

**MINUTES OF THE
ROYALTY POLICY COMMITTEE MEETING**

September 18, 2008

Lakewood, Colorado

Proceedings

Welcome and Opening Remarks

The meeting of the Royalty Policy Committee (RPC) was held in Lakewood, Colorado, on September 18, 2008, and was called to order at 8:30 a.m. by the RPC Chairperson, Daniel Riemer. The meeting was held in accordance with the Federal Register Notice published on Monday, August 25, 2008. The agenda for the meeting is attached. The meeting began with introductions of the RPC members.

Remarks of Deputy Assistant Secretary for Land and Minerals Management, Michael Olsen

Mr. Olsen relayed MMS Director Randall Luthi's regrets that he could not attend the meeting due to his attendance at a congressional hearing. Mr. Olsen introduced the new Associate Director for MRM, Gregory (Greg) Gould and Michael Nedd, the BLM Assistant Director for Minerals, Realty, and Resource Protection. He briefly described the background and experience of both.

Mr. Olsen then said that the Department of the Interior (DOI) Inspector General issued three investigative reports regarding the MRM Program that addressed post employment restrictions and conflict of interest, the conduct of the former Royalty in Kind (RIK) Program Director, and the conduct of some employees of the RIK Oil Marketing Group. He stated that appropriate disciplinary action will be taken against current employees cited in the report and that the letter of the law will be followed, but each employee will be afforded due process. Mr. Olsen reinforced that Inspector General Devaney stated that 99.9 percent of DOI employees are hard-working, ethical, and well-intentioned.

Mr. Olsen commended the MMS employees that are working to assist with the impacts of the recent hurricanes in the Gulf of Mexico. He said that in addition to the Government Accounting Office (GAO) reports on the accuracy of oil and gas measurement including the reliance on self-reported data, government takes, and RIK reviews, the GAO is also performing a review of the non-producing oil and gas leases on Federal lands.

The next topic concerned the current energy situation. He talked about the debate over whether to expand offshore drilling to areas that since the early 1980s had been off-limits to oil and gas operations. He stated that those opposed to expanding offshore oil and gas operations believe that companies should develop the leases they already own before new areas are opened. To require that, he said there have been attempts in Congress to pass legislation known as "use it or lose it." He said that to follow that line of thinking, one has to assume that companies would willingly sit on a lease, given today's energy prices and every acre leased contains oil and gas. He stated neither assumption is true. He also said that the Department has a use it or lose it policy in that we impose lease terms of 5, 8, or 10 years. If companies are not in production or have not demonstrated considerable effort to get to production, then the leases revert back to MMS at the end of that term.

He relayed how the President lifted the executive ban on offshore drilling and how the President called on Congress to lift theirs. Mr. Olsen said that on July 30, 2008, MMS announced a new Five-Year Oil and Gas Leasing Program and stated that even if restrictions were lifted today, we could not immediately move toward expanding leasing under the current 5-year leasing program. He said the approval process for the 5-year leasing program takes at least 2 years. The action taken by MMS will give the next administration a head start. He emphasized that it is important to expand offshore energy production beyond the Gulf of Mexico as it is too much of a risk to have all energy eggs in one basket. He said that alternative energy and conservation are also a focus. Mr. Olsen responded to questions about the Five-Year Leasing Plan and about Alaska lease sales.

Remarks of MRM Associate Director, Greg Gould

Mr. Gould began his presentation by commending the MMS employees in the Gulf for responding to the additional workload related to the hurricanes in the Gulf. He stated that 99.9 percent of the MMS employees do the right thing everyday. He then discussed changes to the RPC Charter and bylaws. The most significant is the lengthening in the terms for members and alternates from 2 years to 3 years. He followed with an MRM personnel update. He informed that Connie Bartram, Manager of the Special Initiatives Office, retired and will be replaced by his current Chief of Staff, Richard Adamski. Additionally, John Price, Chief of the Office of Enforcement, retired; and Don Sant is Acting Chief of Enforcement.

