Draft API Comments/Response to Report to Royalty Policy Committee, "Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf," Completed by the Subcommittee on Royalty Management

I. API commends the Subcommittee on Royalty Management for its hard work and thorough evaluation of the federal royalty management program

II. It is important to recognize that the oil and gas industry did not participate in the completion of the report and had no opportunity to comment. The oil and gas industry is perhaps the most critical stakeholder outside of the government and should thus have an opportunity to comment on a recommendation before any action is taken, including the development of guidance or a proposed regulation. Based upon the limited time API has had to review the report and recommendations, API offers the following preliminary remarks

III. API supports the recommendation for increased coordination sharing among MMS, BLM and BIA, particularly between MMS and BLM
   a. There is currently insufficient information sharing between MMS and BLM; in fact, the MMS and BLM information management systems often do not communicate at all when it comes to minerals royalty management
   b. There is often an unsatisfactory lag when MMS and BLM actually do share information
   c. The ultimate goal of increased coordination, communication and information sharing among MMS, BLM and BIA should be consistency, fairness, and transparency in the application of federal laws and regulations

IV. API supports the establishment of an RIK Subcommittee to the Royalty Policy Committee and new or revised regulations and/or guidelines to provide certainty, consistency, fairness and transparency in the administration of the RIK program

V. API has serious concerns about recommendations made in Chapters 3, 4 and 7; the oil and gas industry was not consulted on the report and these recommendations fail to take into account the impact on the industry. As a result, many of these recommendations may be extremely difficult, if not impossible, to implement; they also fail to adequately consider whether the supposed benefits outweigh the actual costs.
   a. API objects to recommendation 3-8, which is to amend the Royalty Simplification and Fairness Act (RSFA) to allow MMS to pursue only the "payor" for unsettled debts. This recommendation is simply an effort to make things easier for MMS, despite the fact that it could result in inequities to lessees. MMS has failed to follow through on its responsibilities under RSFA to put a system in place to track the identity of operating rights owners. As a result, we now see a recommendation that will reverse the elements of fairness and equity that were put in place by the system established under RSFA. The report fails to address the negative aspects of reverting back to a system where MMS only has to pursue the payor. Specifically, this proposed amendment fails to take into account the fact that the payor may not have the best interests of lessees or other operating rights owners in mind. By pursuing only the payor, lessees and other operating rights owners could be left watching from the sidelines while the payor

fails to protect their interests, leaving them stuck with a judgment that they were unable to defend and without recourse to appeal. Furthermore, the lessee may not have any way of knowing that an issue has arisen between MMS and the payor, and thus will have no opportunity to protect its interests. The lessee, who had made a substantial investment, would have to rely on the payor both to inform the lessee of an issue and to defend it, when it is the lessee rather than the payor who has the most at stake. Notably, it is the lessee, not the payor, that has the contractual obligation to pay royalties and satisfy other lease obligations. In essence, lessees and other operating rights owners are afforded insufficient due process under this proposed system. Such a recommendation should not be taken lightly, considering that the consequences could be economically staggering. API believes that the current law promotes fairness, which is a central tenet of RSFA. In lieu of this recommendation, API encourages MMS to implement a system to enforce its obligations as they currently exist under RSFA, as they pertain to tracking the identities of operating rights owners and lessees.

b. API also cautions against unnecessary changes to Form MMS-2014. With regard to Recommendation 3-6, API believes there is little benefit to including BTU values. This is especially true considering the fact that MMS can calculate such values from the information that is already reported. To wit, MMBTUs and MCF are already reported on the form. MMS can simply divide the reported MMBTUs by the MCF to capture the BTU value. This change may appear simple and straightforward but could actually result in tremendous costs due to changes in accounting and automation systems. Such changes should not be made in situations like this, where the desired data is easily obtained through the information already reported on the form.
c. API is also concerned about any recommendations to require all desired information electronically. From a practical standpoint, this may not be possible, because a great deal of information is still transferred by hard copy. Furthermore, it would be inappropriate to hold an operator responsible for the submission of this information electronically, when the information may be entirely under the control of a third party. Examples of recommendations where these problems may arise include Recommendations 3-11, 4-21 and 4-22. For instance, with recommendation 4-22, many run tickets are still written out by hand and are under the control of third parties.
d. There are some recommendations that are very vague and leave little explanation as to their meaning or necessity. An example is Recommendation 3-27, which simply says that "MMS should prioritize resolving Oil and Gas Operations Report errors and enforcing compliance via written orders and civil penalties." API encourages MMS to consult with the oil and natural gas industry in addressing this recommendation and any others like it, because of the troubling vagueness inherent in it.
e. API has significant concerns about Recommendation 4-6, which is an apparent attempt to encourage whistleblower reports by creating a new whistleblower program, potentially based upon a program from an entirely different federal agency, and offering additional "rewards" for whistleblowers. Federal whistleblower laws can be an important and effective mechanism for uncovering

