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G. William Frick
Vice President, General
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September 12, 1997

David S. Guzy
Chief, Rules and Procedures Staff
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American Petroleum Institute Comments on MMS Notice, "Amendments to Gas Valuation Regulations for Federal Leases." 30 CFR 202, 206, and 211; 62 FR 19536 (April 22, 1997).

Dear Mr. Guzy:

API welcomes this opportunity to submit comments on MMS' April 22, 1997 notice, 62 FR 19536, withdrawing its November 6, 1995 proposed rulemaking. API is a trade association whose over 300 members represent all aspects of the petroleum industry: exploration, production, transportation, refining, and marketing. API's members produce the vast majority of the natural gas produced from federal onshore and offshore leases, pay the bulk of federal natual gas royalties, and have a major stake in this rulemaking.

API has participated actively in this rulemaking. Through its representatives on the Federal Gas Valuation Rulemaking Committee, it took a central role in forging the consensus rule working closely with other industry groups to develop options for MMS' consideration. API filed extensive written comments on the November 6, 1995 consensus rule at 60 FR 56007, on additional options identified in the May 21, 1996 notice at 61 FR 25241, and on still more options identified in the reconvened Rulemaking Committee session held June 12-14, 1996.

Given this prolonged, labor intensive collaborative effort, MMS' publication of the notice withdrawing the November 6, 1995 proposal is disconcerting. In its April 22, 1997 notice, the MMS identifies five reasons for abandonment of the consensus recommendations of the Rulemaking Committee:

- The natural gas market is undergoing dramatic change.
- MMS' existing regulations are very flexible and are the most appropriate means to face the continued changes in the natural gas market.
- MMS does not believe published indices have developed sufficiently to be representative of gross proceeds actually received for lease production.
- Any rule using indices would become complicated because of the requirement to compare them to gross proceeds, thereby placing a significant administrative burden on MMS.
- MMS' cost/benefit analysis indicates that the proposed rule would not achieve revenue neutrality.

In addition, the MMS requests comments on two new options: (1) Index +/- "X-factor"; and (2) Pricing Board-determined values similar to the "norm" prices established for oil by Norway's Petroleum Price Board.

After initiating a time-consuming and costly process which successfully arrived at consensus, the agency has obviously changed its mind. During the negotiated rulemaking process, the agency's leadership was dedicated to addressing complex royalty valuation issues through negotiation and compromise. After consensus was reached, MMS touted the rulemaking at every opportunity as an MMS success story.[1]

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[1] "We view this negotiated rulemaking as a success. . . . We believe this cooperative effort has equitably addressed the needs of our many constituents." Director Cynthia Quartermen, as quoted in March 16, 1995, MMS News Release. Copy attached as **Exhibit "A"**.

"Today one of the primary goals of the mineral revenue collection program is to assist and encourage payors to submit royalty payments correctly the first time. In addition, MMS is actively examining ways to simplify and streamline aspects of the complex revenue collection process, including: . . . implementing a multi-constituent approach to resolving royalty-related issues in our most controversial areas, such as the Federal and Indian Gas Valuation Committees . . . . The rulemakings will result in program changes that reflect the marketplace and simplify royalty valuation, reporting and payment."
March 7, 1996, Congressional Testimony of Cynthia Quarterman Prepared for the Energy and Minerals Resources Subcommittee. Copy attached as **Exhibit "B"**. *See also*, June 8, 1995 Testimony of Deputy Assistant Secretary Sylvia Baca Before the Subcommittee on Energy and Mineral Resources, at 4-6. Copy attached as **Exhibit "C"**.

Now, the MMS' management has decided to retain gas valuation regulations that the MMS itself has described as unworkable, and it has reinterpreted the term "gross proceeds to the lessee" to mean every form of consideration paid to a lessee or any affiliate in which it owns as little as a 10 percent interest, even if this means forcing a series of expensive, protracted court battles.

API strongly opposes the withdrawal of the proposed rule. MMS' stated reasons for doing so are unfounded, and the "new" options it now suggests are merely repackaged ideas previously explored and rejected by the Rulemaking Committee.

1. MMS' Stated Reasons for Withdrawing the Rule Are Unfounded.

As one reason for its decision to withdraw the proposed rule, MMS states that the natural gas market is still undergoing dramatic change, thereby implying that indices do not reflect the market value of gas at a pricing point. MMS offers no support for this broad statement other than a recent notice in the Federal Register in which FERC requested input from the public and industry at a scheduled hearing. FERC was requesting input on how it should act as a regulatory agency. There was neither evidence nor testimony at that hearing, nor is there any other real evidence, which would reasonably lead one to conclude that indices no longer reflect the market value of gas as a result of recent changes in the market place.

Among the more inexplicable of MMS' reasons for abandoning the proposed rule is that "its existing regulations are very flexible and therefore are the most appropriate means to face the continued changes in the natural gas market." 62 FR 19537. After the existing rules became effective in 1988 litigation ensued immediately over the meaning of the non-arm's-length benchmarks, resulting in numerous internal clarifying memoranda. Within two years, MMS concluded that it was impossible for lessees to correctly value and report royalty on production from federal units and issued an advanced notice of proposed rulemaking requesting input on how to correct the regulations. The Secretary of the Interior's Royalty Management Advisory Committee (RMAC) agreed that the existing regulations are unworkable and its recommendations led to the formation of a study group that was eventually reconstituted by Interior Secretary Bruce Babbitt as the Federal Gas Valuation Negotiated Rulemaking Committee. In the Federal Register notice chartering the Rulemaking Committee, Secretary Babbitt stated:

> The study group's discussions have also enabled the MMS to determine that the criteria for negotiated rules, as spelled out in the Negotiated Rulemaking Act, are met for this rule: <u>The rule is needed, since royalty payors are not able to comply with the current regulations particularly in the current gas market</u>.

59 FR 32944 (June 27, 1994) (emphasis supplied). Copy attached as **Exhibit "D"**. *See also* the May 27, 1994 memorandum to Secretary Babbitt from Assistant Secretary Armstrong and former MMS Director Tom Fry. Copy attached as **Exhibit "E".**

Yet, the MMS now states that the existing regulations are very flexible and provide the most appropriate means to face continued changes in the gas market. Not only does this contradict the MMS' earlier stance but it contradicts earlier statements of a previous MMS Director, the Assistant Secretary of Land and Minerals Management, and the Secretary of the Interior. In effect, the MMS now concludes that a new rule was never necessary and that the establishment of the Rulemaking Committee was unnecessary.

Equally hollow are the statements that MMS does not believe that published indices for natural gas have developed sufficiently to be representative of the gross proceeds actually received for lease production, and that the failure of indices to represent fair market value necessitates a safety net calculation which would place a significant administrative burden on MMS. There was never any expectation by the Rulemaking Committee that indices be representative of any sales proceeds regardless of proximity to the lease. Indices represent arm's-length proceeds realized from spot sales at specified locations on a pipeline. Lease production is not always sold at index pricing points. Proceeds from sales upstream of index pricing points, including wellhead sales, are generally less than index prices, and proceeds from sales downstream of index pricing points, including hubs and city gates, generally exceed index prices.

After spending months discussing the administrative/audit burden and legal problems of determining royalty value of production sold downstream of the lease under the existing rules,[2] the Rulemaking Committee agreed that these problems should be avoided by implementing an index-based method with a safety net based on the arm's-length gross proceeds accruing to other lessees in the same zone. The safety net calculation, which the MMS now alleges "would place a significant administrative burden on MMS," was adopted only after MMS insisted on it, and only after MMS assured the Committee that it would not be too burdensome to perform.

MMS' final reason for withdrawing the proposed rule is that its February 6, 1997 cost/benefit analysis, <u>Determination of the Effects of Federal Gas Valuation Rules</u>,

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[2] The Rulemaking Committee closely examined several problems with the existing gas valuation regulations: inability to trace gross proceeds back to individual leases, complexity of calculating weighted average pool price, necessity to perform thousands of retroactive adjustments, difficulty of verifying proceeds based royalty payments, royalty bearing components of gross proceeds, extent of allowable deductions for transportation, processing and other post-production "value-added" costs incurred in order to sell production at a downstream location, whether an affiliate's resale value is part of a lessee's gross proceeds, extent of MMS' right to audit affiliate's books.

indicates that the proposed rule would not achieve revenue neutrality. However, several flaws undermine the reliability of the MMS study. For example:

- The proposed rule specifies that the appropriate index be chosen based on physical connection. However, the study averages all indices in the zone.

- The proposed rule limits transportation deductions to the lessee's actual transportation rate paid in most cases. However, the study deducted an average transportation rate from all reported transactions, even where no transportation deduction was taken by the lessee.

