

# Royalty Policy Committee

## Minutes

January 20, 1999

**Voting Members/Alternates Present:** David Blackmon, John Clark, Pete Culp, Wendy Daboval, David Darouse, Shawn Frank, David Harrison, William Hartzler, Dave Loomis, Charles Mankin, Brian McGee, Stephen Reynolds, Norma Rosner, Perry Shirley, Brad Simpson, William Stone, Charles Turpen, Steven Williams and Carla Wilson.

**Others Present:** Connie Bartram, Mike Baugher, Paul Bodenberger, Walter Cruickshank, Mike Del-Colle, Lucy Querques Denett, Barb Desiderio, Jim Detlefs, Milt Dial, Randall Drake, Anita Gonzales-Evans, Dale Fazio, Gary Fields, John Hovanec, Dennis Johnson, Dennis Jones, Tom Kitsos, Paul Knueven, Barb Lynham, Cheri Lee, Don Lynch, Bonn Macy, Mike Miller, Wayne Pachall, Bob Prael, Cynthia Quarterman, Mary Robyn, John Russo, Don Sant, Greg Smith, Melanie Sorenson, Jan Therkildsen, Debbie Gibbs Tschudy, Ken Vogel, Boh Walker, and Akhtar Zaman.

Welcoming and Opening Remarks - David Blackmon

### **UPDATES FROM CYNTHIA QUARTERMAN (Director, MMS):**

First, I would like to introduce Tom Kitsos, recently selected to serve as deputy director of the Minerals Management Service. Tom's experience on Capitol Hill and as the staff assistant to the Assistant Secretary for Land and Minerals, combined with his thorough understanding of offshore energy issues, will provide MMS a great asset.

I recently announced my resignation from federal service effective February of 1999. First appointed by Secretary Babbitt in 1993 as deputy director of MMS and in 1995 as director, this experience has been the most fulfilling and fascinating in my professional life. I have been privileged to work here with a cadre of extremely professional and intelligent federal employees. After February 1, Tom Kitsos will be acting director until a new director is appointed.

During the past five years MMS has had substantial accomplishments:

- Received the Vice President's Hammer Award for innovations, as well as many other Presidential awards.
- Initiated a program reengineering effort, featuring multi-disciplinary teams and partnerships with our State, Indian and industry constituents. In March 1998 we published our preliminary design document, outlining MMS's future business processes, information needs and support systems; and published an implementation plan called *The Road Map to the 21st Century* in November. To continue implementation efforts we engaged Amoco, Texaco, Chevron, Utah,

Colorado and the Ute Tribe as full partners in the offshore and onshore model teams. The Navajo and Crow Tribes are also participating with our solid minerals team.

- Assisted in the passage of many pieces of legislation, including the Deep Water Royalty Relief Act, the Royalty Simplification and Fairness Act, and the Small Refiner Ratification Act.
- Made substantial progress in implementing the Royalty Simplification and Fairness Act. Most notably we resolved the 14,500 pre-RSFA cases involving discrepancies in royalty and production volume within the RSFA two-year time limit.
- Published a final rule expanding the delegable royalty management functions to States and an interim final rule regarding payment designations.
- Modified our software to enable us to accept interest reports for companies and to make interest payments to companies.
- Initiated royalty gas in kind for the first time in history and began a joint royalty-in-kind pilot with the State of Texas general land office. We also partnered with the State of Wyoming in accepting bids in August of 1998 for 98 properties representing 68 percent of production offered for bid.
- Created more cooperative audit programs and internships with Indian Tribes and a seamless three-agency Indian minerals allottee office in Farmington, New Mexico, and resolved many long-standing policy disputes.
- Established the Royalty Policy Committee (RPC) in 1995 in an effort to reach out to stakeholders and listen to what they tell us. We have implemented several Royalty Policy Committee recommendations, including streamlining and eliminating unnecessary royalty and production reporting, adopting the appeals recommendations that this Committee put forward, establishing a study group on small refiner RIK programs, and incorporating recommended changes to the audit manual.
- Modernized our information systems for year 2000 compliance, initiated a program to provide free software to encourage electronic reporting, inaugurated our popular and easy to use Web page with extensive hyperlinks and information, expanded our wide area network to the office of 17 states and tribes providing state and tribal auditors with faster and more effective access to the data, and established a Website to make FOIA information available electronically.

