conducted a pilot program on the later, and a RIK Feasibility Study in September. The report recommended three additional pilots: one each in the Gulf of Mexico, Wyoming; and with Texas with OCSLA Section 8(g) gas.

As recommended by the RPC, the other RIK study looked at the current crude oil refinery RIK program, on value and volume issues, and producer reporting. The study group will submit recommendations by the end of December on the computation of the administrative fee and the determination of program need.

While the DC Circuit Court ruled against DOI in a gas contract settlement case in August 1996, the Sixth Circuit in April 1997 supported the DOI position. So we are continuing to pursue audits of gas contract settlements with collection to date of \$143 million. There are another \$162 million identified in findings, and we're hoping to complete this effort in the near future.

The Indian Minerals Steering Committee, which is made up of the deputy solicitor and representatives from BIA, BLM and MMS, as well as the Office of the Special Trustee, conducted a symposium on the competitiveness of Indian leases early September. Representatives from tribal governments, allottee associations, industry representatives and government agencies also attended. The IMSC conducted the meeting to address concerns that RSFA made Indian leases less competitive. The recent lease sale conducted by the Farmington Indian Minerals Office for Navajo allottees indicated a high interest level in these leases. But we will look at some of the recommendations made.

Reengineering is my highest priority. The end result should be a highly integrated organization, fully supported by the state of the art technology, process centered and focused on outcomes. Because of changes required by RSFA and our evolving business environment, we need systems that are portable, modular and scalable, that ultimately supports a less costly program. At this point we have completed mapping of our current business systems, identifying a number of areas of duplication that we're targeting for improvement. By December we'll have a better picture of the conceptual business framework. During fiscal 1998 we intend to do some prototyping of the process, and we'll be looking to some industry representatives as well as some States and Indian lease owners to join us.

ELECTION OF A NEW CHAIR AND VICE CHAIR

Ron Cattany motioned that the committee vote a slate of officers, of chair and vice chair.

Motion Seconded.

Vote: With 20 member present more than 14 voted for the motion - carried.

Perry Shirley nominated David Blackmon for chair and David Harrison as the vice chair.

Motion Seconded.

Mr. Cattany nominated David Blackmon as Chair and Perry Shirley as vice chair.

Motion Seconded.

Vote: With 20 member present, one abstention, 3 voted for David Blackmon for chair and David Harrison as the vice chair - failed.

Vote: With 20 member present, one abstention, 15 voted for David Blackmon for chair and Perry Shirley as the vice chair - passed.

Elected for the next 2 year term: Mr. David Blackmon, Chair; Mr. Perry Shirley Vice Chair.

NET RECEIPT SHARING SUBCOMMITTEE INTERIM REPORT

Ms. Johnnie Burton, Chair of the NRS Subcommittee, presented a status report on the subcommittee's progress. Last year GAO and OIG began NRS studies to determine if the States were paying their fair share of expenses. The subcommittee decided that it would be wise for us to wait for their results. While the GAO study was published without helpful conclusions, OIG report is still in draft form. Assuming the OIG issues its report soon, the subcommittee plans to have a final report by the next RPC meeting. Since we started this work, MMS changed many practices and addressed a lot of our concerns.

COAL SUBCOMMITTEE INTERIM REPORT

The Coal Subcommittee Interim Report was presented by Mr. Cattany, who summarized their activities over the last nine months and the recommendation forwarded to the Chair last month. Initially in January the Committee identified 59 issues in five categories to consider. Those included valuation, auditing, reporting, RSFA for coal, and philosophical issues.

The proposed resolution forwarded to the Chair concerns coal waste piles, and we urge the RPC to adopt that resolution. The issue involves the applicability of federal royalty collections on coal recovered from coal mine waste piles resulting from previous mining of federal coal leases. These are unreclaimed waste piles, some of which are on non-federal lands, and the original federal leases may or may not continue to be in effect.

The Coal Committee agreed to several principals:

- If the Federal coal lease is in effect its royalty rate terms apply to the waste coal recovered from the waste pile.
- If the Federal lease from which the waste coal was produced has been relinquished and the waste pile is located on Federally owned surface lands not subject to an existing lease, the relinquished lease's royalty rate terms would apply.
- If the Federal lease from which the waste coal was produced has been relinquished and the waste pile is located on non-federal surface land, the Federal royalty depends on ownership. And if the coal waste pile is Federally owned, the relinquished lease's royalty rate terms apply. If it is not Federally owned no royalty is due the Federal Government.

We recommend to the RPC that it request the MMS director to obtain a Department of the Interior, Solicitor's Office opinion on the ownership of coal waste piles located on non-Federal lands where the coal was originally produced under a Federal lease since relinquished. This is an important issue on two leases right now in Utah. There are potentially some other leases in some other western states where this may appear as well.

(A written proposal was provided to the members.)

After a lengthy discussion Ms. Blackstone restated the motion that the RPC recommends that the MMS Director request a solicitor's opinion on the three situations discussed in the background of this Coal Subcommittee recommendation.

The motion was seconded.

Vote: 19 votes in favor, the motion passes, and the request will be forwarded to solicitor's office.

PARLIAMENTARIAN APPOINTMENT

After the Chair requested comments on whether or not a parliamentarian should be appointed, Mr. Shipps stated that the proposed RPC procedures, item 2, required the vice chairman of the RPC serves as parliamentarian.

Mr. Shirley (vice chair) motioned that the RPC amend the Committee rules and accept Hugh Schaeffer's offer to serve as parliamentarian.

The motion was seconded.

Vote: 19 votes in favor. The motion carries. Hugh Schaefer is now our parliamentarian.

