MARTIN LOBEL
JACK A. BLUM
LEE ELLEN HELFRICH
HENRY M. BANTA

LAW OFFICES OF
LOBEL, NOVINS & LAMONT
SUITE 770
1275 K STREET, N.W.
WASHINGTON, D.C. 20005-4048

(202) 371-6626
TELECOPIER: (202) 371-6643

OF COUNSEL
ALAN S. NOVINS
ARTHUR L. FOX II
DINA R. LASSOW

WILLIAM JOHN LAMONT
(1916 - 1994)

April 30, 1999

By Express Mail

David Guzy, Chief
Rules and Procedures Staff
Minerals Management Service
Building 85, Denver Federal Center
Denver, CO 80225

Re: "Accounting Relief for
Marginal Properties"

Dear Mr. Guzy:

The following comments to the proposal of the Minerals Management Service entitled "Accounting Relief for Marginal Properties," 64 Fed. Reg. 3360, are submitted on behalf of the California State Controller's Office (SCO). Generally, SCO opposes the MMS proposed rules because: (1) they are contrary to law; (2) they go beyond providing accounting and auditing relief; (3) they place burdens and costs on the federal and State governments; and (4) on their face, they cannot be construed in a manner that serves the best interests of the State.

At the outset, SCO notes that MMS's own analyses, made for purposes of determining the processing fee and the Paperwork Reduction Act (64 Fed. Reg. at 336-3368; 3371-3372), demonstrate why the determinations required under 30 U.S.C. §1726(a) will never support the relief proposed.

First, as MMS acknowledges (64 Fed. Reg. at 3368), it is impossible to determine whether any of the relief proposed would "promote production." Such a determination is not merely "remote and speculative", as stated by MMS, it is also demonstrably unlikely. In California, for example, there is no evidence that production has been promoted by BLM's extension of royalty rate relief. The net value of the relief to companies under the MMS proposal is so negligible that it simply could not counterbalance the impact of low crude oil prices, which was in fact the "threat" to marginal production. Federal accounting and auditing

costs do not drive any company's business decisions.

Second, the proposals increase, not decrease, the costs to concerned States. States will incur new costs, not previously assumed, to review lessee relief requests. SCO believes that these costs will be greater than estimated by MMS since the burden is left to the State and federal governments under the proposal to undertake the economic analyses required to make the determinations under RFSA, 30 U.S.C. §1726(a).[1] *See e.g.*, Proposed §204.210. As MMS notes, because of the nature of the auditing program, it is also unlikely that any of these proposals will result in anything more than minimal audit costs savings. 64 Fed. Reg. at 3368. In fact, auditing under different standards, like those proposed under §202.206, will increase, not decrease, costs. Moreover, it will likely be the federal government's position that its increased costs will be passed through to States under Net Receipts Sharing.

Third, even assuming MMS's cost estimates are correct, there is no way to determine in advance whether the relief will "increase net receipts." In fact, the loss to the State of the time value of royalty receipts, as proposed under §204.203, alone is likely to increase or exceed MMS's own estimates of administrative cost savings on a lease by lease basis. For further example, there will be no way to determine whether the relief proposed under §204.206 increases or decreases State return since MMS also proposes to limit a State's ability to evaluate that issue through audit. And how can a State evaluate the costs and benefits of an advance limitation on audit scope? Prior payment history is only one factor considered by auditors in developing audit plans and sampling tests. Advance scope limitations invite royalty gaming. Finally, MMS failed to evaluate the increased interest costs to industry which is an inherent by-product of a longer audit cycle.

The comments above only touch the surface of SCO's objections to the MMS proposals. For convenience, SCO addresses its remaining concerns in the context of particular proposed sections of the Part 204 proposal. However, this approach should not be construed as support for any proposed section not specifically addressed, or suggest that SCO's concerns as to the rule as a whole could be resolved through modifications of particular sections. In short, at this point and based on this proposal, SCO, which is the delegated agency for the State of California, would have to seriously consider whether it must decline, in advance, relief to any federal lessee.

§204.1 to §204.4. SCO objects to any rule, general or otherwise, that would purport to apply

---

[1] SCO also questions MMS's cost determinations because MMS does not currently have a cost accounting system.

to prepayment relief. Without knowing what type of relief this will entail under MMS's future rule, it is impossible to evaluate these proposals and likely that they will need to be amended in any event.