- Downsized the overall personnel at MMS by 12 percent, and our managerial and supervisory positions by 23 percent. And we have accomplished MMS's mission without budget increases for four years.

I wanted to take this opportunity to thank you all for your participation in helping to make the MMS Royalty Management Program a bit better, and ask you to continue to do so in the future.

### **UPDATES FROM LUCY QUERQUES DENETT:**

#### Program Reengineering

The Royalty Management Program's and MMS's number one priority continues to be reengineering. Going to a property based process will allow us to better understand local product values and when to take our royalty-in-kind. It will also enable a reduction in the business cycle from six to three years, providing revenue to recipients faster with a goal of 24 hours upon receipt of royalties. Modernizing the RMP's automated information structure is the key to making this a reality.

#### Fiscal Year 1999 Audit Strategy

Audit managers are developing a revised plan to focus on properties rather than companies and comply reengineering concepts. The final audit strategy draft plan is ready for review by State and Tribal managers who perform many of the audits together with MMS auditors. Attempting to maximize the coverage of the properties, and effectively and efficiently utilize our resources was the goal of revising the audit strategy. With implementation the audit program will be integrated into the reengineered compliance and asset management process with a completion target of the year 2003. As we move to that time frame both audit and the operational models will be frequently monitored to assure appropriate adjustments are made to take advantage of lessons learned.

#### RIK Pilots

The Wyoming pilot is successfully underway with Wyoming and MMS planning to offer a joint sale with delivery of production beginning April 1. Also beginning in December 1998 we initiated a Texas pilot with the Texas Land Office with General Services Administration purchasing gas for use in Federal agency facilities. The third pilot involving Gulf of Mexico gas is still scheduled to begin in the fall of 1999.

#### Small Refiner Royalty-in-Kind Program

Sometimes confused with the RIK pilots is the ongoing small refiner royalty-in-kind program. To address the RPC's recommendations concerning this program we are conducting a study investigating problems with volumes, reporting and valuation. The report, planned for a March 1999 publication, will detail the effects of administrative changes explored during a pilot. During this test we negotiated the contracts to tie the prices small refiners paid to market centers

instead of operator reports.

To review the need for a small refiner RIK program we published a Federal Register Notice on December 9, 1998 with 13 questions posed to interested parties. The responses will be compiled to provide the Secretary with the data and analysis necessary for a determination of whether or not another royalty-in-kind sale should be conducted. If another sale is needed, we will conduct it during the fall of 1999. To facilitate this time frame, current contracts were extended to August 1999. Depending on the results of the need determination, new contracts will either be entered into or the program terminated until another analysis is completed.

Royalty Simplification and Fairness Act (RSFA) Implementation

We accomplished many critical tasks to implement this legislation and plan more:

- Incorporating most of the RPC's recommendations, we published the appeals rule on January 12, 1999 with the comment period closing March 15, 1999. We intend to meet the RSFA date for a final rule of May 1999. As you know, the proposed rule provides for direct appeal to the Interior Board of Land Appeals, with MMS developing the administrative appeal records, conducting settlement discussions when appeals are initiated, and deciding which cases to defend, modify or settle. The rule also describes how the RSFA mandated 33-month time frame will operate. Additional workshops will be announced in the Federal Register.
- The proposed rule on marginal properties will be published in the Federal Register on January 21, 1999. The proposal provides accounting, reporting and auditing relief for lessees of properties with small production volumes.
- By June 1999 we plan to modify the delegation rule so States can select the leases for which to perform delegable functions within their state boundaries. This change was made to accommodate legislatures' funding methods of these activities.
- The proposed takes vs. entitlements rule will combine two RSFA requirements--paying on takes and entitlements and marginal properties' exceptions.
- The chronic erroneous reporting rule, planned for this summer, will define chronic erroneous reporting and the associated assessments.

