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By E-mail/Original by Mail

A. Knueven, Chief
Regulation and FOIA Team
MRM/MMS
Box 25165, MS 320B2
Denver, Colorado 80225-0165

RE: Comments to Supplementary Proposed Rule, Accounting and Auditing Relief for Marginal Properties, 68 Fed. Reg. 15390 (March 31, 2003)

Dear Mr. Knueven:

These comments to the above-captioned rulemaking are submitted on behalf of California State Controller Steve Westly.

By letter dated April 22, 2003, California State Controller Steve Westly asked Secretary Gale Norton to terminate the Bureau of Land Management's (BLM's) stripper and heavy oil rate reduction programs. Under those two programs, the royalty rates on some federal leases in California, for example, declined from the standard 12.5% to 6%. BLM's programs were instituted under the theory that blanket reductions in federal royalties would "promote production" and "increase" royalty receipts. *Compare* Royalty Simplification and Fairness Act (RSFA), 30 U.S.C. § 1726; 68 Fed. Reg. at 15390 (accounting relief may be considered if it will "promote production, reduce administrative costs, and increase net receipts to the United States and the States"). At $24 bbl on a lease "producing 1,000 BOE or less annually" (*cf.* 68 Fed. Reg. at 15391), BLM's rate reduction program would grant, automatically, an annual subsidy of $1,560 on each lease eligible for a 6% reduced royalty.

As the Controller noted in his April 22 letter, an audit by Interior's own Inspector General

revealed that no credible evidence exists that BLM's rate reductions promoted production from these "marginal" properties. Moreover, the stripper rate reduction program did not result in BLM's predicted increase in royalty revenues. *See IG Audit Report 01-I-297 (March 2001).* Under the IG's Audit Reports, any administrative cost savings, if extant, could only be attributed to administrative neglect. *E.g. IG Audit Report* 00-I-300 (March 2000).

At a May 12, 2003 briefing to Congress on fossil fuel subsidies, groups as diverse on public policy matters as CATO and Friends of the Earth agreed that "production" subsidies for the oil and gas industry have never worked. The analyses of these groups is consistent with the conclusions of former President Reagan's DOE and the current White House Council of Economic Advisors that even complete royalty holidays would not serve to increase domestic production. Similar sentiments are echoed in industry's own comments to MMS's initially proposed rule. *E.g.* 68 Fed. Reg. at 15393.

On March 31, 2003, the Minerals Management Service (MMS), which itself criticized BLM's rate reduction program[1], proposed to extend more relief to "marginal" properties in the form of accounting and auditing relief. Under its "Notification-Based" relief option and its own "cost/benefit analysis", a marginal property would *receive $45 in annual relief.* 68 Fed. Reg. at 15396 ($45,000 net benefit/1000 estimated notices).. According to MMS's numbers, extending this relief would cost the public – in estimated revenue loss and administrative costs – approximately $69 per marginal property in the first year, and $65 per marginal property in subsequent years. 68 Fed. Reg. at 15397-15398 (cost/benefit summary charts).

The MMS's proposed "Request-Based" relief option would cost the public at least $2,200 per marginal property in administrative costs to process 10 applications alone, and, indeed cost industry $200 per application. *Id.* MMS concedes, however, that "the administrative savings to industry that may be afforded if they are granted relief" would not "be significant enough" for a lessee to consider incurring a $50 processing fee. 68 Fed. Reg. at 15395. MMS admitted that the impact on royalties owed to the public was unknowable.

Despite the logic of its own numbers and the history of Interior's own "relief" programs, however, MMS says it "believe[s] this reduced cost of operations" – estimated at less than $100 per year per property – "will prolong the life of marginal wells". 68 Fed. Reg. at 15396. Moreover, MMS "believe[s]" that its "relief" proposals will increase royalties, state severance and ad valorem taxes, and serve as a jobs program. *Id.* On their face, MMS's representations are absurd.