He provided a programmatic update. The MRM Strategic Business Plan is close to completion, and he hopes to report on it at the next RPC meeting. He stated that MMS received an unqualified audit opinion on its financial statements for FY 2007 and that no significant issues have been raised to date during the FY 2008 financial audit. Mr. Gould informed the RPC that the external peer review of MRM audit practices for the period January 2005 through May 2008 provided reasonable assurance that MRM's audit practices conform to applicable Government Auditing Standards, policies, and procedures.

Mr. Gould stated that MMS published a Federal Register Notice to determine whether there was a need to continue the small refiner program. Based on the comments that expressed a need to continue the program, the RIK Small Refiner sale was held on August 6, 2008. The MMS awarded contracts for the sale of almost 21,000 barrels of oil with delivery on the 12-month contracts scheduled to begin October 1, 2008. He stated that the Strategic Petroleum Reserve (SPR) fill was suspended as of July 1, 2008, in accordance with a congressional mandate. Discussion followed regarding the impact of discontinuing the SPR fill on the RIK Program and on the potential for location of the Associate Director position in Denver.

Royalty Management Subcommittee Report – Action Plan Status

George Triebisch, the MMS Director of Policy, Management, and Improvement, provided a status update of the Department's actions in implementing the recommendations provided to the Secretary in the December 17, 2007, Report from the Subcommittee on Royalty Management. He outlined the genesis of the Subcommittee Report.

- On March 17, 2007, Secretary Kempthorne appointed an independent seven-member Royalty Management Subcommittee charged with reviewing mineral revenue collection practices.
- The Subcommittee was co-chaired by former U.S. Senator and Nebraska Governor Bob Kerrey (D) and former U.S. Senator Jake Garn (R).
- On December 17, 2007, the Royalty Management Subcommittee issued its draft report entitled, *Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf*, which contained 110 recommendations.
- On January 17, 2008, the RPC accepted the Royalty Management Subcommittee report and transmitted it to the Secretary for his consideration and implementation of the recommendations.

The report has 110 recommendations covering five focus areas: Collections and Production Accountability (36 recommendations); Audits, Compliance, and Enforcement (27 recommendations); Coordination, Communication, and Information Sharing among MMS, BLM, and BIA (10 recommendations); the Royalty-in-Kind Program (31 recommendations); and OCS Royalty Relief (6 recommendations).

He stated that on January 15, 2008, Secretary Kempthorne directed DOI officials to begin implementing the Subcommittee Report recommendations as soon as the RPC approved the report and developed an Action Plan. The Department is very engaged in implementing the recommendations of the

Subcommittee and has taken many steps to ensure that implementation is fully supported including senior executive involvement, sound planning and routine reporting, and rigorous monitoring and tracking. An Implementation Plan was developed that includes milestones, target timeframes, identified leads, and quarterly reports to the Assistant Secretary for Land and Minerals Management. Mr. Triebsch stated that the Department established an Implementation Steering Committee to ensure all RPC recommendations are adequately and timely addressed and a Production Coordination Committee (PCC) to coordinate the implementation of cross-cutting recommendations. Five sub-teams (PCC Enterprise Architecture, Fluids, Solid Minerals, Production Accountability, and Gas and Oil Measurement) were established by the PCC composed primarily of field experts to coordinate and facilitate the implementation of recommendations.

He reported that as of August 2008, 22 of the 110 recommendations have been completed, 29 additional recommendations will be completed by February 2009, and all recommendations are planned to be completed by December 2011. In response to a question about a recent GAO report and how that impacts the RPC report, Mr. Triebsch stated that DOI considers all recommendations made by outside reviewers as it implements the RPC recommendations. Other questions concerned the level of congressional interest in the actions DOI is taking in response to the report. Other members commented on Indian Oil Valuation regulations not being finalized and the need to reconnect Indian Systems. The Chairperson, Mr. Riemer, complimented DOI on addressing all 110 recommendations and was informed by MRM staff that interest billing is current. Mr. Gould, in response to an earlier comment related to the location of the MRM Associate Director, said that he will spend a great deal of time in Denver but the position will remain in Washington, DC. The MRM Deputy Associate Director located in Denver will assume a larger role.