- The proposed rule requires lessees who choose index to value arm's-length dedicated sales, usually with much higher prices, on gross proceeds, which would tend to raise the safety net median price. However, the study assumes that the largest royalty payors would all choose index and that none of their reported transactions would be for arm's-length dedicated sales.

Thus, payments by assumed index payors are minimized, while their transportation deductions are maximized, resulting in artificially low index-based payments. At the same time, payments made by assumed gross proceeds payors are also minimized as a result of excluding index payors' high-priced, dedicated contracts, resulting in artificially low safety net median values. The results of MMS' study are biased and it is invalid.

Other efforts to determine how index-based payments might compare to royalties paid under the existing rules have yielded quite different results. For example, during the negotiated rulemaking, a subcommittee, comprising industry, state and MMS representatives, studied royalty data reported on Form MMS-2014 for a 30-month period. As reported in the March 1995 Final Report of the Federal Gas Valuation Negotiated Rulemaking Committee, the subcommittee's work proved inconclusive: "The study encountered many problems with the 1) quality of data reported to MMS, 2) the inability to segregate the data by index areas, and 3) transportation allowances that are netted from value. Final Report at 14.

Notwithstanding these problems identified by the subcommittee, the MMS' cost/benefit analysis purports to establish revenue impact to the dollar, on a zone-by-zone basis, without any margin for error, even though in most zones the difference between index payments and gross proceeds payments amounts to no more than a few cents per MMBtu.

Another study published in 1995 by an independent consultant, and submitted with the rulemaking comments of the Natural Gas Supply Association, examined much of the same data included in the MMS cost/benefit analysis, but concluded that the use of published indices in the calculation of royalty payments for gas sold under non-dedicated contracts would not reduce royalty payments to MMS.

At best, these studies demonstrate that the issue of revenue neutrality is elusive and cannot be easily resolved because different assumptions yield drastically different results. The Rulemaking Committee recognized this and, to accommodate MMS and state concerns about revenue neutrality, the Rulemaking Committee's consensus contained not only a safety net calculation, but an "escape hatch" enabling MMS to abandon the index methodology in a particular zone without further rulemaking under certain circumstances. Final Report at 38.

II. MMS' "New" Options Were Considered and Rejected by the Rulemaking Committee As Unworkable.

During the Rulemaking Committee's original deliberations, it considered and eliminated half a dozen royalty valuation options before reaching consensus on an index methodology. When MMS reopened the comment period in the May 21, 1996 Notice at 61 FR 25421, it suggested five more options. Then, at the reconvened Rulemaking Committee deliberations held June 12-14, 1996, no less than seven additional options were proposed. MMS now proposes two new options in its April 22, 1997 notice which are similar to options that were previously considered and rejected.

The Index +/- "X-factor" method is similar to the "Index + X" option rejected in the original Rulemaking Committee deliberations because Committee members could not agree on a value of "X". In the new proposal, MMS purports to solve this dilemma based on its flawed cost/benefit analysis. It now proposes to use the index payors' average gross proceeds from the previous year to add to, or subtract from, index payments during the current year.

This concept is completely unworkable for several reasons:

- Adding/ subtracting last year's gross proceeds to/from this year's index prices does not avoid the problems of the current gross proceeds rule, (*e.g.*, inability to trace gross proceeds back to individual leases, complexity of calculating weighted average pool price, necessity to perform thousands of retroactive adjustments, difficulty of verifying proceeds based royalty payments, the need to determine the royalty bearing components of gross proceeds, extent of allowable deductions for transportation, processing and other post-production "value-added" costs incurred in order to sell production at a downstream location, whether an affiliate's resale value is part of a lessee's gross proceeds, extent of MMS' right to audit affiliate's books). Administrative burden and legal disputes would remain, and would probably increase.

- The method would disproportionately impact different lessees. There would be winners and losers.

- MMS reported at its May 20, 1997 public meeting in Golden, Colorado, that all non-dedicated arm's-length sales would have to be valued on this method for the sake of simplicity. This would have an enormous negative impact on small producers who were given the option in the proposed rule to report on gross proceeds for all arm's-length sales.

- Certainty and simplicity would decrease rather than increase. Lessees would still have to trace, and MMS and the states would still to verify, gross proceeds.

- The requirement to calculate the "X-factor" zone by zone would impose a far greater administrative burden on MMS than the consensus rule. MMS would have virtually no time to verify gross proceeds payments for the ending months of a year period before having to calculate the "X-factor" for the ensuing period.

- Because it is a hybrid of values from two separate years, the method could never approximate the value of current production, except by coincidence.

The Norway method is merely a re-packaged "secretarial established value" which was rejected by the Rulemaking Committee. In addition to the reasons for rejecting this method, set forth in the Final Report at 11, the Norway method has other fatal flaws:

- MMS proposed "simplifying" the Norway method by "eliminating the aspect of retroactive adjustments." 62 FR 19538. As a result, the method would use stale data from the prior quarter to value current production.

- To the extent the Pricing Board's determination was based on downstream gross proceeds, many problems associated with the existing gross proceeds rule would not be averted (*e.g.*, inability to trace gross proceeds back to individual leases, complexity of calculating weighted average pool price, difficulty of verifying proceeds based royalty payments, the need to determine royalty bearing components of gross proceeds, extent of allowable deductions for transportation, processing and other post-production "value-added" costs incurred in order to sell production at a downstream location, whether an affiliate's resale value is part of a lessee's gross proceeds, extent of MMS' right to audit affiliate's books).

- The requirement to calculate a quarterly price, zone by zone, or pipeline by pipeline would impose a far greater administrative burden on the Pricing Board than the consensus rule. MMS would have virtually no time to verify gross proceeds payments for the quarter before having to calculate the norm price for the ensuing quarter.

- The Norway method requires the Pricing Board to calculate the value of 11 grades of crude oil. Considering the number of published indices, the United States gas market is far more complex. The Pricing Board would have to establish many times as many prices, or the method would not reflect the market value of production in different lease locations.

- In the end, the "norm price" is nothing more than an index established by the Pricing Board. Publised indices already reflect assessments of market value by impartial third parties. Establishing a Pricing Board would be an inappropriate intrusion by government into the market place which would bleed into non-federal transactions. Norway has no such problem because there is no private ownership of mineral rights in Norway.

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For the above reasons, API opposes the most recent options proposed by MMS and urges it to reconsider its decision to withdraw the proposed rule. If we can be of further assistance to you in this important rulemaking, please contact me.

Sincerely,

G. William Frick

G. William Frick
Vice President, General Counsel and
Secretary

ATTACHMENT A

"Negotiated Rulemaking Gas Valuation Team Recommends Improvements In Regulations On Federal Laws" MMS News Release, March 16, 1995

MMS

U.S. Department of the Interior
Minerals Management Service
Office of Communications and Government Affairs

NEWS RELEASE

FOR RELEASE: March 16, 1995
EMBARGOED UNTIL 10:00 AM

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NEGOTIATED RULEMAKING GAS VALUATION TEAM RECOMMENDS IMPROVEMENTS IN REGULATIONS ON FEDERAL LANDS

The U.S. Department of the Interior's Minerals Management Service (MMS) today released a report containing recommendations to improve gas valuation regulations for federal lands. The report was prepared by a 20-member committee of MMS, state and industry representatives.

The committee recommends that some gas produced from federal leases be valued based on indices published in trade publications such as "Inside FERC" and "Natural Gas Intelligence." The committee also recommends that where agreements contain a mix of federal, state, Indian and fee leases, royalties be reported and paid based on the amount of production to which each lessee is entitled whether or not that amount of production is actually taken and sold by the lessee. However, an exception is recommended for small independent gas producers who pay on their actual annual sales of production (commonly referred to as "takes"). This would allow these producers to pay royalty based on the amount of gas they actually sold rather than the amount of gas that they were entitled to take from production on a lease.

"This report is the result of a 13-month comprehensive examination of valuation issues by parties with very diverse interests," said MMS Acting Director Cynthia Quarterman. "This consensus decision will serve as the basis for regulations that provide more simplicity and certainty in valuation of gas produced from federal leases.

"We view this negotiated rulemaking as a success and, in fact, MMS is working to complete proposed regulations based upon this report," she added.

Acting on a recommendation from the Royalty Management Program's National Performance Review Laboratory, a study group was formed in December 1993, to determine the best approach for valuing natural gas produced on federal public lands.

The study group was later transformed into the more formal "Federal Gas Valuation Negotiated Rulemaking Committee," and chartered by the Secretary of the Interior to advise MMS on a federal gas valuation rulemaking.