MMS suggests that its proposals are the result of the recommendation of its Royalty Policy

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[1] *IG Audit Report 01-I-297* at 9-10. "According to MMS, while the [BLM] study showed an increase in production from New Mexico, Wyoming experienced a decline in production. MMS also said that Wyoming was more representative of a stripper oil state ...." As the IG report noted with the agreement of DOE and MMS, BLM could not even attribute the insignificant increase in production in New Mexico to its rate reduction program. New Mexico's royalty receipts declined.

Committee (RPC). This is true – in part. After proposing a rule in 1999, the issue of accounting and auditing relief was referred to the RPC for study. RPC appointed a subcommittee with members from both industry and states[2], and "technical advisors" from MMS and Interior's Solicitor's Office. 68 Fed. Reg. at 15390. The RPC was tasked by MMS to make recommendations regarding changes to its 1999 proposed rule and its report reflects an analysis aimed at the goal of promulgating some type of rule.

Neither the subcommittee nor the RPC found that the potential "benefits" of accounting and auditing relief would serve to promote production, increase royalty receipts and reduce administrative costs. There is nothing in the report that even suggests that the two MMS options that survived subcommittee review did so because they were consistent with all three of RSFA's objectives.[3] The report was forwarded to the Secretary with the caveat that these findings could not be made. Report at 6. The RPC subcommittee's conclusions, in fact, are consistent with the IG's Audit Report, which was issued after the subcommittee completed its work. No one brought the IG's Audit Report to the attention of the RPC during its consideration of the subcommittee's report on March 27, 2001.[4]

There is, of course, a built in incentive for States to simply ignore the absurdity of MMS's proposed rule and the failure of any of the "relief" options to meet all three of the statutory prerequisites. Any State, under the MMS proposal, can simply "opt out" the federal leases from which it receives royalty income from any accounting and auditing relief authorized by an MMS rule. In fact, it can "opt out" by simply remaining silent. 68 Fed. Reg. at 15391. As the elected officer under the California Constitution and the Secretary's delegate under the Federal Oil and Gas Royalty Management Act, as amended (FOGRMA), please be advised that California does exercise its right under 30 U.S.C. § 1726 to refuse to extend accounting or auditing relief to federal lessees should this proposal be finalized.

The Controller, however, is responsible to the people of the State of California. Under

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[2]SCO was represented on the RPC subcommittee; California, however, has no representative on the RPC. SCO's representative did not vote to send the subcommittee report to the RPC on the grounds that the two MMS "relief" options that remained after the subcommittee reviewed MMS's 1999 proposal would "promote production", "increase net receipts" and "reduce" administrative costs. Indeed, subcommittee members insisted that the report contain language that indicated that it could not make these findings. *See also* footnote 4 *infra.*

[3]In fact, MMS fails to note that "consensus report" for purposes of the subcommittee's vote to send its report to the RPC was specifically defined to mean "that those listed have neither agreed nor disagreed" with the report "but believe they can support the recommendations to their organization." Minutes of Royalty Policy Committee at 3 (March 27, 2001). All that the RPC voted to do was "forward" the subcommittee report to the Secretary; the vote was not unanimous.

[4]As noted, the IG's report was also issued in March, 2001.

California law, the State's share of federal oil and gas royalties is dedicated to public education. Given his April 22 letter regarding the BLM rate reduction programs, which extend a bigger, but no more productive, subsidy to federal lessees, the Controller will not sit by and allow the federal government to represent to the public that $45 per property in annual relief to a marginal producer will generate more royalty dollars, tax dollars and create jobs too. In economic terms, this rulemaking is a charade, which, if it goes forward, will simply facilitate more bad investments of public money – school money – under the fiction that the government is increasing domestic production.

