

**TESTIMONY OF MARY KENDALL
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BEFORE THE HOUSE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON INTERIOR, ENVIRONMENT, AND RELATED AGENCIES
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Mr. Chairman, members of the subcommittee, thank you for the opportunity to appear today to discuss the findings from our efforts in examining oil and gas royalty collection programs within the Department of the Interior.

The Office of Inspector General (OIG) has devoted many resources over the past three years to understanding and investigating the role of the Minerals Management Service (MMS) in collecting royalties from offshore oil and gas drilling. We discovered weaknesses in the oversight of royalties, in communications in the drafting of leases, the under-payment of royalties, and a culture in the Royalty-In-Kind program where employees felt exempt from the ethics rules that govern all other federal employees.

We are now devoting resources to tracking progress on the implementation of myriad recommendations by OIG, the Government Accountability Office (GAO), and the Royalty Policy Committee (RPC). There are more than 150 recommendations to account for. The OIG will continue to monitor the progress of these implementations in the coming months, as we collect the relevant data for our verification process. On April 15, we will be conducting a team review of the status of the recommendations, and would be happy to report back to the subcommittee shortly thereafter.

In addition, we are reviewing the Department's onshore leasing and drilling programs of the Bureau of Land Management (BLM), and how BLM coordinates with MMS on production data and royalty collection. Finally, we have begun to examine alternative energy generation authorities, regulations, and practices within the Department, to include MMS and BLM offshore and onshore programs in the areas of wind, wave and ocean current, and solar and geothermal.

We recently completed an evaluation, at the request of Chairman Dicks, concerning the status of non-producing federal oil and gas leases. In addition to some very challenging data integrity and lease oversight issues, we found that BLM and MMS need to develop much clearer

policy concerning the expectations of production of oil and gas on federal lands. We recommended that the Department consult with Congress in this regard. We are presently conducting an audit of MMS's process for verifying oil volumes delivered as RIK, including oil destined for the Strategic Petroleum Reserve (SPR).

With respect to our report on the non-producing leases, we found that oil and gas companies that own federal drilling leases have little obligation to actually produce resources. The Department has no formal policy to compel companies to bring these leases into production. While current statutes, regulations, and policies do promote exploration, production activities are not required to commence within the primary lease term. The bureaus do not inquire about the production strategies of companies and have not attempted to enforce the performance clause included in lease agreements. Both industry and bureau officials cautioned, however, that mandating production activities may not necessarily have positive outcomes, and could, in fact, be counter-productive by reducing industry interest in federal leases.

With few exceptions, the Department does not track oil and gas leases until a company applies for an Application for Permit to Drill (APD). This means it may be years before the Department records any data about a lease. There being no mandate to track a lease, MMS and BLM do not begin tracking until the lease holder applies for an APD and exploratory activity begins or the primary term of the lease ends.

While BLM and MMS are able to work together, their data collection systems and definitions of producing and non-producing leases are incompatible. The systems do not "speak" to one another, and data integrity is compromised due to delays in data input. In many instances, both BLM and MMS are relying on companies to provide royalty payment information. Our recent evaluation of non-producing leases highlighted that BLM and MMS define and report on the status of leases using conflicting definitions. We have recommended that the Department work with Congress to develop clear policy regarding the production of oil and gas leases. This policy should more clearly define expectations concerning production monitoring and development activities.

We believe that improved and more comprehensive data would assist in instituting a monitoring program for non-producing leases and paint a much more accurate picture of the

production status of DOI leases. Similarly, a better understanding of the processes and problems leading to production would lead to a more accurate perception by the public of the production status of DOI leases. Further, more explicit statutory and/or regulatory mandates would contribute to clearer expectations on the parts of both DOI and the oil and gas industry.

Other on-going activities by OIG are intended to explore royalty collection and program management in the areas of onshore oil and gas drilling and alternative energies. We are examining relationships with oil and gas companies and decisions by BLM managers relating to oil leases, oil production and royalty collection.

Recently, we initiated an evaluation of BLM's Inspection and Enforcement Program. This evaluation is being conducted as a joint effort by our Royalty Initiatives Group and our Energy Investigations Unit. The focus of this review will be BLM's effectiveness in performing required inspection and enforcement activities related to onshore oil and gas leases, from lease issuance to well-abandonment and lease closeout. Our evaluation will include a closer look at the reliability and integrity of the systems BLM uses to manage this program, and how effectively BLM coordinates and collaborates with MMS.

Presently, our Energy Investigations Unit is conducting two investigations concerning royalty payments for geothermal leases. We have learned that current regulations allow a producer to claim operating deductions of up to 99 percent of the royalty owed. The companies currently under investigation have allegedly claimed the 99 percent deduction from their owed royalties for as many as 10 years. Once we have more information, we may recommend that Congress consider reviewing allowable deductions for alternative and renewable energy sources.

Finally, we have conducted a preliminary study on alternative energy generation. The study surveyed alternative energy authorities, regulations, and practices of BLM and MMS. It includes a review of current programs and projects, fee and royalty rates and structures, and timelines. BLM is the lead agency for alternative energy activities within the continental U.S., while MMS has the lead for activities on the Outer Continental Shelf. BLM's responsibilities include wind, solar, and geothermal; MMS's responsibilities include wind, wave, and ocean current. We are presently reviewing the results of our study to determine next steps.

Mr. Chairman, members of the Committee, that concludes my testimony. Thank you for the opportunity to appear before you today. I would be happy to answer any questions you might have.