REORGANIZATION OF THE OTHER LEASABLE SOLID MINERALS SUBCOMMITTEE

Mr. Herb Wincentzen, Chief of the Solid Minerals Evaluations Branch in Lakewood, Colorado, provided a background on the development of the current policy and regulations governing the leasing of solids other than coal. Most important are the potassium and sodium industry principally located in Wyoming, Utah, New Mexico, and California.

The governing regulations haven't been changed since 1978. The 1978 rule making was an outgrowth from a 1976 Secretarial decision document. Most of the significant valuation practices and policies for sodium and potassium are not in the regulations. They're in the guidelines which occurred prior to the regulations. At this point in time with new markets developing, new questions have been raised that the current regulations are totally inadequate to answer. The remedy for that is to revisit the regulations as we're now doing internally. The question before the RPC is whether the expertise of the industry and the interest of the States should be able to aid in the formulation of revised product valuation regulations for sodium and potassium. The principal sodium and potassium operations are Wyoming in the Green River area, California in the Mojave Desert at Searls Lake, Utah at Riley, Windover, and New Mexico of course at Carlsbad, and recently, near Rifle, Colorado. Annual royalty revenue associated with sodium and potassium is approximately \$50 million a year. No Tribal lands are presently involved. Offshore sulfur is not

covered by the subject regulations, but by lease specific terms.

Ms. Burton motioned that the RPC reorganize the subcommittee to look into sodium and potassium regulations, and help study the issue with MMS.

The motion was seconded.

Vote: Twenty votes in favor, the motion carries.

Ms. Burton was named Chair of the Subcommittee, with a Vice Chair to be named later after a nomination is submitted by the National Mining Association.

UPDATE ON RSFA BY DONALD SANT

Referring to a handout entitled "Recent Publications" Mr. Sant outlined the final rules, proposed rules, and the Dear Payor letters that were issued approximately over the last year, mostly required by RSFA. Next week an additional Dear Payor letter will describe how to report interest beginning in October. We have been calculating interest on both underpayments and overpayments since the February report month. A workshop is scheduled on the 5th and 6th of November in Lakewood, Colorado on this issue.

The RSFA clarified liability issues with the lessee liable for their proportion in interest in lease, defining lessee as the operating rights owner or the lessee of record. The operating rights owner is primarily liable for royalty payments and lessee of record secondarily liable. The law allows a lessee to designate another entity to pay on their behalf who is not liable for the royalty payments. It also required that the lessee file with the Department who they had designated as their payor on a particular lease.

While we did have workshops last fall on this issue, there's still some differences of opinion on the best way to identify an entity that's been designated a payor on somebody else's behalf. One of the complications is that non-payor lessees would not know account identification numbers and other payment data. In our workshops there was agreement that we would start by asking payors to identify whether they were a lessee, and if not, who they were paying on behalf of. Once that information was obtained, we planned to sort by lessee, send the information back to the lessees and request a confirmation that they had designated a particular payor.

We sent letter requests to payors during January 1997 and by April, agreed with OMB that our approach violated the Paperwork Reduction Act. Working with OMB through its emergency processing procedures we published an interim final rule on August 5, 1997, granting us the regulatory authority to ask payors for this information. A public comment period on this rule will end in early November.

About 40 percent of the payors responded to the January 1997 data requests. Only a few

completely refused to submit the lessees data. On August 14, 1997 we sent out an additional Dear Payor letter as an order requiring the same information and citing the rule.

Some of the comments we received on the interim final rule state that RSFA does not give us the authority to ask payors for this information, and that some payors simply do not know lessee identity. We recognize that payors may not have some data, such as taxpayer identification numbers. That's another reason why confirmations by lessees will be necessary.

Ms. Denett commented that the necessity to create a new data base may increase our net receipts sharing costs, and it's something that the RPC could help with, since there really isn't a clear cut answer.

ORGANIZATION OF THE LESSEE-DESIGNEE REQUIREMENTS SUBCOMMITTEE

After extensive discussion of the effects of the lessee-designee requirements, Mr. Blackstone motioned that the RPC form a subcommittee to look at the issue and make recommendations.

The motion was seconded.

During the discussion of this motion participates questioned if anything else could be done that the agency is not already doing. Ms. Denett explained that she requested RPC look at this issue since it does have reporting implications, and the reporting subcommittee came forward with lots of many good recommendations to streamline reporting. There are a lot of issues involved that are going to be impacting the industry and MMS for a very long time. Recommendations for a legislative fix, if that's necessary, from this committee would have more weight to go through the Department.

Vote: Unanimous, 20 votes in favor; motion passed. Mr. Blackmon named Mary Stonecipher as Chair and Brad Simpson as Vice Chair of the new subcommittee.

ROYALTY-IN-KIND PRESENTATION BY VERN INGRAHAM

Mr. Ingraham referred to a recently published report by MMS, entitled the Oil RIK Value and Volume Reporting Recommendations which was provided to all members. He then discussed in detail the report's findings and recommendations, which was followed by a question and answer session.

ROYALTY-IN-KIND PRESENTATION BY TODD MCCUTCHEON

Mr. McCutcheon referred to a recently published report by MMS, entitled the 1997 Royalty In Kind Feasibility Study which was made available to all members. He then discussed in detail the report's findings and recommendations, 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 HOVANEC

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.

APPEALS PRESENTATION BY HUGH HILLIARD

Mr. Hilliard discussed in detail the Royalty Policy Committee's recommendations on appeals to the Department of the Interior, and the Secretary's response, both documents made available to all members. This was followed by a question and answer session.

NEXT RPC MEETING

Mr. Blackmon stated he would schedule a date during the second week in January, with the arrangements made in December.