§204.2. SCO objects to the definitions of "designee" and "producing wells" and to the use of these definitions in the design of the relief options and the definition of marginal property under proposed §204.4. First, nothing in §1726(c) states that designees can seek accounting or auditing relief with or without the consent of the lessees. Congress was quite explicit in many other provisions of RFSA in referring to both a "lessee or its designee," where it wanted options or provisions to apply to both. *See e.g.*, 30 U.S.C. §1724. This language is absent from §1726(c) and, under normal principles of statutory construction, this means that Congress did not intend to extend §1726(c) to designees. SCO also notes that this RFSA language was essentially drafted by industry, who presumably knew who it wanted to be the recipients of relief.

Second, based on its experience, SCO cannot support the definition or use of "producing wells." In California, there are no spacing requirements and some of the State's most prolific onshore federal leases can be classified as "marginal." For example, a lease producing over 260,000 barrels a month is entitled to relief because the lessee maintains nearly 300 "active" wells on the lease. This problem is exacerbated by the lack of metering at the wells, which means there is no real way to cross check lessee allocations or confirm that a well is producing at all. These circumstances, which may be unique to California, require that marginal relief determinations, if there are to be any, must be made on a case-by-case basis.

§204.6. SCO objects to this provision because it does not explicitly acknowledge that nothing in RFSA serves to "waive" a State's immunity from suit. *See e.g., Seminole Tribe of Florida v. Florida,* 517 U.S. 44 (1996). Moreover, SCO believes that the "best interests" analysis can be appropriately interpreted as discretionary and non-reviewable. Finally, if MMS is to interpret RFSA to permit either administrative or judicial review of *federal* decisions, both the showing that must be made by a lessee under proposed §204.210 must be strengthened and the burden on the lessee should be clearly defined as clear and convincing evidence that relief is, in fact, in the best interests of the government.

§§204.200 to 204.205 SCO objects to these proposed sections for the following reasons:

(a) Section 1726(a) specifically requires that relief requests be considered jointly by the federal government and the concerned State on a "case-by-case" basis. Yet, MMS has delegated to itself through broad, generally applicable rules the determination of the "amount of what marginal production for a lease or leases or well or wells, or parts thereof" will be entitled to

relief. The option of a State to decline granting any relief under these proposals, without consideration of particular circumstances, is contrary to §1726(a).

(b) This problem is exacerbated by the facts that: (i) MMS fails to provide any rationale for its various volume cut-offs in these proposed sections, and (ii) MMS proposes that a lessee can obtain relief under all three of the automatic relief provisions; a complicating review factor. A concerned State under these proposals is not even placed in a position to adequately consider whether or not to exercise MMS's proposed blanket option. As noted above, the logical conclusion from the provisions on their face and from MMS's preamble analyses is that these provisions do not meet the "best interests" test. SCO also notes that allowing lessees more time to report if they have less production provides an incentive to produce less.

(c) SCO particularly objects to §204.203 because it modifies the lease obligation to pay royalties on a monthly basis.

(d) MMS has omitted any reference to penalties on those who do not remit royalties correctly under these proposals.

(e) SCO generally disagrees with any reduction of reported information because it reduces the ability of the government to cross check royalty payments and design audit tests. For example, removal of the two-line entry (*see* §204.203) will obscure audit trails; the audit burden on the government is thus increased. SCO also believes that requiring the same lessee to prepare different reports depending on classifications based on lease production will prove confusing and lead in the long run to errors costly to industry.

§204.206. SCO recommends that this provision be deleted in its entirety.

(a) First, this recommendation is not accounting, reporting or auditing relief, but royalty relief. While SCO agrees that an oil valuation system based on spot or NYMEX prices would prove more efficient for industry, most of industry is extended this option or is required to pay on that basis under MMS's proposed oil valuation rule. Moreover, the potential relief is not limited to MMS's preamble example.

(b) Because this is relief that is to be extended in the future, there is no realistic way that the government can determine that a lessee's proposal will "approximate" royalties actually due under MMS's valuation rules. This is particularly true since the relief presupposes certain audit relief, i.e., that MMS and State auditors would not be permitted to look to alternative values as a means of cross check of the lessee's proposal.

(c) Whether a new value "approximates" a value under MMS rules is a standardless requirement that invites litigation.

§204.207. SCO recommends that this provision be deleted in its entirety. SCO opposes any proposal that would (a) limit the scope of an audit, (b) permit a lessee to define audit scope in advance, or (c) directly or indirectly limit the government's right to access relevant information. Except for subsection (a)(2), all of MMS's listed options would have this effect. Moreover, it has not been SCO's experience that "independent" auditors review whether royalty payments were made correctly under federal regulation. Finally, it is SCO's understanding that subsection (a)(2) impacts issues of State law, which are not discussed by MMS.