Committee participants included representatives from the American Petroleum Institute, Independent Petroleum Association of America, Independent Petroleum Association of Mountain States, Natural Gas Supply Association, Rocky Mountain Oil and Gas Association, Council of Petroleum Accountants Societies; representatives from individual large independent oil and gas companies; representatives from the States of Montana, New Mexico, North Dakota and Utah; and MMS.

(more)

Meeting at least monthly for the past 13 months, the committee addressed all aspects of the process including such controversial and complex valuation issues as gas produced from unitization and communitization agreements and gas sold under non-arm's-length contracts.

"We believe that this cooperative effort has equitably addressed the needs of our many constituents," said Quarterman. "The proposed regulation will help to clarify how to pay royalties on natural gas, while reducing administrative costs, decreasing litigation, and maintaining revenue neutrality. MMS expects to publish the proposed rule early this summer."

Free copies of the report are available by contacting John Barder at (303) 275-7234.

MMS is the federal agency that manages and regulates the nation's natural gas, oil and other mineral resources on the Outer Continental Shelf, and collects and disburses revenues from offshore federal mineral leases and from onshore mineral leases on federal and Indian lands.

--MMS--

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

MAR 13 1995

Dear Constituent:

I'm pleased to share with you the final report of the Federal Gas Valuation Negotiated Rulemaking Committee (Committee). The report contains consensus recommendations from the Committee for streamlining the valuation of gas produced from Federal leases. I fully support the work of the Committee and I'm committed to publishing a proposed rule based on the consensus reflected in the Committee's report. The proposed rule will simplify royalty payments on natural gas produced from Federal leases, while reducing regulatory burden and administrative costs, decreasing litigation, and maintaining revenue neutrality.

If you're a constituent not familiar with the Committee's deliberations, the report may appear to provide for a more complex regulatory structure. However, I believe you'll find its complexity does not result in additional regulatory burden, but instead provides regulatory relief through valuation options to meet the demands of this ever-changing natural gas market. The Committee's recommendations balance the needs of all types of producers who pay royalties, as well as the needs of Federal and State Governments who are responsible for properly collecting and verifying those royalties.

As you'll see from the enclosed transmittal memorandum included with the report, the Committee's recommendations provide numerous benefits to each of Minerals Management Service's (MMS) constituent groups. These benefits resulted from the Committee's willingness to compromise in an effort to resolve longstanding disputes and achieve administrative cost savings.

I encourage you to comment on the upcoming proposed rule. Your input into this effort, as well as other MMS endeavors, is always appreciated.

Sincerely,

Cynthia Quarterman

Cynthia Quarterman
Acting Director

Enclosure

ATTACHMENT B

Testimony of Cynthia Quarteman, Director, Minerals Management Service, Before Energy and Mineral Resources Subcommittee, Resources Committee, U.S. House Of Representatives, March 7, 1966.

Congressional Testimony

Cynthia Quarterman, Director
Minerals Management Service, Department of the Interior

Prepared for the Energy and Mineral Resources Subcommittee, Resources Committee

House of Representatives

March 7, 1996

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear today to present testimony on the programs of the Minerals Management Service (MMS) -- including how those programs have evolved during the 14 years the Bureau has existed; improvements we have made and hope to make in the future; and whether an "organic act" will help the bureau better accomplish its mission.

As you are aware, the MMS consists of two major programs: the Royalty Management Program and the Offshore Minerals Management Program. As such, all mineral revenue management functions for Federal (onshore and offshore) and Indian lands are centralized within MMS. Further, the leasing and oversight of mineral operations on the Nation's Outer Continental Shelf (OCS) is also centralized within the bureau. Together, these programs provide major energy and fiscal benefits to the public. For example, approximately $4 billion in mineral revenues are collected and distributed on an annual basis from Federal and Indian lands, and OCS natural gas and oil production accounts for approximately 24 and 15 percent, respectively, of our Nation's domestic energy production.

Background

MMS is both a relatively new bureau as well as a relatively small bureau. It was created in 1982 by Secretarial Order 3071 following the independent Commission on Fiscal Accountability's recommendations. The Commission found that proper fiscal accountability and management would be best served by an agency devoted solely to minerals management. That recommendation served as a driving force to formalize and consolidate the mineral revenue collection and offshore minerals management functions within a single agency and has helped ensure top-level management attention to these two important programs. By consolidating both the functions and associated personnel into a single entity, the bureau has been better able to accomplish its mission and has developed integrated processes to oversee the operations of its programs. Further, consolidation has afforded economies of scale, thus saving the taxpayer dollars and providing for improved service to customers.

In its early years, MMS focused attention on developing systems, policies and procedures to meet the mandates of the Federal Oil and Gas Royalty Management Act (FOGRMA) and the OCS Lands Act, as well as the expectations of oversight organizations and its constituencies. Since 1982, the bureau has made major strides, including:

- designing and implementing automated fiscal and production accounting systems that are centralized and integrated;

- reducing recurring errors caused by data discrepancies and industry reporting mistakes from almost 39 percent in 1982 to just over 2 percent in 1995;

- steadily increasing the percentage of revenues being disbursed on time from 92 percent in 1985 to approximately 99 percent in 1995;

- increasing the frequency of disbursements to the Federal Treasury and States from semi- annually in 1982 to monthly;

- implementing comprehensive and systematic audit and compliance programs to enhance revenue collections. Since 1982, these efforts have generated over $1.8 billion, with over $525 million coming in the last 2 years;

- designing and implementing three comprehensive OCS 5 Year lease sale programs to help meet the Nation's energy needs while taking into serious consideration the concerns of State and local constituencies. Bonus revenues from the 45 lease sales held to date under these programs total over $18 billion;

- developing policies and procedures to help ensure that all exploration and development activities carried out on the OCS are done in a safe and environmentally sound manner, thereby reducing the rate of oil spills since 1980 to 8 times lower than the previous 15 years. In 1994, the bureau was the first Federal organization awarded the President's Council on Environmental Quality and National Association of environmental Professional's "Federal Environmental Quality Award" for successfully integrating environmental values into its agency mission and decisionmaking;

- responding to the needs of our Nation's coastal residents by establishing a program to provide access to much-needed OCS sand and gravel resources for coastal restoration and onshore aggregate projects; and,

- changing the reputation of the Department of the Interior's minerals collection and disbursement effort from one of mismanagement to one of top quality management--as evidenced by MMS's receipt of the 1991 award for management excellence from the President's Council on Management Improvement and as a finalist in 1993 and 1994 for the Federal Quality Institute's Quality Improvement Prototype Awards. In 1995, MMS received the Vice President's "Hammer Award" for its pioneering work in writing regulations in plain English.

MMS Today--Goals and Initiatives

Despite the strides made by the bureau since its inception, we also realize that the challenges and opportunities the bureau faces today are different from those of the previous decade. In response to these new challenges, MMS has developed an overall strategic plan which will help guide our efforts and give our employees a clear sense of direction in these times of change. As an outgrowth of this strategic planning, the bureau is focusing its efforts on finding ways to carry out its programs more efficiently and effectively; to improve our level of service both to the regulated community and the public; and to treat our various constituencies as partners in decisions that could affect them. Another goal is to make information easily and rapidly available to a wide range of constituencies. In November 1995, MMS established a Home Page on the World Wide Web.

Royalty Management Program

Today one of the primary goals of the mineral revenue collection program is to assist and encourage payors to submit royalty payments correctly the first time. In addition, MMS is actively examining ways to simplify and streamline aspects of the complex revenue collection process, including:

- establishing a Royalty Policy Committee to provide input from affected parties on important policy questions;

- implementing a multi-constituent approach to resolving royalty-related issues in our most controversial areas, such as Federal and Indian gas valuation committees. These committees are engaging in negotiated rulemaking efforts involving industry, States and the Indian community. The rulemakings will result in program changes that reflect the marketplace and simplify royalty valuation, reporting, and payment;

- offering a variety of electronic reporting and paying options to our customers. The goal of this effort is to receive 100 percent of incoming reports electronically by the end of 1997. Both the bureau and industry should realize substantial monetary savings once that goal is achieved;

- piloting innovative and cost-effective ways to collect royalties. MMS is currently reviewing the results of a one-year pilot project it conducted in which offshore gas was collected, in lieu of cash royalties, and sold directly to gas marketing companies, with the proceeds going directly to MMS. This pilot has the potential to significantly reduce administrative costs for both the Federal government and industry;

- involving interested States and Indian Tribes in the royalty collection activities of the bureau. Currently, MMS contracts with 10 States and 7 Indian Tribes to assist in auditing mineral leases; and,

- staffing 3 service-oriented Offices of Indian Assistance near Indian Tribes and allottees to better serve their needs.