Annual Performance Review

Expanding the criteria for the mineral revenue stewardship award program, we will be performing an annual review to recognize the best royalty and production reporters. While the

previous program focused on reported lines' error rates, criteria will now look at electronic commerce participation, outstanding receivables, civil penalty history, audit and data request compliance, and issue letter responsiveness. We will benchmark the best reporters to identify success factors for educating companies that aren't doing as well.

Electronic reporting

A final electronic reporting rule will be published shortly to implement the April 1998 proposed rule. While that proposal suggested mandated electronic reporting for all reporters by the end of 1999, the final rule will include exclusions for hardship cases and other situations based on the number of lines a company reports. Ultimately our goal is to lower error rates, increase accuracy and reduce costs for both industry and Government.

Indian Minerals Steering Committee

The Indian Minerals Steering Committee is made up of senior level Department representatives to address mineral management issues crossing agency lines. Meeting three times each year the Committee's activities include listening conferences where allottees and Tribes present issues that they have with any part of the Department that they feel we are nonresponsive.

Farmington Indian Minerals Office

This office combines the responsibilities of BIA, BLM and MMS into a one-stop service center for Navajo allottees with staff from the 3 agencies under one manager. Last year over 3,000 Indian mineral owners visited the office to address their particular problems. With the functional responsibilities of all 3 agencies, allottees have been pleased to be able to receive answers to their questions on any minerals topic. Issues that formally requires weeks and months with visits to 3 offices can now be addressed in an hour or less.

This fall we will evaluate FIMO to decide if this program should be expanded to other areas. To assist in this effort questionnaires will be sent to the industry, allottees, and Department staff interacting with this office.

Legislative Update

The 105th Congress adjourned on October 21, 1998, with legislation on two RMP issues involving Federal crude oil valuation and royalty-in-kind that died when the 105th Congress came to an end. But there is sufficient interest in both proposals to be reintroduced in the 106th Congress. All of the subcommittee chairs from the 105th Congress will remain for the 106th Congress. Our authorizing committee, Energy and Minerals, will continue to be chaired by Congresswoman Barbara Cubin in the House. The committee recently held formal organizational meetings to finalize the subcommittee membership. Both the House Resources Committee and the Senate Energy Committee plan to focus on coastal impact assistance legislation. The Senate Energy Committee will also study the effects of low oil prices on the domestic oil industry, mergers of the majors, as well as the nation's continuing dependence on imports.

A question and answer session followed the presentation.

**APPROVAL OF THE SEPTEMBER 22, 1998 MINUTES**

Motion was made that the minutes be accepted as drafted.

Motion seconded.

Vote: 15 votes in favor, none opposed.

Motion carried.

**RECOMMENDATIONS ON THE LESSEE/DESIGNEE ISSUES**

Mr. Mike Miller explained that at the last meeting a report was approved by the RPC with several outstanding issues: obtaining information from the Bureau of Land Management and the inclusion of Indian leases. Since then we received comments on the lessee form and received authority to continue the information collection. The form should be approved soon.

A nonpaying lessee has the responsibility to provide a written designation of who will pay for them. To assist them the BLM will send a copy of the designation form with an explanation whenever there is a new lease or an assignment change. Once the designation form has been approved it will be available on the RMP home page so anyone can access it. RMP will receive the designations and use the information to maintain our database.

The Royalty Simplification and Fairness Act does not apply to Indian leases. For those leases our primary source of collections will continue to be payors. Since neither BLM or BIA approves assignments on Indian leases we cannot use them to collect the data necessary to bill lessees.

**ROYALTY-IN-KIND PILOT REPORT**

Mr. Macy provided a handout and discussed in detail the current status of the three RIK pilots, Wyoming, the Texas 8-G and the Larger Gulf of Mexico pilot. The presentation was followed by a question and answer session.

