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Mr. Chairman and Members of the Committee, thank you for the opportunity to appear here today to provide technical information regarding possible reform of the Mining Law of 1872.

Through its Minerals Revenue Management (MRM) Program, the Minerals Management Service (MMS) collects, accounts for, substantiates, and disburses revenues associated with leasing and mineral production from Federal onshore and offshore lands and Indian lands. In Fiscal Year 2007, MMS collected over $11.4 billion in mineral revenues.

Statutory Basis for Current Program

The Mineral Leasing Act of 1920 (MLA), (30 U.S.C. §§ 181 et seq.) established a type of mineral category called “leasable” minerals. Under the MLA, deposits of coal, potassium, sodium, phosphate, oil shale, native asphalt, tar sands, oil, and gas were made subject to disposition through a leasing process. This leasing process allowed the United States to maintain title to the land and establish the type of lease, the duration of the lease, acreage limitations, and royalty and rental terms. MMS collects and disburses revenues from these leases including royalties on these types of minerals.

The Materials Act of 1947 established another type of mineral category called “salable” minerals for which minerals commodities are sold by the Bureau of Land Management (BLM). Under this Act, deposits of common varieties of sand, stone, gravel, pumice, pumicite, cinders, clay, and petrified wood were made subject to disposition through a sales process. The Bureau of Land Management collects revenues from sales of this type.

The Mineral Leasing Act for Acquired Lands of 1947 (30 U.S.C. §§ 351 et seq.) extended the mineral leasing laws (the Mineral Leasing Act, etc.) to all lands acquired by the United States. The Act allowed the United States to maintain title to the land and establish lease terms for all minerals found on acquired land. MMS collects and disburses royalties on these types of minerals.

All minerals found on Indian tribal and allotted lands are administered using a leasing process under the Tribal Lands Leasing Act, Indian Mineral Leasing Act, and other statutes. Solid mineral leases on Indian lands are negotiated between the mine operator and the tribe or an allottee on a case-by-base basis. Neither the general mining laws nor the Federal leasing laws are applicable to Indian lands; however, MMS accounts for these mineral royalties on behalf of Indian tribes and allottees.

The Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) (30 U.S.C. §§ 1701 et seq.) required the development of comprehensive fiscal and production accounting and auditing systems to accurately determine oil and gas royalties, interest on late payments, fines, penalties, and other payments owed, and to collect and account for such revenues in a timely manner.

Description of the Current Royalty Program

The MMS collects, accounts for, disburses, and verifies royalty payments from all leasable minerals, which include oil, natural gas, coal, oil shale, sodium potash, phosphate, and all minerals on acquired lands. The term "hardrock mineral" is often used as a synonym for locatable minerals and includes the base and precious ores, ferrous metal ores, and certain classes of industrial minerals. Examples include gold, silver, platinum, copper, lead, zinc, magnesium, tungsten, bentonite, barite, feldspar, fluorspar, uranium, and uncommon varieties of sand, gravel, and dimension stone.

Following is a summary of the key components of the current royalty program for 1) oil, natural gas, and coal, 2) non-coal solid minerals, and 3) hardrock minerals on acquired lands.

Oil, Natural Gas, and Coal
Royalty payments in the context of oil, gas, and coal are based on the production amounts, the lease royalty rate, and the value of the product. In general, all production is subject to royalty payments, except in limited cases where royalty payments are statutorily or administratively waived for policy reasons, for unavoidably lost production, or for production used on or for the benefit of the lease. Royalty is computed on the basis of the quantity and quality of production at the point of royalty determination.

The BLM establishes the royalty rate for oil, gas and coal produced from Federal onshore leases. The royalty rate is a percentage of the value of the production removed or sold from the leased lands and there is a statutory minimum of 12.5 percent for oil, gas, and surface coal mines, and 8 percent for underground coal mines. The MMS establishes royalty rates for Federal offshore resources.

Federal and Indian oil, gas, and coal lease terms provide for the Secretary to determine the value of production. The Secretary does so through the promulgation of regulations. Having the value determined by regulations allows flexibility to change the valuation methodology in response to changes in the market conditions and operations.

In general, the royalty value of production from Federal leases is based upon the gross proceeds accruing to the lessee from its arm's-length sale of oil, gas, or coal. An arm's-length sale is a bona fide transaction between independent parties. If production is not sold at arm's-length, then the value is determined by other market indicators such as comparable sales, publicly available prices, etc. Valuation regulations allow deductions for the costs of processing natural gas or washing coal and transporting production to the point of sale. The costs of that are not deductible include: 1) production related costs, 2) placing oil, gas, or coal into marketable condition, and 3) marketing (i.e., finding or maintaining a market for the oil, gas, or coal

production). The costs of placing production in marketable condition are generally field processes that take place on or near the lease such as mechanical separation, heating, cooling, dehydration, and compression for natural gas; and crushing and sizing for coal. These activities are distinguishable for 1)natural gas processing in which elements or compounds (e.g.: natural gas liquids) are removed from the natural gas stream and sold or otherwise disposed of, and 2) coal washing in which the value of the coal is enhanced.

