

**MINUTES OF THE  
ROYALTY POLICY COMMITTEE MEETING**

**January 17, 2008**

**Golden, Colorado**

## Proceedings

### **Welcome and Opening Remarks**

The meeting of the Royalty Policy Committee (RPC) was held in Golden, Colorado, on January 17, 2008. RPC Chairperson, Daniel Riemer called to order at 8:30 a.m. The meeting was held in accordance with the Federal Register Notice published on Thursday, December 27, 2007. Attached is the agenda for the meeting. Introductions of the Committee members occurred after the morning break.

### **Remarks of MMS Deputy Director, Walter Cruickshank**

Mr. Cruickshank relayed MMS Director Randall Luthi's regrets that he could not attend the meeting due to his participation as a witness at a Congressional Hearing. Mr. Cruickshank briefly described Director Luthi's background and experience. He then outlined recent personnel changes at Minerals Management Service (MMS) that included the appointment of Jon Hrobsky as the second Deputy Director, and Lars Herbst, as the Regional Director of MMS Gulf of Mexico Region, Offshore Minerals Management.

Mr. Cruickshank discussed ongoing and completed Government Accountability Office (GAO) and Department of the Interior (DOI), the Office of Inspector General reports. He stated that MMS welcomes this oversight as the Minerals Revenue Management (MRM) is a very complicated and important program, in terms of the revenue it collects. He also wanted to inform people that many of these reports have noted that there are a lot of very dedicated employees at MMS who are doing a great job.

Mr. Cruickshank outlined recent MMS accomplishments. In Fiscal Year (FY) 2007, MMS collected and disbursed more than \$11 billion in mineral revenues to states, Office of the Special Trustee for American Indians, other Federal agencies, and the U.S. Treasury. Mr. Cruickshank said the Royalty in Kind (RIK) Program continues to benefit the U.S. Government and the American public by increasing receipts to the Treasury, reducing administrative costs, and helping to fill the Nation's Strategic Petroleum Reserve. The RIK Program generated a revenue gain of \$26.2 million in FY 2006, over what would have been received if the Government had taken its royalties in value.

Mr. Cruickshank announced that MMS published the Final Rule on Indian Oil Valuation in the *Federal Register* on December 17, 2007, with a February 1, 2008, effective date. The final rule implements technical corrections to the existing 1988 rule regarding the valuation of oil produced from Indian leases. He announced that MMS is working on a *Federal Register* notice that proposes to convene a negotiated rulemaking committee to address the major portion calculation for oil produced from Indian leases.

Mr. Cruickshank highlighted the accomplishments of the Offshore Program. He discussed the 5-year plan, which was approved July 1, 2007. The plan adds 48 million acres to the program, calls for 21 lease sales over a 5-year period, and includes changes in offshore lease royalty rates. The program will also provide an estimated 10 billion barrels of oil and 45 trillion cubic feet of natural gas production. To ensure fair market value, MMS increased royalty rates for deep-water leases from 12.5 percent to 16.67 percent with the onset of the program, and royalty rates for all new leases in the Gulf will be increased to 18.75 percent starting with the 2007 lease sales.

Mr. Cruickshank outlined proposed offshore rules relevant to the MRM program. The MMS expects to publish this spring a proposed rule for offshore alternative energy, which will include proposed financial terms for leases issued for offshore wind, wave, and current energy. He said that two proposed rules implementing the Gulf of Mexico Energy Security Act of 2006 (GOMESA) should be published soon. One proposed rule provides for royalty and bonus credits for companies that wish to relinquish their leases in portions of the Eastern Gulf of Mexico in exchange for the credits. The other proposed rule establishes the allocation formula for the first phase of GOMESA's revenue-sharing provisions.

Mr. Cruickshank closed by summarizing the recently published proposed rule on deepwater royalty relief. The proposed rule brings the regulations into compliance with the court ruling in Santa Fe Snyder. The ruling requires that the royalty relief volumes specified in the Deepwater Royalty Relief Act apply to each lease issued during the 1996-2000 period of mandatory relief.