- Also in the next year, MMS will explore the feasibility of establishing a performance based organization (PBO) structure for program activities deemed appropriate.

Recently, MMS has been making great strides in further simplifying some of its royalty processes and procedures. For example, just in the last 6 months, the bureau has:

- refined its policies related to reporting assessments. In October 1995, MMS implemented a new policy whereby the bureau will no longer charge companies for filing (1) late royalty and production reports; and (2) erroneous reports, if certain conditions are met. This new policy relieves the bureau of the need to process approximately 1,000 annual assessment bills and will eliminate approximately 35 percent of all appeals;

- revised its regulations to simplify payor reporting of allowable deductions from royalty value. This effort resulted in the elimination of several transportation and processing allowance forms and removed sanctions that had been imposed when companies failed to observe reporting procedures in filing those forms;

- refined its policy with regard to recouping royalty overpayments for Federal offshore mineral leases. The new policy raises the de minimis reporting requirement from $250 to $2500. By raising the de minimis level, companies may now recover overpayments below the de minimis amount from future royalty payments. This policy change will cut paperwork by over 50 percent and will be beneficial to both the Federal government and industry; and

- reengineered mineral lease and payor data processes. The Common Reference Data Reinvention Laboratory focused on categories and levels of information required by the Payor Information Form (PIF), the way it is processed, and how it can be improved. The pilot showed that MMS can reduce its processing time from 14 to 3 days, resulting in a more timely distribution of both data and revenues to State and Indian customers. In the second phase of the process, customers will participate in the redesign of the PIF itself, resulting in simplified reporting of information currently provided by the PIF.

Offshore Minerals Management Program

The challenges and opportunities facing the offshore natural gas and oil program have also changed during the past decade. Today, the Offshore program has shifted its emphasis to a more focused leasing program and is also concentrating on the safe and sound development of resources on over 5,200 existing leases. In line with this shift in focus, MMS has made changes aimed at making the program more efficient and effective while maintaining its environmental and safety emphasis, including:

- more effectively employing sound science in the OCS decisionmaking process, including:

- establishing a Joint Subcommittee on Environmental Information for Select OCS Areas Under Moratoria. This Subcommittee will assess environmental information and requirements in light of budgetary constraints, oil and gas technological advances, industry interest and the nature of potential hydrocarbon resources. The results of this assessment will help MMS as it determines environmental studies necessary for leasing or development decisions as well as various mitigating measures; and,

- developing the online Environmental Studies Program Information System (ESPIS). When complete in October 1996, the full reports of all MMS-sponsored research will be available online via the Internet--adding up to 20 years and over 500,000 pages of scientific information.

- doubling production from the Pacific region (to approximately 200,000 barrels/day) since 1985 with extensive involvement by local constituents, including the creation of a Tri-County Forum to work in partnership with MMS to address and resolve issues related to the development of existing leases;

- revising existing regulations to be less prescriptive and more performance-based. Through its Safety and Environmental Management Program, MMS is endorsing privately-adopted safety and environmental plans for self-regulation by OCS mineral operators to better facilitate innovation while still ensuring safety and protection of the environment;

- encouraging royalty relief, where appropriate, in order to provide an economic incentive to ensure continued production on older leases and maintain the stream of royalty revenues to the Federal Treasury. In 1995, MMS issued interim guidelines that streamline and simplify the royalty relief application process for OCS producing leases;

- expeditiously developing regulations to implement recently-enacted OCS deep water royalty relief legislation. The Administration has supported this initiative and is committed to developing the necessary regulations by the statutory timeframe and new lease provisions in time for the next Central Gulf of Mexico lease sale;

- developing cooperative efforts with States, local governments, and others to address various OCS issues. For example-

  - in 1995 MMS concluded a successful multi-constituent effort to develop an acceptable approach to implement financial responsibility requirements for offshore facilities under the Oil Pollution Act of 1990. The results of this effort have been used by the Congress as it considers amendments on this issue;

  - the upcoming OCS 5 Year Plan (1997-2002) will incorporate the recommendations of a special Alaska Regional Stakeholders Task Force;

  - the Pacific OCS region is working with industry and key State and local agencies to conduct a planning study that will examine possible development scenarios for existing, undeveloped leases offshore California and associated onshore infrastructure; and,

  - MMS is pursuing, through its Marine Minerals Program, opportunities with interested coastal States to supply sand and gravel for beach restoration efforts. Currently, the bureau is involved in 12 cooperative projects.

Conclusion

As you can see from the above discussion, MMS has made and continues to make significant strides in managing the public's resources while reducing unnecessary burdens on the industry it regulates. However, our goal is to make continual progress in the years ahead since we will face new challenges and opportunities. In accomplishing that goal, we will look for ways to do our business better, whether it be from a regulatory, administrative or legislative standpoint.

In closing, you have asked that I address whether an "organic act" will help the bureau better accomplish its mission. Certainly, an "organic act" will recognize the ongoing programs and activities of the bureau and will, thus, formalize those programs within an administrative framework. However, as you are aware, authorizing legislation is just one tool that can help the bureau accomplish its mission. Finally, it is also important that the bureau be provided with funding sufficient to carry out its programs. We look forward to working with Congress to explore various avenues in which we can better accomplish these goals.

Mr. Chairman, this concludes my prepared remarks. However, I would be pleased to answer any questions you or Members of the Subcommittee may have.

Go to the
MMS
Home Page

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webmaster@smtp.mms.gov
updated July 1, 1996

ATTACHMENT C

Testimony Of Sylvia Baca, Deputy Assistant Secretary, Land and Minerals Management, U.S. Department of the Interior, Before Subcommittee on Energy and Mineral Resources, Resources Committee, U.S. House of Representatives, June 8, 1995.

Final
Testimony

Testimony of

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United States Department of the Interior

Before the

House Resources Committee
Subcommittee on Energy and Mineral Resources

June 8, 1995

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you to testify on management alternatives for the Bureau of Land Management and the Minerals Management Service (MMS) with regard to mineral leasing, operation and royalty management. I understand that the emphasis of today's hearing pertains to management alternatives with respect to onshore minerals. Accordingly, I will focus the majority of my remarks in that area.

This hearing, and the issue it is intended to address, is a timely one. There is general agreement that the old ways of conducting the public's business through Federal government programs must be thoroughly analyzed, reinvented, and in some cases, abandoned. We cannot and should not be content to rely on the practices of the past to work in the 21st century. Furthermore, the general public has indicated its desire to see a government that is responsive, yet leaner.

Given our desire to respond to changing needs and legitimate requests of the public we serve, both the Department and the Administration have embarked upon an unprecedented effort to restructure government. Recently, under the Administration's REGO II effort, the Department proposed significant shifts in several of the programs under its purview representing the Department's best assessment of how to perform its core functions.

With those general remarks as background, I would now like to turn to the subject of today's hearing. Understandably, a portion of my remarks will focus on the REGO II proposals for the BLM and the MMS. However, I would also like to touch briefly on some other initiatives that we are undertaking to operate more efficiently while enhancing service to our regulated community and other constituencies.

PROPOSAL WITH RESPECT TO THE MINERALS MANAGEMENT SERVICE

As you are aware, MMS is responsible for managing two major programs--the Royalty Management Program and the Offshore

Minerals Management Program. Although the recent Departmental REGO II proposal addressed both programs, I will limit my remarks to the proposal to consult with States and Indian Tribes on a possible devolvement to state governments of the responsibilities of the MMS for the management of onshore mineral revenues.

On March 27, 1995, the President proposed this consultation as part of the National Performance Review's Phase II. The proposal was based on the belief that some of the functions of the MMS can be performed more efficiently at the state and tribal levels.

Specifically, the proposal recommends consulting on the issue whether the royalty collection program for onshore Federal lands should be transferred to the States and for Indian lands to Tribes. The responsibilities to be transferred would include all royalty collection functions except those that are inherently Federal, such as enforcement of lease terms, issuing final policy and regulations, determining value for royalty purposes, and adjudicating appeals. The transfer of the royalty collection process to the Tribes would be accomplished by compacting the royalty functions under the Self Governance Act to interested Tribes.

It should be emphasized that the MMS proposal is a proposal to consult regarding the elimination of MMS. While the Department proposed a specific scenario with associated cost savings to devolve royalty management-related functions, it also is cognizant that affected States, Tribes, and other affected parties may recommend a different approach. We are open to discussing different approaches if they can achieve an equivalent level of cost savings.