noncompliance. However, the federal royalty management system, laws, and regulations are very complex, and oftentimes lead to legitimate disputes over the interpretation of the laws and regulations. There is little rationale for posting hotlines in federal facilities and notices "at each Federal oil and gas location" to report "theft of Federal minerals." A third party may not have any understanding of the regulations governing what he perceives as wrongdoing, but could still file a claim that is without merit, triggering a compliance review or audit that could consume substantial resources (on both the government's and the lessee's sides). The recommendation contains a number of vague concepts and ill-defined parameters. For example, if an investigation is initiated there appears to be no time limit for disposition of the case. Furthermore, the recommendation states that "information provided by a whistleblower would trigger *some* form of compliance review or audit." Another concern is keeping the identity of the whistleblower confidential. Whistleblowers should have some protections, but fairness and due process dictate that companies have the right to know who is bringing a claim against them in order to defend the claim. It is also unclear how this system would work in connection with the False Claims Act. Would this program supplant claims brought under the False Claims Act? IRS claims are exempted from the False Claims Act. Would there be a similar restriction recommended under this proposed program? Whistleblowers should not have the opportunity to bring claims under both the False Claims Act and and a separate MMS royalty whistleblower program. For these reasons, API questions the need for Recommendation 4-6.

f. API requests that MMS consult the oil and natural gas industry if MMS chooses to address Recommendation 4-16, related to calculating interest on royalty payments. Interest is paid to both the government and lessees, and stakeholder involvement is necessary to ensure that all problems are resolved.
g. MMS should acknowledge and understand the practical implications of making changes to oil and gas measurement processes, including the changes proposed in Recommendations 3-22 and 3-23. Changes in measurement processes impact not only large numbers of industry operators, but also large numbers of BLM employees. Therefore, the costs of such changes should be weighed against any supposed benefits.
h. API is concerned about Recommendation 4-26, which addresses revisions to the federal gas valuation regulations. For some time now, the Royalty Policy Committee has been attempting to find common ground among the stakeholders on potential revisions to the federal gas valuation rule. However, there has been little progress. API encourages MMS to continue to work with all of the stakeholders before engaging in such a difficult task and to make sure that any such regulatory effort adheres to principles of transparency, certainty, consistency and fairness.
i. API believes that Recommendations 7-1 and 7-2 are beyond the scope of the charge of the Subcommittee on Royalty Management and could produce unintended consequences. Assistant Secretary Allred's September 2007 letter was clear in that he asked the subcommittee to review offshore lease issuance procedures outlined in a February 2007 memorandum. These procedures

specifically relate to future lease sales. As a result, the subcommittee went beyond its authority in making Recommendations 7-1 and 7-2, which pertain to past lease sales. Published remarks by senior Interior officials bolster API's concern. Regarding Recommendation 7-1, which suggests that DOI should continue efforts to pursue voluntary royalty payment agreements with holders of the 1998 and 1999 leases without price thresholds, MMS Director Randall Luthi, in a recent interview, noted efforts by MMS to address these oil and gas leases are on hold pending the outcome of the *Kerr-McGee v. Burton* case. With respect to Recommendation 7-2, which suggests Congress should continue to explore legislative options which could address the loss of royalties under the 1998 and 1999 deep water leases without violating legitimately signed contracts, Assistant Secretary Allred has cautioned that "we must be mindful of unintended consequences, including potential new legislation that might result in litigation affecting future lease sales in the gulf" and that "litigation could take years to resolve."