**Remarks of MRM Associate Director, Lucy Querques Denett**

Ms. Denett began her presentation by introducing Mr. Mike Olsen, Deputy Assistant Secretary for Land and Minerals Management. She also introduced and provided background on Mr. Jim Steward, the new RIK Program Director. She stated that of the approximately \$11.4 billion of royalty revenues collected by MRM, a record \$4.4 billion were oil royalty revenues; \$4.6 billion were natural gas royalties; \$900 million were bonus revenues; and \$267 million were annual rental revenues. Included in the almost \$2 billion disbursed to the states was \$4.3 million to 32 counties in California, Idaho, New Mexico, Nevada, Oregon, and Utah, resulting from geothermal energy production.

Ms Denett detailed the progress of the MRM Strategic Business Planning effort and informed the Committee of the addition of a sixth business plan for production accounting. She said that MMS has not yet awarded the new operations and systems support contract due to a protest by one of the bidders and that MMS extended the current contract with Accenture, LLP. She provided a progress report on implementation of the Energy Policy Act of 2005 including the continued development of advanced coal royalty regulations in collaboration with the Bureau of Land Management (BLM).

Ms. Denett stated that MRM once again received an unqualified audit opinion on its FY 2007 financial statements with no material weaknesses. The MRM eliminated the interest bill backlog and kept its late disbursement interest for FY 2007 to \$1.08 million, well under its \$1.48 million goal. The MRM also published two rules, Geothermal Valuation on May 2, 2007, and Indian Oil Valuation on December 17, 2007.

Ms. Denett announced her retirement effective February 1, 2008.

**Royalty Management Subcommittee**

David Deal, Vice-Chair of the Royalty Management Subcommittee, and Larry Finfer, Deputy Director of the DOI Office of Policy Analysis, provided a briefing on the Royalty Management Subcommittee Report entitled "Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf." Mr. Deal gave a general overview of the Subcommittee and its report. He detailed the purpose of the Subcommittee as outlined in a November 14, 2006, letter from C. Stephen Allred, Assistant Secretary for Land and Minerals Management, to the RPC Chairperson. He noted that the scope of the Subcommittee was expanded in September 2007 at the request of the Assistant Secretary to review procedures promulgated by the Department in response to the lack of price thresholds in the Gulf of Mexico leases from 1998 and 1999 sales.

Mr. Deal stated that the Subcommittee members were announced on March 22, 2007. The delay was due to difficulty in assembling the panel. He said the Subcommittee members were very engaged and had a mix of expertise. The DOI Office of Policy Analysis and BLM provided staff support to the Subcommittee. The MMS only provided data as requested by the Subcommittee. Drafts of the Subcommittee reports were not reviewed by MMS, industry, states, tribes, or political appointees of the Department. Mr. Deal said that the Subcommittee recognized that MMS was working on improvements in many areas before the Subcommittee work began. The Subcommittee did not review personnel issues. The role of the Subcommittee was not investigative, but a forward-looking assessment of the program. He said that many critics do not understand the RIK Program.

Mr. Deal followed with an outline of the report including major themes, findings, and recommendations. He described the differences between the offshore and onshore programs. The onshore program is comprised of many older leases in remote locations and comprised of smaller operators. There are fewer operators and bigger leases in the offshore program, and the operations are more technologically advanced. He said that 36 of the 110 recommendations are in the area of collections and production accountability. Accuracy of collection and production information is a critical first step and a key to the effectiveness of the minerals revenue collection program. He stated that incorrect Btu reporting affects royalty value and said the Subcommittee recommended that the Form MMS-2014 be amended to record natural gas Btu values. He discussed that gas plant efficiency data is critical and needs to be improved. The BLM has outdated production accountability guidance and needs to improve their production accountability records tracking system. He cited staffing issues, including training needs, in MMS and BLM related to production accountability.