At this time, we are in the process of undertaking extensive consultation with affected parties. Specifically, we have sent the devolution proposal to the Governor of each State receiving revenue from Federal mineral leases and to Tribal leaders and Indian allottee associations with mineral leases. We are also seeking input from industry. We will be able to put more specifics to the proposal after we have consulted and received the views and ideas from these affected parties.

We plan to meet with representatives of the interested States, Tribes, allottee associations and industry associations in July in order to provide more information about the proposal, respond to initial comments, explain our process for future consultations and discuss other alternatives. This meeting would be followed by additional sessions in late summer as needed.

The cost savings associated with the devolution proposal is an extrapolation assuming all 38 States and Tribes are willing to accept royalty collection functions based on the proposal submitted to the House Natural Resources Committee in July 1993 by then-Governor Sullivan of Wyoming. It calls for a simplified and redesigned royalty accounting system which is included in the devolution proposal. This redesigned accounting system is estimated to cost almost $65.5 million to design and transfer to States and those Tribes accepting the royalty accounting functions--approximately $16.1 million will be needed to develop a new system and approximately $49.4 million will be needed for system implementation and start-up costs. However, for those Tribes that decline to assume these functions, it is the Department's intent to provide to those Tribes the same level of service that is currently provided.

The savings to the Treasury described in the proposal assume all States and Tribes will take over the royalty function and also is predicated on an increase the cost recovery provisions (net receipts sharing) of the mineral leasing administrative program costs to 50 percent from the current 25 percent that was included in the Omnibus Budget Reconciliation Act (OBRA) of 1993. Legislation will be needed to change current provisions in the Federal Oil and Gas Royalty Management Act and the OBRA and to enact appropriations consistent with the proposal. Overall, the proposal is estimated to generate net savings of $59.8 million over a four year period.

Significant segments of the oil and gas industry have raised concerns about the elimination of MMS. Their concerns focus on the increased regulatory burden of having to deal with multiple states and absorption of the offshore program into a large agency that lacks mineral expertise.

Many states, while philosophically supportive of a greater state role, have expressed concern about performing ministerial functions for the compensation included in the proposal. They are more interested in the functions which have been determined to be inherently Federal functions. Tribal leaders have raised concerns about being provided the same level of service as is currently the case with MMS.

Ongoing Efforts to Simplify Royalty Management

Even before the Department announced this proposal to consult on the issue of devolution, the MMS was committed to reducing the costs of collecting royalties. As part of the National Performance Review-Phase I, led by Vice President Gore, the bureau initiated a number of actions to simplify the valuation of gas production and reduce the overall costs of compliance.

Royalty collections are based on three elements: royalty rates, amount of production, and value of production. Valuation is by far the most controversial of the these elements. Because producers have a multitude of different types of contracts for selling their gas, it is often difficult to determine exactly how much the producer received for minerals extracted from Federal lands and to ensure there were no deductions from the royalty value for services that are the sole responsibility of the producer. This is further complicated by the existence of many non arms-length contracts, where MMS cannot simply assume that the price a purchaser paid to an affiliated producer is an accurate measure of value.

Resolution of issues relating to valuation often lead to costly administrative appeals and litigation. If we can simplify the process for the valuation of gas production in a way which is fair to industry and the revenue recipient, we can reduce the overall cost of royalty management. The following initiatives represent some of the most important actions we have started to accomplish this goal.

Negotiated Rulemaking

Federal Gas Valuation Negotiated Rulemaking Committee

In February 1995, the Federal Gas Valuation Negotiated Rulemaking Committee completed its negotiations on how royalties should be paid on natural gas produced from Federal leases. Specifically, the Committee's negotiations focused on improving the methods for valuing gas sold to affiliates, gas produced from unitized and communitized leases, and gas sold remote from the wellhead under the new marketing environment brought about by Federal Energy Regulatory Commission Order No. 636 (Order No. 636). The culmination of these negotiations is a series of recommendations that should improve and simplify the payment of royalties as well as help save both the government and industry administrative costs.

The Secretary chartered the Committee effective June 27, 1994, although discussions began in December 1993. The Committee represented a diverse cross-section of MMS's constituents, including States, major oil and gas companies, marketing companies, large independent producers, and small independent producers, as well as representatives from MMS. Decisions and recommendations were reached by consensus; that is, all recommendations needed the support of each Committee member for approval. The Committee operated under the Federal Advisory Committee Act, but generally followed the guidelines of the Negotiated Rulemaking Act. Meetings were held publicly and recorded for the public record. A final report containing the Committee's recommendations is also available to the public.

The Committee set out specific objectives for developing improved and simplified methods for valuing natural gas. These objectives were to:

(1) provide certainty to both producers and government auditors in determining value;

(2) facilitate timely and accurate remittance of royalties;

(3) use information to which the producer has access; and

(4) provide administrative cost savings to all parties.

The Committee's recommendations may provide the certainty and simplicity sought by MMS's constituency.

- The option to allow producers to use published index prices could result in simpler and more definitive royalty values closer to the wellhead. Index prices are published monthly, are specific to each pipeline, are readily available to the public, and represent sales closer to the wellhead than those typically occurring under Order No. 636.

- For processed gas, producers may have the option to value their gas at the wellhead, eliminating multiple line reporting and complex downstream computations.

- For unitized and communitized leases that involve multiple royalty owners, producers would simply pay royalties based on their ownership interest in the lease. Complexities associated with tracking where the gas actually went and who sold it would be eliminated.

- For independent producers not wishing to use index prices, the recommendations allow them to continue using their sales proceeds. For qualifying small producers in unitized and communitized leases, a waiver would allow them to pay on actual sales interest-free for one-year.

- For all producers recommendations may remove some regulatory burdens:
  (1) the preparation and filing of gas transportation allowance forms and processing allowance forms;

  (2) the reporting and valuation of natural gas liquids in most areas, including the calculation of a processing allowance;

  (3) the requirement to dually account for Federal gas;

  (4) ambiguities in determining allowable gathering and compression; and,

(5) obstructions to using third party transportation rates and regulatory tariffs.

Indian Gas Valuation Negotiated Rulemaking Committee

In January 1994, MMS formed the Indian Gas Valuation Study Group. Throughout 1994, MMS met with representatives of several Tribes and allottee associations. The MMS used an informal study group format to obtain and clarify varying viewpoints. Discussions focused on methods of improving regulations implementing the specific Indian lease term requirements concerning major portion analysis and dual accounting. The MMS published the first work product of the study group on August 4, 1994, an Advance Notice of Proposed Rulemaking soliciting comments on new methodologies being considered to establish value of production from Indian leases.

The Committee, chartered on February 1, 1995, grew out of the Indian Gas Valuation Study Group. It is comprised of representatives of MMS, Bureau of Indian Affairs, Indian mineral owners and their representatives, and the oil and gas industry. The Committee has met three times. Much progress is being made in the areas of major portion analysis, dual accounting, gross proceeds, and transportation allowances.

The Committee is currently working on a formula to value gas produced from Indian lands using publicly available spot market index prices and a discount factor. The formula-derived price would be applied to the wellhead MMBtu volume and would be used in lieu of gross proceeds and major portion calculations. Under this scenario, filing of forms for transportation allowances would not be necessary. The Committee is also working on a formula-based valuation method in lieu of dual accounting calculations. Less paperwork and fewer reporting requirements for industry mean less administrative oversight by the government.

The goal of the Indian Gas Valuation Negotiated Rulemaking Committee is to publish regulations that will maximize royalty revenues for Indian tribes and allottees while streamlining administrative activities. The regulations will also satisfy the oil and gas industry by being clear, economizing on the information needed by a lessee to properly compute royalty, and making it easier for a lessee to comply in a timely manner.

The Committee is confident that it will reach consensus on a valuation method and royalty collection procedure that benefits the MMS, Indians, and industry by assuring:

- Fairness
- Simplicity
- Predictability
- Adaptability
- Maximization of revenue consistent with laws and lease terms
- Timely Compliance (certainty and closure)
- Ease of administration
- Enforceability
- Consistency with market
- Availability of data
- Longevity

Gas Production Taken in-Kind

The MMS has initiated a Royalty Gas Marketing Pilot, currently underway in the Gulf of Mexico. Although the pilot involves only offshore leases, we may be able to institute similar programs onshore in the future, and therefore are bringing this pilot to the Committee's attention today. The purpose of the pilot is to streamline and simplify the royalty collection process by taking the Federal royalty share in-kind. In light of the potential benefits offered by this new approach to royalty collection, the Department officially designated the pilot as a National Performance Review Laboratory in 1994.