May 2008 Office of the Inspector General (OIG) Evaluation Report RIK Oil Sales Process – Jim Steward

Mr. Steward outlined the recommendations contained in the report. He commented that many of the recommendations contained in the OIG report were similar to those contained in the RPC Royalty Management Subcommittee report. **Recommendation One** concerned the development of a comprehensive operations manual to guide the Crude Oil Front Office. In response, the RIK program is developing additional procedures regarding calculation of minimum acceptable bids, solicitation, bidding, award, security, and roles and responsibilities of the participants. RIK anticipates completion of these procedures by February 2009. **Recommendation Two** concerned the need to obtain legal review of all existing contract documents and implement changes as appropriate. In response, the Office of the Solicitor (SOL) and MMS agreed to establish an attorney position dedicated to the RIK Program. The new attorney has been onboard since August 4, 2008. **Recommendation Three** addressed the development of guidelines for oil sales contracting and implement guiding principles and processes. In response, RIK agreed to coordinate and consult with the SOL in review and development of any contractual terms that need to be strengthened for future sales. He stated that the Western Administrative Service Center Procurement Office provides advice for all RIK sales, and MMS anticipates completion of the contract sales review and any resulting changes by February 2009. **Recommendation Four** said that, in a comprehensive staffing plan, RIK should address staffing needs, position qualifications, and training. In response, the RIK Program developed a personnel plan that addressed staffing needs, position qualifications, and training. That plan was completed in August 2008. **Recommendation Five** stated that RIK implement a pilot project to evaluate the viability of other sales methods, such as the FCC's simultaneous multiple-round auction or an outside marketing agent. In response, in April 2007, staff from the RIK Program visited the FCC offices in Washington, D.C., and received a demonstration of their auction process. The MMS will evaluate alternative auction types by April 2010. **Recommendation Six** stated that in order to reduce workload and administrative costs, RIK should use longer term oil sales contracts. In response, MMS offered both 6-month and 12-month contracts in its unrestricted oil sale held on August 12, 2008, and 10 of 11 packages were sold for a 12-month term. Mr. Steward stated that RIK is

currently evaluating the results of this sale, and further analysis will be done for each bid package in future sales.

RIK Annual Report – Jim Steward

Mr. Steward stated that the Annual Report is required by Section 342 of the Energy Policy Act of 2005 (EPAct). He began by describing the overall status of the program for FY 2007. The program encompasses 90.5 million BOE and over \$4 billion in revenue. The RIK program was supported by a staff of 54 headquartered in Lakewood, Colorado, and supplemented with an office in Houston, Texas. He stated that process improvements for FY 2007 included improved sales procedures and documentation, strengthened internal controls, and increased coordination with the MMS Procurement Office. Highlights of the RIK natural gas program include a revenue uplift of over \$37 million which the report attributed to higher RIK volumes, favorable Wyoming processing contracts, and other advantageous transportation and processing positions maintained throughout 2007.

He stated that the RIK uplift for crude oil was over \$18 million. This revenue uplift was due to crude oil price increases during FY 2007, volumes recovered after Hurricanes Rita and Katrina, and purchasers passing downstream economic benefits to RIK. Administrative cost savings in FY 2007 totaled over \$3.5 million. Savings result from less audit-review costs in RIK and no appeals related to RIK properties. Mr. Steward stated that savings in FY 2007 due to the time value of money totaled over \$3 million. These savings result from RIK payment receipt 5 to 10 days earlier than RIK payments. Total benefits from the RIK program for FY 2007 are estimated to be over \$63 million.