Mr. Deal outlined the audit, compliance, and enforcement section of the Report. The Subcommittee consulted with representatives of the Internal Revenue Service (IRS) who shared their compliance strategies. The consultations with IRS were helpful to the Subcommittee. The IRS uses a risk-based compliance strategy which is continually refined. The MMS has initiated a risk-based compliance pilot. Mr. Deal stated that the report emphasized that you cannot implement a successful risk-based approach to compliance without a robust and flexible data system support. Mr. Deal discussed the major recommendations in this section of the report including the need to finalize the technical changes to the Indian oil valuation rule, implementation of a risk-based approach to compliance, development of new GPRA goals and metrics, consolidation of duplicative databases, electronic submission to LVS and GVS, revision of the gas valuation regulations, and revision of the regulations for calculating prices used in checking royalty compliance for solid minerals. Mr. Deal outlined the IRS Whistleblower Program.

Mr. Deal stated it was evident as they prepared their report that inter-bureau coordination is critical, and it warranted a separate chapter. In that chapter, the Subcommittee emphasized the importance of improving access to the Indian Lease System and reconnecting Indian data systems.

Mr. Deal told the RPC that the Subcommittee Co-Chairs, former Senators Bob Kerrey and Jake Garn, support the RIK Program and believe it should continue. He said that it was important that RIK be accountable, but it needs to be able to operate as an enterprise. They made the following major recommendations: establish an RIK Subcommittee under the RPC; establish new or revised regulations/and or guidelines; clarify application of Federal Acquisition Regulations; and require cost reimbursement for the Strategic Petroleum Reserve. Other recommendations included analyze alternative governance structure for RIK, discontinue the onshore crude oil program and the small refiner set-aside program, ensure personnel depth, provide dedicated legal program support, use standard financial reporting tools, and establish systematic procedures for handling bid documents.

In his summary of Chapter 7 of the report, Mr. Deal said that price thresholds are a leasing issue rather than a royalty management issue. The Committee recommended implementation of the Secretary's September 15, 2007, memorandum regarding offshore lease issuance procedures. They also recommended that procedures for document reviews be incorporated into the performance standards for key staff, and additional targeted ethics training be conducted. Mr. Deal discussed the establishment of a trust fund using royalty management revenues to fund program improvements including production accountability and audit.

Mr. Deal closed his presentation by stating that the royalty program needed improvement, but that the program was not broken or dysfunctional. The panel concluded that MMS is the best agency to run the Minerals Revenue Management Program. The Subcommittee offered some very specific suggestions for

how improvements might be undertaken by MMS; however, Mr. Deal stated that the recommendations of this advisory group were only advice and needed to be weighed by BLM and MMS, respectively.

### **Committee Deliberation**

A number of Committee members recognized the efforts of the Subcommittee and thanked them for the report. Various RPC members expressed concern over the impact of some of the recommendations on their constituencies. Certain states and tribes expressed concern that they had no opportunity to provide input to the subcommittee. Members inquired whether written comments on the report would be accepted. The decision was made by the Committee to submit the report to the Secretary without including comments from Committee members. However, Committee members and others may submit their comments on the report to the Secretary of the Interior. Committee members made and discussed several motions regarding the approval and transmittal of the report. The RPC approved a motion to accept the Royalty Management Subcommittee report and transmit it to the Secretary for his consideration and implementation of the recommendations.

### **Coal Subcommittee Update**

Mr. William Hartzler provided a brief report to the Committee on the activities of the Coal Subcommittee. The Coal Subcommittee met once since the last RPC meeting. The Subcommittee meeting was well attended by representatives from MMS, BLM, The Navajo Nation, states, and industry. He reported on the progress on the Federal Coal Advanced Royalty proposed rule and discussed the issue of the royalty rate applicable to continuous high-wall mining operations. He also stated that MMS is preparing a White Paper proposing to change the non-arm's-length benchmarks in the current coal valuation regulations. He discussed payment data access concerns. He stated that with regard to outstanding invoice issues, industry will request that MMS develop a report or allow industry access to MMS's systems in order to be able to view how payments submitted to MMS were applied and to what document.