Under the pilot, MMS takes the Federal royalty share of gas production from 77 volunteered leases (representing approximately 8 percent of the gas in the Gulf of Mexico) and immediately sells it to 13 competitively chosen marketers. The pilot is scheduled to run from January 1995 through December 1995. Potential benefits of the pilot include:

- Lessees will no longer determine the value of production for royalty purposes.
- Lessees will no longer have to submit as much information as they would on the normal royalty report.
- Audit streamlining will occur, a simpler compliance system will be created and there should be reduced litigation.
- MMS auditors or systems processing will only be responsible for confirming the delivery of the Federal royalty share of gas production to the marketer.
- Administrative costs should be reduced for both industry and MMS.

The MMS will conclude its evaluation of the pilot by mid-1996. The focus of the evaluation will be on revenue neutrality and the administrative cost savings of taking royalty in-kind. The MMS will make a decision if it should extend the pilot with differing features in 1996.

Royalty Fairness Issues

In addition to improving on the way we do our royalty management activities, we are also interested in being fair to industry and have tried to improve on the timeliness of our compliance reviews.

Contemporaneous Audits

The MMS began a Contemporaneous Audit Initiative in the fall of 1988 in an effort to become contemporaneous in its audit efforts. This required an accelerated audit effort to finish off old, unaudited periods. That effort was successfully completed in November 1992. Completion of that effort means that it is now feasible for field audit personnel (Federal, state, and tribal) to engage royalty payors and complete audits within a 6-year period.

Companies with audit teams in residence (now the 11 largest companies) and major payors (now 111 large companies) targeted for audit are responsible for paying about 87 percent of all mineral revenues on Federal and Indian leased lands. The current audit strategy for the 11 largest companies is to audit the 3-year period October 1989 through September 1992 within a 3-year period ending September 1995, completing the audit cycle within 6-years.

For the 111 major payors, the current strategy is to audit a 5-year period in 1-year. Thus, for one-fifth of the major payors, MMS will complete audits by September 1995 for the period 1989-1994. In October 1995, MMS will begin audits of a different one-fifth, covering the 1990-1995 period. This policy is consistent with the record retention policy of the Federal Oil and Gas Royalty Management Act.

Contract Settlement Audits: The majority of these audits are also being accomplished within 6-years of when payments are believed to have passed from purchasers to royalty payors. However, we have often found that settlements dated in the early to mid 1980's contain provisions for allocation of proceeds to future production in periods of current audit coverage. These settlements must be reviewed to make such determinations. Accordingly, some payors have been engaged for audit or have been asked to provide records for periods extending beyond 6-years.

Except for the contemporaneous audit effort, the few contract settlement audits which require reviewing records older than 6-years, and potential findings associated with companies' use of posted prices to value California crude oil, we are considering issuing further guidance to MMS auditors that they should limit their bills and orders to no longer than six years back from the date the royalty is due.

Interest on Royalty Overpayments

The MMS is undertaking several initiatives to improve on the way it conducts the public's business, and is committed to continual improvement.

PROPOSALS WITH RESPECT TO THE BLM

I will now outline the proposals contained in Reinventing Government (REGO II), as well as the final report of the Onshore Oil and Gas Performance Review.

BLM's Plan for REGO II Proposals

Pursuant to REGO II, the BLM will consult with the States and Indian Tribes on the proposal to transfer certain oil and gas inspection responsibilities to the States and Native American Tribes, and cost recovery for pre-lease and post-lease energy and minerals programs.

Transfer of oil and gas inspection and enforcement

REGO II proposes that the BLM transfer certain oil and gas inspection and enforcement responsibilities regarding production verification and surface compliance in the Onshore Oil and Gas program to individual States and Native American Tribes. This proposal will eliminate duplication of efforts by State and Federal governments, and promote tribal governments' involvement in the management of their oil and gas resources. The BLM is forming a Consultation Task Force consisting of State, Tribal and Federal representatives to establish the initial ground rules surrounding the transfer to the States and Tribes. The joint Task Force will complete its analyses and prepare an report for the BLM Director no later than October 1, 1995. Letters have been sent to Governors and Tribal Chairmen requesting the names of their representatives for the Task Force.

The Task Force plans to have several meetings to develop options and to draft a report with recommendations on the transfer of the inspection operations. The Task Force will be instructed to implement an outreach and consultation plan, which includes the general public, Tribal governments, constituents in the industry, environmental and other interest groups, and local and State governments. The draft report will be distributed for review and comment. After comments are received and analyzed, the Task Force will prepare a final report with recommendations.

The BLM would not require legislation to implement this proposal. Current authority exists under Section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), P.L. 97-451, to delegate the inspection and enforcement program to the States. Tribes are eligible to contract for programs through the Indian Self-Determination Act and the Tribal Self Governance Act of 1994. Currently, there is no mandate to require either the States or Tribes to accept this inspection responsibility.

The Task Force will analyze the regulations at 43 CFR § 3190, et seq., which provide for delegation of authority of oil and gas inspections mandated under FOGRMA cooperative agreements with States and Tribes. As determined by the Consultation Task Force, there may be modifications to certain oil and gas operating orders to insure oversight and consistency with respect to the inspection and enforcement standards. In addition, the Task Force will analyze the regulations at 25 CFR § 211, which apply to Tribes.

The BLM estimates that most of the federal employees affected by this proposal would be the Petroleum Engineering Technicians and their support staff. A buyout opportunity was made available to these groups, and eighty-five people have elected to take the buyout opportunity. These employees are scheduled to leave Government service on March 3, 1997. The estimated cost savings over five years, beginning in FY 1997, is $9,000,000 and 99 FTEs.

Cost recovery for pre-lease and post-lease programs

Extensive pre-leasing activity is necessary for oil and gas operations. These activities include analyses required by the National Environmental Policy Act. Individual leases may require environmental analyses and land use planning decisions informing the agencies and the public of potential effects of the proposed leasing action on the environment. The BLM currently recovers some costs under some circumstances. Under the REGO II pre-leasing proposal, the BLM will analyze and identify the costs necessary to perform these analyses, and will seek to recover those costs from the industries benefiting from the leasing actions.

The BLM also incurs administrative costs from actions necessary to conduct mineral operations. These administrative costs include, but are not limited to, preparation of licenses, permits, and other land use authorizations individuals and companies need to use the public lands. Currently, charges are imposed for several of these land uses, but are outdated and must be revised to meet present circumstances.

The cost recovery for NEPA compliance will be significant. In our REGO II proposal, we estimate that the BLM spends approximately $6,000,000 on prelease NEPA compliance. Postlease NEPA compliance is substantially less, as the prelease work generally provides the basis for postlease analysis.

A cost recovery Consultation Team has been established to review and analyze the way BLM processes land use applications, and monitors the land uses, the fees charged to process and monitor the actions, and the financial systems BLM uses to distribute the collected fees. The analysis will identify the strengths and weaknesses of the existing program. The goal of the re-engineering initiative is to build upon the strength of the existing programs, while eliminating weaknesses and adding other attributes to make the system more effective to users of the public land and fairer to the American taxpayers.

Due to current legislative authorities, the team does not foresee a need for legislation in this area. The team expects to re-engineer the existing cost recovery processes by regulatory and internal directive changes. Major changes to the regulations and other internal directives that currently directs the cost recovery efforts would be needed if costs for administering land use authorizations are to be appropriately and efficiently recovered. The appropriate changes to other BLM directives would follow the finalization of the regulations.

The reinvention measures are designed to reduce dependency on appropriated monies for processing land use authorizations.

Ongoing efforts to improve management of onshore minerals

Even before the Administration and the Department of the Interior announced the REGO II proposals, the BLM was committed to identifying ways to improve the management of the public resources and providing improved services to all of its stakeholders.

BLM Performance Review

The BLM Performance Review (BPR) was initiated in late 1993 to review oil and gas program operations, regulations and policies, and to identify opportunities to improve the way BLM provides service to its customers. The review culminated in the establishment of issue resolution teams and process review teams comprised of BLM staff and personnel from other federal agencies.

These teams were asked to develop recommendations for innovative changes to improve BLM's ability to manage oil and gas resources while sustaining the health, diversity and productivity of the public lands for the use and enjoyment of present and future generations.

The final report of the BPR was issued on April 27, 1995. The report recommends numerous changes to the BLM's oil and gas program. The next task for the BLM is to review the recommendations. Some of the options are short term; others require more time. Some options will be more popular than others. All of the options should improve the way the BLM conducts its oil and gas business by improving the quality of decisions to lease, providing incentives to industry for increased production, reducing unnecessary paperwork and duplication, holding industry accountable for environmental problems it creates, maintaining the health of the land, improving BLM's on-the-ground monitoring efforts, and ensuring continuous public and industry participation in finding improvements to the way business is done.