**REENGINEERING AND OPERATIONAL MODELS**

Ms. Denett provided a copy of the RMP's Road Map to the 21st Century and explained the implementation plan for reengineering. John Russo, Debbie Gibbs-Tschudy and Jim Detlefs provided handouts on the operational models and discussed them in detail. The presentation was followed by a question and answer session, during which several Industry representatives commended MMS for embarking on the reengineering process.

**JOINT VENTURES PAPER**

Mr. Cruickshank provided a copy of the Joint Ventures Paper and discussed it in detail. A question and answer session followed.

**ANNUAL PERFORMANCE REVIEW**

Dr. Sant explained that the criteria for the mineral revenue stewardship award program will be expanded, with an annual review to recognize the best royalty and production reporters. While the previous program focused on reported lines' error rates, criteria will now look at electronic commerce participation, outstanding receivables, civil penalty history, audit and data request compliance, and issue letter responsiveness. We will benchmark the best reporters to identify success factors for educating companies that aren't doing as well. Of these MMS will select 10 to 12 companies with demonstrated reporting problems. MMS would visit with these selected companies to work out a program to improve their compliance activities and reduce error rates. Conceptually the program would be beneficial for both the company and the RMP by lowering the costs of correcting errors. The exact selection criteria for this program has not as yet been agreed to within the agency, and input from the RPC is needed. A question and answer session followed.

**MARGINAL PROPERTIES RULE - ACCOUNTING RELIEF**

Ms. Gibbs Tschudy provided a detailed explanation of the marginal properties rule scheduled to be published in the Federal Register on January 21, 1999 and a handout. A question and answer session followed.

**OTHER LEASABLE SOLID MINERALS SUBCOMMITTEE INTERIM REPORT**

Mr. Reynolds, chairman of the subcommittee, explained that they reviewed a draft proposed rule in a November 9 through 11 meeting and made several recommendations for changes. The MMS staff is now revising the rule for the subcommittee's on March 15 through 17. A final report to the RPC should be available for the next meeting.

**COAL SUBCOMMITTEE INTERIM REPORT**

Since Mr. Cattany, the chairman of the subcommittee, was not available Mr. Hartzler presented the report. Since the last RPC the Coal Subcommittee met twice to work on a list of 27 issues provided by Mr. Wincentzen, MMS. At our next meeting we will consider 5 issues:

- Fixed royalty rate initiative. We're going to identify our likes, dislikes and concerns. We are looking at a regional basis to keep the various recipient States on a break-even point as to where they're at now, and then use indices for

adjustments to minimize valuation questions.

- Since solid minerals still lacks a statute of limitations we will examine what recommendations we could submit to obtain closure.
- While MMS is concerned that coal option payments are included in royalty determinations, industry feels they are premiums received for risk and not subject to royalty. We plan to discuss options on appropriate way to treat those payments.
- MMS's proposal for determining advance royalty amounts for leases not meeting diligence. Industry believes the purpose of the advance royalty provisions are for operator relief to ride out the low spots in the marketplace, while MMS's proposal might tie to long term contract prices which the law may not have intended.
- The relationship between the duty to market and unavoidably lost coal. What is the royalty responsibility when we have a duty to market the coal, but yet the only market for that coal is the export market?

We now have a BLM person participating full time to help address issues from their aspect, and we're making progress slowly. Some issues we have agreements but we are attempting to package them for RPC consideration rather than presenting them one by one. We are still waiting for the solicitor's opinion on the coal waste pile issue.

**TERMINATION OF THE NONCONVENTIONAL ALTERNATIVES SUBCOMMITTEE**

Mr. Blackmon explained the this subcommittee was formed to address many of the same issues that RSFA settled. It also was to look at royalty-in-kind, which MMS is addressing with pilot projects.

Motion was made to terminate this subcommittee.

Motion seconded.

Vote: 15 votes in favor, none opposed.

Motion carried.

**NEXT RPC MEETING**

Mr. Blackmon stated he would schedule a date during May 1999 for the next meeting.