§204.208. SCO recommends that this provision be deleted in its entirety. The administrative costs, burden and difficulties associated with having to review individual relief proposals to determine both whether they are in the State's "best interests" *and* "appropriate" for a particular "marginal property" simply are too great. It could require a considered review of both the economics of the property and a lessee's total accounting system and potential cost savings under the proposal. Nothing in RFSA requires the State or federal governments to develop another level of bureaucracy and expertise to provide marginal properties what is, in essence, a meaningless level of cost savings.

§204.209. SCO does not oppose the list of disallowed relief, but would add that any proposal should not decrease royalty income to a level below true market value, increase allowances, or reduce royalty bearing volumes. SCO notes that most, if not all, MMS's relief six options proposals are inconsistent with proposed §204.209(i).

§204.210. SCO has several objections to this proposal.

(a) For the reasons stated in the comments to §§204.200 to 204.205, SCO opposes MMS's proposal for "automatic" relief upon simple notification.

(b) The data that MMS proposes for inclusion in a written relief request is insufficient. For example, there is no requirement that the lessee demonstrate that the relief will "promote production." The burden should not be placed on the federal or State governments to develop the information that supports a grant of relief; nor should it be the governments' burden to disprove that the requested relief is unnecessary. Lessees are in a better informational position to justify their relief requests for particular properties.

(c) The $50 dollar processing fee bears no relation to the costs that will be incurred by

both the State and federal governments. This is even truer under MMS's proposal to set a $50 fee for multiple requests made in a single document. While we understand MMS's position that the fee should not be so high that it dissuades lessees from seeking relief, SCO does believe that the public interest factors support setting a fee at a level that provides lessees an incentive to gauge whether the relief requested will be truly beneficial to them.

(d) MMS should address how the processing fee will relate to Net Receipts Sharing.

§204.212 to §204.214 SCO objects to these provisions for the following reasons:

(a) Nothing in RFSA authorizes MMS to legislate the scope, timing or process of a "concerned" State's consideration of a relief request and there are serious legal questions whether any federal statute could ever give the agency that power. *See e.g., Printz v. U.S.,* 138 L.Ed 2d 914 (1997); *New York v. U.S.*, 505 U.S. 144 (1992).

(b) Even assuming such authority exists and is lawful, nothing in RFSA authorizes MMS to determine who in the State shall make that determination. *See* proposed §204.212(b). For example, unlike other RFSA provisions, §1726 makes no reference to "the highest official having ultimate authority over the collection of royalties." In fact, §1726(c) references both delegated and concerned States, which suggests that if there are different administrative agencies involved in any particular State (although such a difference does not exist in California), all the relevant State entities must be involved. SCO objects to MMS's proposed 30 day deadline for State decisions; the deadline is unrealistically short, especially since MMS is not requiring lessees to submit substantive support for relief and because it does not take into account individual States' internal review or sur-naming requirements. SCO also objects to MMS's legislating how State silence will be "deemed"; at the very least, if a State does not affirmatively act, i.e., "pocket vetos" a request, the lessee's request should be "deemed" *denied*, not granted.

(c) For the reasons stated in the comments to §§204.200 to 204.205, SCO opposes MMS's proposed §204.214.

§204.216. To the extent that this provision suggests that MMS will issue guidance that will dictate how a State reviews a relief request or will expand the types of relief available, SCO objects to this section.

§204.217. Nothing in §1726(a) or (c) suggests that relief will continue for the life of the property and only be discontinued if the property ceases to be a marginal property. SCO opposes such continuous relief. Eligibility is not merely contingent on a property's status, but

also on whether it remains in the "best interests" of the State and federal governments. The latter also must be subject to monitoring. SCO objects also to any provision, like this section, that purports to limit State authority over the allowance or disallowance of relief.

§204.218. While alternative relief should not bar relief under RFSA, SCO believes that the existence of other relief is relevant to the "best interests" determination. Thus, lessees should be required to disclose all other forms of relief they have taken under State or federal law, and the related savings to them from each form of alternative relief.

As it has highlighted in many comments to MMS on its various recent rulemakings, SCO shares the concerns of independent producers and MMS about low well head postings and preserving marginal production. Yet, SCO does not agree that relief should be achieved through increasing government costs and bureaucracies. Nor should the public,and particularly California's school children, experience revenue loss. SCO sincerely believes that MMS's proposal will have these effects, without producing any meaningful relief to economicly threatened producers or production. In fact, most of the minor cost savings under this proposal will benefit companies in California that are not truly injured by the current price decline.

For the foregoing reasons, while SCO admires MMS's efforts and goals, it must oppose this proposed rulemaking.

Respectfully submitted,

Lee Ellen Helfrich
On behalf of the
California State Controller's Office