I will now outline some of the specific recommendations contained in the report.

Royalty rate relief and reductions

The report recommends that the BLM consider royalty rate reductions for high operating cost wells, such as those with a high water cut. The granting of royalty rate reductions on a case-by-case basis is also recommended for enhanced recovery projects. The enhanced recovery project must be capable of producing additional reserves not recoverable under existing operations. The report also recommends that the BLM grant royalty waivers on a case-by-case basis for drilling wildcat and deep wells, for drilling horizontal or directional wells, or multiple wells from a common drill pad. Further, the BLM will consider eliminating the minimum royalty provisions on leases qualifying for the stripper well royalty rate reduction program. All of these proposals have been or are being studied to estimate the effect on Federal and State revenues. Once the analysis is complete, a determination will be made of which, if any, royalty rate relief/reduction scenarios is adopted for rulemaking.

Environmental compliance self-certification

The report recommends that the BLM establish a one-year pilot program to allow industry to self-certify environmental compliance in an area office, such as the BLM's Buffalo Resource Area of Wyoming. The BLM Wyoming State office would then do an analysis of the pilot program, and devise a policy that can be adapted in other offices. The pilot would be limited to operators with a history of compliance.

Responding to cumulative impacts

The report recommends that this effort be used as a model to incorporate analysis of cumulative impacts. This will allow the BLM to: (1) test the BPR recommendations under field conditions; (2) refine its planning techniques; (3) evaluate proper use of mitigation measures; and (4) improve the quality of post-lease monitoring. A key element of the effort will be to include the concept of "net effect" into the concept of cumulative impacts.

Streamline the unitization process

The report recommends that the unitization approval and administrative process be streamlined and simplified. This would save operators and the BLM time and money, and provide flexibility to operators.

Reducing or eliminating unnecessary costs to operators

The report recommends that the BLM identify policies and regulations that impose unnecessary costs to the operators and can be resolved by reinterpretation, waiver, or a variance, without compromising the intent of the regulations. The report further recommends that, in conducting this review, the BLM solicit input from local oil and gas trade associations.

Bonding and unfunded liability recommendations

There are several recommendations to improve the Government's ability to reduce its liability in the event of bankruptcies or operators who abandon the site, while at the same time reducing costs to industry. The BPR recommends that the BLM eliminate or minimize duplicate bonding between State and Federal agencies, revise assignment forms to more clearly lay out the relationship between assignor and assignees, provide for selective increases in bond amounts when a situation so warrants, develop an improved data base on shut-in wells, and adopt a new policy to reassess risk and bonding needs prior to assignments.

BLM Performance Review implementation

The initial implementation phase may begin on several of the proposals, including options which can be accomplished within the framework of existing statutes, options which have a relatively high degree of consensus support or the absence of opposition from any one group of stakeholders, options which will have a substantive impact on our ability to better serve our stakeholders, and options which can be implemented within a time-frame of four to twelve months.

CONCLUSION

Both the REGO II and the streamlining initiatives discussed above are being pursued by the BLM and MMS in a manner which includes the American people. The goal is to make these programs more efficient by improving the way we do business, ensuring the timely collection and distribution of mineral revenues to the States, tribes, allottees and U.S. Treasury, reducing unnecessary paperwork and duplication, maintaining the health of the land, and ensuring continuous public and industry participation in finding improvements to the way business is done.

Mr. Chairman, this concludes my written testimony. However, I will be happy to address any questions you may have at this time.

ATTACHMENT D

MMS Proposal, "Establishment of the Federal Gas Valuation Negotiated Rulemaking Committee, 59 FR 32943 (June 27, 1994).

DEPARTMENT OF LABOR

Occupational Safety and Health Administration

29 CFR Part 1926

Steel Erection Negotiated Rulemaking Advisory Committee

AGENCY: Occupational Safety and Health Administration (OSHA), U.S. Department of Labor.

ACTION: Notice of meeting and agenda.

SUMMARY: Under the provisions of the Federal Advisory Committee Act (FACA), notice is hereby given of a meeting of the Steel Erection Negotiated Rulemaking Advisory Committee (SENRAC). Notice is also given of the location of the meeting and the agenda. Information on room numbers will be available in the lobby of the designated building. A schedule of additional meetings will be provided in a future notice.

DATES: The meeting is scheduled for July 11–13, 1994 at the Executive Tower Inn, 1405 Curtis Street, Denver, Colorado 80202; Telephone (303) 571–0300. *The meeting will begin at 11:00* a.m. on July 11. This meeting will be open to the public.

FOR FURTHER INFORMATION CONTACT: Mr. James F. Foster, OSHA, U.S. Department of Labor, Office of Information and Consumer Affairs, Room N–3647, 200 Constitution Avenue, N.W., Washington, D.C. 20210; Telephone: (202) 219–8151.

SUPPLEMENTARY INFORMATION: On May 11, 1994, OSHA announced that it had established the Steel Erection Negotiated Rulemaking Advisory Committee (SENRAC)(59 FR 24389) in accordance with the Federal Advisory Committee Act (FACA), the Negotiated Rulemaking Act of 1990 (NRA) and section 7(b) of the Occupational Safety and Health Act (OSH Act) to resolve issues associated with the development of a Notice of Proposed Rulemaking on Steel Erection. Appointees to the Committee include representatives from labor, industry, public interests and government agencies.

The first SENRAC meeting was held in Bethesda, Maryland on June 14–16, 1994. The Committee established three workgroups and developed an agenda for the second meeting in July. The workgroups were established to address issues on Fall Protection, Allocation of Responsibility, and Construction Specifications. According to the agenda, the workgroups will meet the first two days of the meeting (July 11 & 12) and the full Committee will meet on the last day (July 13).

All interested parties are invited to attend both the workgroup and full Committee meetings at the time and place indicated above. No advanced registration is required. Seating will be available to the public on a first-come, first-served basis. Individuals with disabilities wishing to attend should contact the Facilitator to obtain appropriate accommodations.

During the meeting, members of the general public may informally request permission to address the full Committee and workgroups.

Minutes of the meetings and materials prepared for the Committee will be available for public inspection at the OSHA Docket Office, N–2625, 200 Constitution Ave., N.W., Washington, D.C. 20210; Telephone (202) 219–7894. Copies of these materials may be obtained by sending a written request to the Facilitator.

The Facilitator, Philip J. Harter, can be reached at Suite 404, 2301 M Street, NW, Washington, DC 20037; telephone (202) 887–1033, FAX (202) 833–1036.

Authority: This document was prepared under the direction of Joseph A. Dear, Assistant Secretary of Labor for Occupational Safety and Health, U.S. Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210, pursuant to section 3 of the Negotiated Rulemaking Act of 1990, 104 Stat. 4969, Title 5 U.S.C. 561 *et seq.*; and Section 7(b) of the Occupational Safety and Health Act of 1970, 84 Stat. 1597, Title 29 U.S.C. 656.

Signed at Washington, D.C., this 22nd day of June, 1994.

Joseph A. Dear,

Assistant Secretary of Labor.

[FR Doc. 94–15557 Filed 6–24–94; 8:45 am]

BILLING CODE 4510–26–P

DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Part 206

Establishment of the Federal Gas Valuation Negotiated Rulemaking Committee

AGENCY: Minerals Management Service, Interior.

ACTION: Establishment of advisory committee.

SUMMARY: As required by Section 9(a)(2) of the Federal Advisory Committee Act (FACA), 5 U.S.C. App., the Department of the Interior (Department) is giving notice of the establishment of the Federal Gas Valuation Nego[illegible] Rulemaking Committee (Co[illegible] to develop specific recommendations with respect to Federal gas valuation pursuant to its responsibilities imposed by the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. 1701 *et seq.* (FOGRMA). The Department has determined that the establishment of this Committee is in the public interest and will assist the Agency in performing its duties under FOGRMA. Copies of the Committee's charter will be filed with the appropriate committees of Congress and the Library of Congress in accordance with section 9(c) of FACA.

FOR FURTHER INFORMATION CONTACT: Ms. Deborah Gibbs Tschudy, Chief, Valuation and Standards Division, Minerals Management Service, Royalty Management Program, P.O. Box 25165, MS–3920, Denver, Colorado, 80225–0165, telephone number (303) 275–7200, fax number (303) 275–7227.