Moreover, several of the "legal" assumptions underlying the rule may adversely impact the Controller's ability to protect California's school fund from other federal efforts to reduce lessee obligations. These include, but are not limited to:

- The conversion of a State's equal role in making a determination of what is "in the best interest of the United States and the State concerned" into a requirement that MMS will "consult" with States. *Compare* 30 U.S.C. § 1726(a) *with* 68 Fed. Reg. at 15394. This "interpretation" could adversely affect a State's equal participatory role, as established by Congress, in other federal royalty matters. *E.g.*, 30 U.S.C. § 1724 (i). Congress knew how to require consultation when it intended consultation. *See e.g.*, 30 U.S.C. § 1735 (d).

- The proposal for a blanket "Notification-Based" option when "accounting and auditing" relief for marginal properties is required under the plain language of the statute to be made on a "case by case" basis. 30 U.S.C. §§1726(a); 1726(b).

- The refusal of Interior's "technical advisors", which included representatives of the Solicitor's Office, to take a position with regard to a State's "sovereign immunity"; a failure that facilitated a tortured reading of RSFA. 68 Fed. Reg. at 15391-15392. Congress's power to waive a State's sovereign immunity must be explicit. *E.g.*, *Edelman v. Jordan*, 415 U.S. 651, 671-672 (1974). There is no statutory language that suggests that Congress intended to waive the State's sovereign immunity.

- The related failure of Interior to advise the RPC that there is nothing in the statute that requires that decisions under 30 U.S.C. § 1726 be subject to administrative appeal. If a federal lessee is unlikely to request relief because of a $50 processing fee (68 Fed. Reg. at 15395), it is equally unlikely to file a lawsuit in U.S. District Court contesting either MMS's or a State's decision to deny relief. Moreover, in light of the IG's Audit Report, a federal lessee is also unlikely to prevail on any claim that accounting relief would promote production, increase royalty receipts *and* reduce administrative costs.[5]

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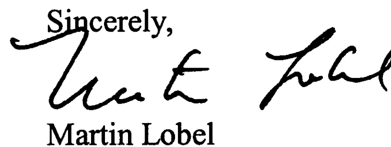
[5]For the same reasons, should MMS go forward with this rulemaking, MMS's failure to act within 120 days should be deemed a denial of any relief request, not an approval. 68 Fed. Reg. at

- The assumption by MMS of the power to "by rule waive an obligation under the lease terms if doing so does not change the lessee's position to its detriment" (68 Fed. Reg. at 15392), without citing any legal authority and ignoring the federal government's statutory obligation to royalty beneficiaries. *E.g. Peabody Coal Co.*, 93 IBLA 317, 327 (1986). There is nothing in 30 U.S.C. § 1736 that even suggests, for example, that Congress, by authorizing Interior and a State to simply consider "accounting, reporting and auditing" relief, intended to authorize Interior to "waive" the requirement that it receive full fair market value in royalties. 30 U.S.C. § 226. *See* 68 Fed. Reg. at 15394 (alternative valuation methods may be considered as "accounting" relief).

It has been suggested to the Controller informally that objecting to this rulemaking might offend its sister state jurisdictions by suggesting that their representatives' hard work for the RPC was meaningless. The Controller's vocal and public support of organizations like the State and Tribal Royalty Audit Committee (STRAC) clearly demonstrates the fallacy of this suggestion. The Controller's opposition to this rulemaking in fact recognizes the hard work and valid conclusions of both the State and industry participants on the RPC subcommittee that "accounting, reporting, and auditing" relief is simply not worth the regulatory candle.

Nonetheless, at bottom, federal rulemakings are not about egos and monuments, they are about implementing sound policies that promote the public interest and are consistent with congressional intent. This rulemaking does neither.

Sincerely,



Martin Lobel

15393. If anything, the RPC's acceptance of its subcommittee's report represents an acknowledgment by both industry and States that a lessee's ability to prove that relief under 30 U.S.C. §1726 would be in the "best interests" of the United States and the State is highly unlikely. The facts thus support a presumption of denial.