Mr. Steward stated that other benefits include the market knowledge gained as a result of RIK is shared with other MMS operations and is extremely valuable to support continuity of operations before, during, and after natural disasters. He concluded his presentation by detailing major RIK initiatives for FY 2008. These include utilizing long-haul transportation on Rockies Express, evaluating and acting on recommendations from internal and external reviews, and developing a new business plan for the RIK Program to cover FY 2010-2012. Discussion followed on the National Helium Reserve and factors utilized to compute RIK administrative savings.

Compliance Program Update - Roman Geissel

Mr. Geissel summarized the recommendations contained in the RPC Royalty Management Subcommittee Report that related to compliance. The recommendations were organized into seven general categories: system modifications, reporting, strategy, process modifications, performance measures, regulatory changes, and coordination with others. He stated that 3 of the 24 recommendations are complete. Mr. Geissel informed the RPC that MRM Compliance staff have held meetings with the Internal Revenue Service (IRS) and have reviewed the IRS "Balanced Measures" performance system. The IRS may participate in the new CAM Compliance Strategy Council. He also stated that CAM will share results of the risk model pilot project with GAO and the OIG and is determining ways to best communicate progress to them. Discussion followed regarding self-audits and internal quality control reviews.

RIK Subcommittee Update – Dan Riemer

Mr. Riemer discussed the activity to date of the RIK Subcommittee that was formed in response to two recommendations contained in the RPC Royalty Management Subcommittee Report. He reported that the RIK Subcommittee had balanced membership, a formal charter and met five times via teleconference. The issues addressed by the Subcommittee include title transfer, risk of loss during delivery, reimbursement costs and lessee-controlled pipelines, reimbursement costs and operator-controlled pipelines, legal authority for MMS to take away from the Facility Measuring Point, information on producer-owned transportation costs, imbalances, royalty due on retrograde, and MMS take of their allocated share of retrograde. He described the three types of leases that exist for Offshore Gulf of Mexico and the payment and delivery options associated with each lease. These include Louisiana State

Form Leases (Section 6), DOI, BLM, Lease Forms 4-1255 and 3380-1, beginning May 1954 through September 1969, and DOI, BLM/MMS Lease Forms 3380-1, 3300-1, MMS-2005 beginning October 1969 through current. He also stated that MMS is in compliance with FERC regulations regarding “shipper must have title rule” and prohibited buy/sell transactions. He said that future RIK Subcommittee activities include continuing addressing items on the Issues List, discussing the merits of creating a “Code of Conduct” to govern situations that are silent, uncertain or different depending on lease form, and reviewing performance benchmarks.

Indian Oil Valuation Negotiated Rulemaking Status – Paul Tyler

Mr. Tyler discussed the status of establishment of a Negotiated Rulemaking Committee for Indian Oil Valuation. The MMS announced its intent to establish an Indian Oil Valuation Negotiated Rulemaking Committee in the Federal Register on April 28, 2008. He said that MMS is giving due consideration to the comments received and nominations submitted. MMS has drafted a charter and hopes to convene the Committee in the near future. Discussion revolved around the number of Committee members and the list of persons being considered by MMS for membership. Mr. Tyler stated that MMS is seeking approximately 15 members, and he hoped to not reopen the nomination period but is leaving the option open.

Advanced Royalty for Coal Rule Status – John Hovanec

Mr. Hovanec’s presentation concerned the proposed rule, “Valuation of Federal Coal for Advance Royalty Purposes and Information Collection Applicable to All Solid Minerals Leases.” Mr. Hovanec said that the EPO Act requires coal advance royalty to be determined using spot market prices of comparable coal in the regions. The EPO Act also prescribes that if there are no spot market prices for comparable coal from the same region, the Secretary of the Interior may establish a “comparable method...to capture the commercial value of coal.” He also discussed the RPC Royalty Subcommittee recommendation that stated MMS should review, and (as appropriate) revise and implement the regulations and guidance for calculating prices used in checking royalty compliance for solid minerals, with particular attention to non-arm’s-length transactions. The MMS Action Plan related to this recommendation includes coordinating with the RPC Subcommittee on Coal Valuation on revising regulations for calculating prices for solid minerals, consulting with tribes, issuing a proposed solid minerals valuation rule, and implementing the final rule by December 2010.