### **Indian Oil Valuation Rule**

Mr. Paul Tyler provided a briefing on the technical amendments to the Indian oil valuation regulation. The MMS published the amendments on December 17, 2007, with an effective date of February 1, 2008. He described the major differences in marketing oil produced from Indian leases. Since the marketing and disposition of Indian oil contrasts sharply with that of Federal oil, the final rule does not use either NYMEX or spot index pricing as primary measures of value for oil produced from Indian lands. He stated that the rule applies to oil produced from Indian oil and gas leases except for leases on the Osage Indian Reservation. The rule explains how the lessee must calculate the value of production for royalty purposes consistent with applicable statutes and lease terms and is intended to ensure that the United States discharges its trust responsibilities for administering Indian oil and gas leases under the governing Indian mineral leasing laws, treaties, and lease terms.

Mr. Tyler discussed the many definition revisions in the rule. He described how lessees calculate royalty value for oil that lessees or affiliates sell or exchange under arm's-length contracts. Mr. Tyler explained how a lessee determines value for oil that a lessee or affiliate does not sell under an arm's-length contract. He also stated that MMS did not promulgate amendments to the current major portion valuation provision. The MMS will convene a negotiated rulemaking committee to consider all aspects of major portion valuation. MMS also did not promulgate amendments to the current transportation allowance provision. The MMS believes that further analysis of the transportation provisions is appropriate and is reserving transportation allowances for a possible future supplemental final rulemaking.

Mr. Tyler closed by stating that lessees may ask MMS for guidance in determining value, and MMS will provide a non-binding valuation determination to the lessee. A discussion followed among RPC members about the proposed Negotiated Rulemaking Committee. Mr. Riemer asked Mr. Perry Shirley if there was

a continuing need for the Indian Oil Valuation Committee. Mr. Shirley requested that the Subcommittee remain in place until he was confident that it was no longer needed.

#### **Committee Roundtable**

Mr. Riemer stated that the Royalty Management Subcommittee has no further work and will be disbanded. The Indian Oil Subcommittee will continue with Mr. Perry Shirley as Chair. Ms. Marvinette Ponder will chair the Royalty Reporting Subcommittee, and Mr. Ed Sullivan will continue as Chair of the Coal Subcommittee. The Oil and Gas Valuation Subcommittee will continue with David Deal as the Chair. Mr. Riemer established a Royalty in Kind (RIK) Subcommittee based on the recommendation contained in the Royalty Management Subcommittee Report. Members of the RIK Subcommittee include Eric Milito, API; Patrick Lyons, WSLCA; Floyd Phillips, Shoshone Arapaho Joint Business Council; Akhtar Zaman, The Navajo Nation; David Deal, public representative; and Mary Ann O'Malley, BP, as a non-voting member. David Deal stated that the RPC Royalty Management Subcommittee saw the RIK Subcommittee as a resource to assist the RIK Program with various issues. Mr. Riemer did not designate a Subcommittee Chairperson.

Mr. Bob Anderson, BLM, stated that BLM plans to issue proposed oil shale regulations in March that will have royalty provisions. He discussed mining law reform and the new requirement that requires a \$4,000 fee for drilling permit applications. Mr. Bob Middleton from the Assistant Secretary for Indian Affairs stated that the final Tribal Energy Resource Agreement Final Rule is at the Office of Management and Budget and will be going to the *Federal Register* for issuance shortly. He stated that the rule allows tribes to petition the Secretary to enter into an agreement to take on responsibilities for managing energy development on trust lands.

Mr. Dan Riemer recommended September 18, 2008, as the date of the next RPC meeting. The date was agreed upon by the Committee. The meeting was adjourned at 4:30 p.m.

## **Meeting Attendees**

### **RPC Members or Alternates**

John Baza, Western Governors' Association  
Lisa Crothers, Independent Petroleum Association of America  
David Deal, Public Representative  
Mark Gress, Natural Gas Supply Association  
William Johnson, Ute Mountain Ute Tribe  
Isaac A. Julian Sr., The Jicarilla Apache Nation  
Orme Lewis, Public Representative  
Patrick Lyons, Western States Land Commissioners Association  
Erik Milito, American Petroleum Institute  
Floyd Phillips, Shoshone/Arapaho Joint Business Council  
Marvinette Ponder, Council of Petroleum Accountants Societies  
Daniel Riemer, U.S. Oil & Gas Association  
Edward Sullivan, National Mining Association  
Akhtar Zaman, The Navajo Nation  
Bob Anderson, Bureau of Land Management  
Bob Middleton, Assistant Secretary Indian Affairs  
Lucy Querques Denett, MRM