Non-Coal Solid Minerals

Royalties for non-coal solid minerals, in this case the sedimentary minerals sodium and potassium, are based on the gross value of primary products, defined as naturally occurring components of ores or brines and the first marketable products produced from the processing of raw ore or brine. The royalty value of an arm's-length sale is the actual selling price, less deductions. Royalties on products sold under non-arm's-length conditions, are generally based on the weighted average sales price of the lessee's arm's-length sales of the same product, sold in bulk at the mine. Secretarial guidelines for sodium and potassium allow three types of deductions:

- When the sales price includes delivery to a destination remote from the mine, the lessee may deduct transportation costs from sales price.
- When the sales price includes the cost of packaging, the lessee may deduct packaging costs from sales price.
- When the product sold contains material not derived from the Federal lease, the lessee may deduct the cost of purchasing those non-lease materials from the sales price.

The BLM establishes royalty rates for sodium/potassium leases – generally 5 or 6 percent of gross value. The minimum royalty rate set by statute is 2 percent.

Hardrock Minerals on Acquired Lands

Unlike oil, natural gas, coal, or sedimentary minerals, hardrock mineral deposits must generally undergo physical processing and intensive chemical processing to produce salable products, such as gold, silver, uranium, or copper. Final products are the purified base or precious metals.

MMS has no role in the oversight of hardrock mining operations for mining claims on original public domain lands because companies are not currently required to pay royalties on production from these lands. However, MMS does collect royalties from hardrock operations on certain acquired lands authorized under the Reorganization Plan No. 3 of 1946 (5 U.S.C. Appendix). For example, the MMS currently collects royalties from a large lead, zinc, and copper operation on Federal acquired lands in Missouri. The royalty rate established in the lease is 5 percent of gross value of the lead, zinc, or copper mineral concentrates processed from the ore. The lessee sells the zinc and copper concentrates at arm's-length prior to smelting. In this case, the lease defines gross value as the price paid in an arm's-length sale of the zinc and copper mineral concentrates without reduction for processing or mining costs. The lease terms allow for deductions for transportation from the mine to the mill.

The lead concentrate is smelted by the lessee prior to sale of the final lead product. In this case, the lease term states that gross value is based on the net smelter return methodology using prices received for metals less the costs to ship, smelt, and refine all mineral concentrates.

MMS verifies the gross value calculation by auditing the lessee's sales records and costs of transportation. Verifying the net smelter return calculation requires an audit of sales records, transportation costs, and smelting costs.

Challenges Associated with Implementing a Royalty Program for all Hardrock Minerals

If a royalty program is to be established for all hardrock minerals, we offer five basic financial management principles that need to be considered.

1. Simplicity. Based on our experience, a successful Federal royalty program should:
   - be clear and well defined in statute,
   - minimize litigation,
   - minimize the complexity of royalty calculations and associated deductions,
   - assure contemporaneous compliance,
   - minimize administrative costs to the Federal Government and lessees,
   - be applied prospectively, and
   - provide a fair return to taxpayers.

2. Adequate audit and compliance resources. Today, MMS, State, and Tribal auditors ensure compliance for about 150 coal and other solid mineral mines with approximately 35 audit and compliance staff. BLM inspectors also inspect mines and verify the production reported to MMS. The BLM currently administers approximately 350,000 hardrock mining claims and estimates that there are 620 active plans of operations; these are claims or mines that are either producing or have development drilling occurring on the claim. Additional audit and compliance resources would be needed to implement a royalty program for all hardrock minerals.

3. Efficient and effective automated reporting system. The MMS has in place a flexible and easy-to-use web-based system for companies to report royalties and production for solid mineral leases. Both large mining operations and small hardrock reporters use this system. Implementing a royalty program for all hardrock minerals would require modifications to MMS's system including establishing an interface with BLM's systems.

4. Audit and investigative authority. The MMS currently has authority under FOGRMA to conduct audits and inspections, demand records, require record keeping, conduct hearings and investigations, issue subpoenas, assess interest on late payments, etc. (30 U.S.C. 1701 et seq.). This authority would be necessary to carryout an effective audit and investigative program for hardrock minerals.

5. A strong and effective enforcement program is a key component of a successful royalty program for any mineral. For example, the enforcement provisions in

FOGRMA, at 30 U.S.C. §§ 1719 and 1720, provide a starting point for creating an effective enforcement program.

Conclusion

The Administration would like to work with Congress on any update of the Mining Law and believes that any legislative solution must be accomplished in a way that provides a reasonable level of certainty to the industry while pursuing goals to protect our environment. The Administration believes that if Congress chooses to apply royalties to hardrock minerals, the royalty provisions should be set at a level that does not threaten the continued, reliable domestic mineral production on which this Nation relies.