Oil and Gas Valuation Subcommittee Update – David Deal

Mr. Deal said that at the January 2008 RPC meeting, the O&G Valuation Subcommittee was directed to take up Recommendation 4-26 which stated that by the end of FY 2008, MMS should publish proposed revisions to gas valuation regulations and guidelines to address cost-bundling. He described that for the gas valuation rulemaking, MMS was directed to consider the use of market indices for valuation of non-arm’s length transactions in lieu of existing benchmarks. He stated that cost-bundling guidance included transportation costs and gas processing costs as allowable deductions; however, service providers do not generally separate deductible costs and non-deductible costs, which greatly confounds MMS’s review of transportation and processing allowances. He stated that previous efforts of the Oil and Gas Valuation Subcommittee had failed to reach consensus. He said that the Subcommittee decided to first focus on the bundling of costs by service providers before again addressing gas valuation in advance of a Federal rulemaking effort. He stated that placing gas in a marketable condition and gathering are situation specific and do not allow a bright line test applicable to all circumstances. He said that MMS is providing the Oil and Gas Valuation Subcommittee updates regarding the studies it is undertaking of several gas systems to attempt to break charges into deductible and non-deductible costs. Subcommittee participants include representatives from trade groups, states, industry and the Indian community. Since January, the Subcommittee has held four meetings; all directed at cost unbundling, and no consensus has yet been reached on a better approach.

Mr. Deal described the three concepts related to cost unbundling that have emerged and their pros and cons. The concepts include, **Standard Deduction:** MMS-prescribed amounts for use on each system based on MMS analysis of cost structure of service-related engineering and equipment; **Itemized Deductions:** Case-by-case amounts offered by producers based on templates provided by MMS; could require renegotiation of contracts with service providers to allow cost unbundling; and **Percentage of Commodity Price:** Case-by-case amounts offered by producers based on MMS-prescribed percentage which could include minimum and maximum limits. He stated that future Subcommittee activity will include continuing to work on the unbundling issue. If no consensus is reached, the Subcommittee can still assist the MRM by characterizing the cost-unbundling issue, identifying alternatives and isolating relevant factors for decision-making.

RPC Royalty Reporting Subcommittee – Marvinette Ponder

Ms. Ponder discussed the initiatives the Reporting Subcommittee is working on including reporting and paying 100 percent, electronically, offshore Facility Measurement Point reporting and compliance issues. She said that reporting issues related to the Form MMS-2014 include keep-whole contracts, transportation deductions, agreement number reporting, and overlapping agreements. She stated that in the future, meetings of the Reporting Subcommittee will occur monthly.

Public Comments

There were no public comments.

Committee Roundtable

Greg Gould informed the RPC that there was a strong possibility that reappointments to the RPC may not occur prior to October 26, 2008, the date that most of their current appointments expire. He said that he would notify them of any impact this might have on the work of the RPC Subcommittees.

Mr. Orme Lewis and Mr. Harold Kemp, both of whom will not be returning to the RPC due to term limits, offered their thanks for the opportunity to serve on the RPC. Mike Nedd informed the RPC members that the comment period for oil shale regulations expired the following week. He briefly described the royalty options.

Mr. Dan Riemer recommended March 12, 2008, as the date for the next RPC meeting. The date was agreed upon by the RPC members. The meeting was adjourned at 3:15 p.m.

I certify that the above minutes are an accurate caption of the September 18, 2008, Royalty Policy Committee (RPC) proceedings. The minutes may be released to RPC members and made available for public inspection.