SUPPLEMENTARY INFORMATION: Through an informal study group, MMS has conducted discussions to receive input on the current gas market and identify the challenges facing royalty valuation of gas produced from Federal leases for royalty purposes. The discussions have *gone well and needs for regulatory* changes have been identified. The MMS now believes that using a negotiated rulemaking committee to make specific recommendations with respect to Federal gas valuation would help the agency in developing a rulemaking. The Department is, therefore, establishing the Federal Gas Valuation Negotiated Rulemaking Committee.

Background

Since the publication of the March 1, 1988, gas valuation regulations (30 CFR Part 206) many of MMS's constituents have expressed concern about the current "tracing method" of valuing production from unit and communization agreements. Of particular concern is determining the proper value, for royalty purposes, when the working interest owner sells none of the production allocated to him under the agreement. Likewise, constituents have pointed out difficulties with the current benchmark system utilized to value non-arm's-length and no-sales situations. Those difficulties include issues of comparability, certainty, and access to information. As part of Vice President Gore's National Performance Review (NPR), the Royalty Management Program recently initiated a Reinvention Laboratory Team to examine ways to streamline the royalty management process. One of the recommendations of that team was to improve the valuation benchmark system. The NPR Team recommended to the Royalty Management Advisory Committee (RMAC) that a pilot be conducted to evaluate the use of spot prices as the second benchmark.

In commenting on the recommendations of the NPR Team, RMAC recommended that the entire benchmark system be evaluated and that the evaluation be limited to gas produced from Federal leases.

Statutory Provisions

Pursuant to FOGRMA (30 U.S.C. 1701 *et seq.*), 30 CFR Part 206 (1993) and Federal oil and gas lease and agreement terms, certain principles of royalty accounting will form the basis for a proposed rule:

Volume: Royalties must be paid each month on the volume of production allocated to or produced from the Federal lease under the agreement terms.

Royalty Rate: Royalties must be paid in accordance with the royalty rate specified in each lease unless specified otherwise under the terms of the agreement.

Value of Production: Value should be determined at the time of production. Value should be based on the fair market value at the lease.

Payment Responsibility: Federal lessees or their working interest owners are ultimately responsible for paying royalties, but other entities can be assigned the royalty payment responsibility.

The Committee and Its Process

During the winter and spring of 1994, MMS met with representatives of the oil and gas industry and States to receive input about the current gas market and identify regulatory changes needed to add certainty and simplicity to valuation, for royalty purposes, of gas produced from Federal leases in a new gas market. An informal study group format was used to obtain and clarify varying viewpoints. The materials received to date during the input sessions are available for inspection and copying at the address referenced above for Ms. Deborah Gibbs Tschudy.

Members of the study group include representatives of the American Petroleum Institute (API), the Council of Petroleum Accountants Societies (COPAS), the Rocky Mountain Oil and Gas Association (RMOGA), the Independent Petroleum Association of America (IPAA), the Independent Petroleum Association of Mountain States (IPAMS), the Natural Gas Supply Association (NGSA), an independent marketer, and representatives of the States of Utah, North Dakota, Montana, and New Mexico. The MMS and the study group participants believe that the input sessions have been mutually beneficial. As a result, MMS now believes it would be appropriate for the study group to transform itself and make specific regulatory recommendations for implementing a rulemaking regarding Federal gas valuation. The Department is therefore establishing the Federal Gas Valuation Negotiated Rulemaking Committee.

The recently enacted Negotiated Rulemaking Act of 1990 (Pub. L. 101-648) contemplates a "convening" process which involves identifying the potential parties and issues, publishing a notice of intent to form a committee, waiting 30 days for comments to be submitted responding to the notice, and only then proceeding with the establishment of the committee provided it meets the criteria of the Act. In this case, the study group process has served the same function as the convening—parties that would be significantly affected and the issues in controversy have been identified. The study group's discussions have also enabled the MMS to determine that the criteria for negotiated rules, as spelled out in the Negotiated Rulemaking Act, are met for this rule:

- The rule is needed, since royalty payors are not able to comply with the current regulations particularly in the current gas market.
- A limited number of identifiable interests will be significantly affected by the rule. Those parties are oil and gas companies who produce gas and pay royalties on Federal leases and States who receive royalties from gas produced from Federal leases located in their State.
- Representatives can be selected to adequately represent those interests, as reflected above.
- The interests are willing to negotiate in good faith to attempt to reach a consensus on a proposed rule.
- There is a reasonable likelihood that the Committee will reach consensus on a proposed rule within a reasonable time. This determination has been made based on discussions of the study group, and hence is built on the developments to date.
- The use of the negotiation will not delay the development of the rule if time limits are placed on the negotiation. Indeed, its use will expedite both development and ultimate acceptance of the rule.

The Department is not proposing to issue a separate notice of intent to form a negotiated rulemaking committee for this rule. Given the evolution of this committee, the publication of such a notice would only slow down the rulemaking process and the functions of the notice of intent have either already been met or are provided for in this notice. Moreover, the Negotiated Rulemaking Act specifically provides that its provisions are not mandatory.

The Negotiated Rulemaking Act does anticipate an outreach to ensure that people who were not contacted during the convening process can come forward to explain why they believe they would be significantly affected and yet are not represented on the Committee or to argue why they believe the rule should not be negotiated. The MMS believes that the interests who would be significantly affected by this rule are represented by the informal study group already in place which includes representatives from API, COPAS, RMOGA, IPAA, IPAMS, NGSA, an independent marketer, and the states of Utah, Montana, North Dakota, and New Mexico. If anyone believes that their interests are not adequately represented by these organizations, they must demonstrate and document that assertion through an application submitted no later than 10 calendar days following publication of this notice. You may fax your documentation to (303) 275-7227.

Certification

I hereby certify that the Federal Gas Valuation Negotiated Rulemaking Committee is in the public interest in connection with the performance of duties imposed on the Department of the Interior by 30 U.S.C. 1701 et seq.

Dated: June 2, 1994.

Bruce Babbit,

Secretary of the Interior.

[FR Doc. 94-15462 Filed 6-24-94; 8:45 am]

BILLING CODE 4310-MR-M

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30 CFR Chapter II

Meeting of the Federal Gas Valuation Negotiated Rulemaking Committee

AGENCY: Minerals Management Service, Interior.

ACTION: Notice of meetings.

SUMMARY: The Secretary of the Department of the Interior (Department) has established a Federal Gas Valuation Negotiated Rulemaking Committee (Committee) to develop specific recommendations with respect to Federal gas valuation pursuant to its responsibilities imposed by the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. 1701 *et seq.* (FOGRMA). The Department has determined that the

ATTACHMENT E

Memorandum of Tom Fry, Director, Minerals Management Service, to Secretary, "Notice of the Establishment of the Federal Gas Valuation Negotiated Rulemaking Committee," May 27, 1994.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

MAY 27 1994

Memorandum

To: Secretary

Through: Bob Armstrong MAY 27 1994
Assistant Secretary - Land and Minerals Management

From: Tom Fry
Director, Minerals Management Service

Subject: Notice of the Establishment of the Federal Gas Valuation Negotiated Rulemaking Committee

The attached charter, Federal Register notice establishing the Federal Gas Valuation Negotiated Rulemaking Committee, and letter to Director Panetta are submitted for your signature. Copies of the signed charter will be filed with the oversight congressional committees upon receipt of concurrence by the General Services Administration and the Office of Management and Budget.

Through an informal study group, the Minerals Management Service (MMS) has received input on the current gas market and identified the challenges facing valuation of gas produced from Federal leases for royalty purposes. The discussions have gone well and needs for regulatory changes have been identified. The MMS now believes that using a negotiated rulemaking committee to make specific recommendations with respect to Federal gas valuation would help the agency in developing a rulemaking.

The study group's discussions have enabled the MMS to determine that this rule meets the criteria for development by the negotiated rulemaking process, as spelled out in the Negotiated Rulemaking Act. Among the various criteria, the rule is needed because royalty payors are not able to comply with existing regulations, particularly in the current gas market. Further, a limited number of identifiable interests will be significantly affected by the rule. Those parties are oil and gas companies who produce gas and pay royalties on production from Federal leases and States who receive royalties from gas produced from Federal leases located in their State. Finally, the interested parties are willing to negotiate in good faith to attempt to reach a consensus on a proposed rule and there is a reasonable likelihood that the Committee will reach consensus on a proposed rule within a reasonable time.

We are, therefore, requesting that the Department establish the Federal Gas Valuation Negotiated Rulemaking Committee. The

Committee will only be used to negotiate the terms of the royalty valuation rule generally following the guidelines of the Negotiated Rulemaking Act of 1990. The charter will expire upon completion of the rule or two years after this charter is filed, whichever comes first.

If I can answer any questions regarding the attached documents, please don't hesitate to call me.

3 Attachments