### **Additional Attendees:**

MMS: Walter Cruickshank, Richard Adamski, Shirley Conway, George Triebsch, John Barder, Connie Bartram, Theresa Bayani, Nathan Brannberg, Peter Christnacht, Gina Dan, Pat Etchart, Deborah Gibbs Tschudy, John Hovanec, Lonnie Kimball, Nancy Messer, Robert Prael, John Price, Donald Sant, James D. Steward, Paul Tyler, Mary Williams, David Smith

**Others:** Michael Olsen, Deputy Assistant Secretary for Land and Minerals Management; John Broderick, BLM; Stacey Crouser, Office of the Inspector General; Larry Finfer, Deputy Director of DOI Office of Policy Analysis; William Hartzler, Foundation Coal Corporation; Tim Musil, Office of the Inspector General; Mary Ann O'Malley, BP Oil; Alan Rabinoff, BLM (retired); Valdean Severson, State of New Mexico; Rebecca Watson, Hogan & Hartson; Robert O. Wilkinson, Conoco Phillips; Pam Williams, Shell Oil Company; Dallas Rippey, NMSLO; Mike Geesey, State of Wyoming; Steve Dilsaver, State of Wyoming; Ken Vogel, FTI Consulting; Karen Lukin, API/SEPL; Perry Shirley, The Navajo Nation; John Kunz, Office of the Solicitor; Timothy Murphy, Office of the Solicitor; Roger Good, Council of Petroleum Accountants Societies.

### **Meeting Documents**

Subcommittee on Royalty Management Report to the Royalty Policy Committee "Mineral Revenue Collection from Federal Lands and the Outer Continental Shelf"  
Presentation of the Subcommittee on Royalty Management  
Presentation on the Indian Oil Valuation Rule  
Coal Subcommittee Report  
*Federal Register* Notice - Technical Amendments to the Indian Oil Valuation Rule  
Indian Oil Valuation Rule Training Schedule  
*Federal Register* Notice - Royalty Relief for Deepwater Outer Continental Shelf Oil and Gas Leases – Conforming Regulations to Court Decisions.  
Project on Government Oversight January 8, 2008, letter to RPC Chairperson  
Draft API Comments/Response to Report to Royalty Policy Committee, "Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf"

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I certify that the above minutes are an accurate caption of the January 17, 2008, Royalty Policy Committee proceedings. The minutes may be released to RPC members and made available for the public inspection.



Date 3/11/08

Daniel F. Riemer  
Chairman, Royalty Policy Committee  
Minerals Management Service

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**Royalty Policy Committee  
Agenda  
Denver, Colorado  
January 17, 2008**

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| Welcome and Opening Remarks                                | 8:30 - 8:45   | Dan Riemer  |
| MMS Deputy Director's Remarks                              | 8:45 - 9:05   | Walter Cruickshank                                  |
| MRM Associate Director's Remarks                           | 9:05 - 9:20   | Lucy Querques Denett                                |
| Royalty Management<br>Subcommittee Report                  | 9:20- 10:15   | Subcommittee Chair<br>Executive Director -<br>Staff |
| <i>Morning Break</i>                                       | 10:15 -10:30  |   |
| Royalty Management<br>Subcommittee Report (Cont.)<br>Staff | 10:30 - 12:00 | Subcommittee Chair &<br>Executive Director -        |
| Lunch  | 12:00 - 1:30  |   |
| Coal Subcommittee Update                                   | 1:30 - 2:00   | Edward Sullivan<br>John Hovanec                     |
| Indian Oil Valuation<br>Rule                               | 2:00 - 3:00   | Paul Tyler  |
| <i>Afternoon Break</i>                                     | 3:00 - 3:15   |   |
| Public Remarks   | 3:15 - 3:45   |   |
| Committee Roundtable                                       | 3:45 - 4:15   | Committee   |
| Schedule Next Meeting/Adjourn                              | 4:15 - 4:30   | Chairperson   |