Date 11/17/08

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

Meeting Attendees

RPC Members or Alternates

William Barger, Public Representative
Lisa Crothers, Independent Petroleum Association of America
David Deal, Public Representative
Terence Fisher, Ute Mountain Ute Tribe
Marcella Giles, Oklahoma Indian Land/ Mineral Owners of Associated Nations
Roger Good, Council of Petroleum Accountant Societies
Isaac A. Julian Sr., The Jicarilla Apache Nation
Harold Kemp, State of Wyoming
Orme Lewis, Public Representative
Karen Lukin, American Petroleum Institute
Mike Nedd, Bureau of Land Management
Floyd Phillips, Shoshone/Arapaho Joint Business Council
Marvinette Ponder, Council of Petroleum Accountants Societies
Joanna Prukop, State of New Mexico
Daniel Riemer, U.S. Oil & Gas Association
Marc Smith, Independent Petroleum Association of Mountain States
Edward Sullivan, National Mining Association
Perry Shirley, The Navajo Nation
Akhtar Zaman, The Navajo Nation
Bob Middleton, Assistant Secretary Indian Affairs

Additional Federal Attendees:

AS/LM: Michael Olsen; BLM: Bob Anderson; BIA: Darryl Francois; MMS: Gregory Gould, Richard Adamski, Shirley Conway, George Triebsch, Emily Kennedy, John Barder, Theresa Bayani, Jim Browning, Peter Christnacht, Gina Dan, Janet Drake, Pat Etchart, Gary Fields, Roman Geissel, John Hovanec, Glenn Kepler, Adam Kremer, Morgan Latimer-Brown, Nancy Messer, Tami Sluss, Dave Smith, Jim Steward, Marti Thompson, Paul Tyler, and Mary Williams

Meeting Documents

Royalty Policy Committee Operating Procedures and Bylaws
Royalty Policy Committee Charter
Federal Register Notice – Royalty-in-Kind (RIK) Eligible Refiner, Determination of Need Solicitation of Comments
Federal Register Notice – Reporting Amendments – MMS is amending existing regulations for reporting production and royalties on oil, gas, coal, and other solids and geothermal produced from Federal and Indian Lands
Federal Register Notice – Notice of Royalty-in-Kind Eligible Refiner Program Continuation and Sale
Federal Register Notice – Notice of Intent to Establish an Indian Oil Valuation Negotiated Rulemaking Committee
Royalty-In-Kind Annual Report
Presentation on RPC Recommendation Implementation Status Updates
Presentation on Inspector General Evaluation Report-RIK Oil Sales Process
Presentation on RIK Energy Policy Act Section 342- FY 2007 Report to Congress
Presentation on RPC Recommendations Compliance and Asset Management- Action Items
Presentation of the Interim Report of RIK Subcommittee
Presentation on Advanced Royalty for Coal Rule Status Update
Presentation of the Interim Report of Subcommittee on Oil & Gas Valuation

**Royalty Policy Committee
Agenda
Denver, Colorado
September 18, 2008**

Welcome and Opening Remarks	8:30 - 8:45	Dan Riemer
ASLM Remarks	8:45 - 9:15	Michael Olsen
MRM Associate Director's Remarks	9:15 - 9:45	Greg Gould
<i>Morning Break</i>	9:45 - 10:00	
Royalty Management Subcommittee Report -Action Plan Status	10:00 - 11:00	George Triebisch
RIK Annual Report and May 2008 Inspector General Evaluation Report RIK Oil Sales Process	11:00 – 12:00	Jim Steward
Lunch	12:00 - 1:30	
Compliance Program Update	1:30 – 1:45	Roman Geissel
RIK Subcommittee Update	1:45 – 2:15	Dan Riemer/ Jim Steward
Indian Oil Valuation Negotiated Rule Status	2:15 – 2:30	Paul Tyler
Advanced Royalty for Coal Rule Status	2:30 – 2:45	John Hovanec
<i>Afternoon Break</i>	2:45 – 3:00	
Oil & Gas Valuation Subcommittee Update	3:00 - 3:15	David Deal/ Mary Williams
Oil & Gas Royalty Reporting Subcommittee Update	3:15 - 3:30	Marvinette Ponder/ Robert Prael
Public Remarks	3:30 – 3:45	
Committee Roundtable	3:45 – 4:00	Committee
Schedule Next Meeting/Adjourn	4:00 - 4:15	Chairperson