COMMENTS ON MMS PROPOSED RULE, 71 Fed. Reg. 38545 (July 7, 2006)

Submitted by David C. Harrison on behalf of himself and the
Council of Energy Resource Tribes (CERT).

David C. Harrison and CERT offer the following comments in response to the proposed rulemaking, and respectfully suggest that the proposed rule is insufficiently attentive to the mandate of section 9 of Public Law 104-185, 110 Stat. 1700, 30 U.S.C. 1701, *et seq.*, which states unequivocally

> **SEC. 9. INDIAN LANDS.**
>
> The amendments made by this Act shall not apply with respect to Indian lands, and the provisions of the Federal Oil and Gas Royalty Management Act of 1982 as in effect on the day before the date of enactment of this Act shall continue to apply after such date with respect to Indian lands.

Id., 110 Stat. At 1717. The proposed rule changes appear designed to harmonize the regulations with changes in agency practices that in turn came about through successive efforts to implement the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA). Section 9 of that Act emphatically states the intent of Congress to exempt Indian lands from its amendatory provisions.

Reporting Indian Oil production and disposition

The proposed changes to Subpart B of 30 CFR, Part 206, appear both unwarranted and unhelpful in a regulatory regime designed to ensure timely and accurate royalty payments for oil produced from Indian lands. The separate language currently contained in that Subpart for Indian Oil was arduously arrived at after more than fifteen years of generally unsuccessful efforts to force crude oil production from federal and Indian lands into a single regulatory regime, following enactment of the Federal Oil and Gas Royalty Management Act of 1982. The proposed rule change reflects a large step back into recent history by making attempting to make the reporting for federal and Indian production as nearly identical as possible.

The current Subpart B of 30 CFR, Part 206, reflects considered judgments made to bring the Department's regulatory regime for Indian oil production into conformity with the Secretary's obligations under the applicable statutes and judicial decisions interpreting those statutes. There has been no appreciable change in the authorities cited for the current 30 CFR, Part 206, as it is currently written. The Department's explanations and preamble language offer no justification for the proposed changes to Subpart B, other than to conform the regulations to current practices which were themselves largely the result of efforts to implement RSFA.

The proposal to permit payors to report all crude oil sales on a "rolled up basis" under a single contract type ("sales type code") will complicate efforts to maintain an effective and timely program to ensure accurate reporting of crude oil production, sales, and royalty payments.

Moreover, the proposed language to effect the intended change is not readily or easily understood. The proposed definition of a "sales type code" is simply not clear. If the intended effect is merely to require characterization of the crude oil sale transaction as either an arm's-length or a non-arm's-length one, and to permit single-line reporting of all sales falling under each category, that understanding is not well communicated by the proposed definition. In fact, it appears that the difficulty the drafters experienced is not so much the meaning to be conveyed but the term to be applied to it. The apparently desired objective might be more readily achieved by simply changing the definition of the currently employed term of "selling arrangement," rather than contriving a new term that does not readily connote the intended meaning.

Further, the distinction apparently intended to be drawn between the "sales contract/disposition" and the "arm's-length/non-arm's-length nature of the transportation or processing allowance" is unclear in the proposed definition. The only use of the term "selling arrangement" in either the singular or plural form in the current version of Subpart B of 30 CFR, Part 206, appears in the sections dealing with transportation allowances, §§ 206.54(b)(1),(2). In other words, the term which would be replaced in the proposed rule seems by the proposed definition to exclude application to determinations of transportation allowances. Yet, the only actual uses of the term appear in those subsections dealing with transportation allowances.

All this might be clear and meaningful to current reporters who were involved in the "re-engineering" process that gave rise to the proposed rule. It is by no means clear to others, however.

More importantly, the "rolled up" reporting contemplated by the proposed rule, even under the proposed definition of "sales type code," seems quite inconsistent with other provisions of Subpart 206 dealing with transportation allowances. The current requirements for allocating allowances to gaseous and liquid products transported, and for allocating transportation allowances between or among different liquids transported seem to be more easily achieved by the current reporting regime of requiring each individual "selling arrangement" to be reported, as the current regulations require.

In short, the proposed substitution of the currently used term "selling arrangement" with the proposed term "sales type code," seems unwarranted and ill-advised for Subpart B of Part 206 of 30 CFR, dealing as that Part does solely with crude oil produced from Indian lands.

Netting

The proposed rule offers no explanation whatsoever for the proposed change in the definition of "netting," in Subpart D, dealing with crude oil produced from federal lands. Neither is any explanation apparent from the language of the proposed change. If the only purpose of the proposed change is to achieve a certain aesthetic parallelism in section 30 CFR § 151 by replacing the verb "is" with the verb "means" in the predicate part of the sentence, then the proposed change will be a resounding success if made final. If, in fact, that is the purpose, then the same change should be made to the same term as it is defined in Subpart C.

If a substantive change in the meaning of the term is intended by the proposed deletion of the words "one line," that intended change in meaning is not communicated. If the Department believes that the words "one line" currently used in the definition are somehow unclear, confusing, or redundant, a short explanation of that tentative determination would be helpful to reviewers who otherwise will be prone to seek a meaning in and a meaningful reason for any proposed rule change. In any event, if the word is intended to have the same meaning in each of the Subparts where it appears in Part 206, then other changes are warranted in addition to those proposed in the current publication.

Forms and Reports

The proposal to eliminate entirely the forms previously required to report Indian mineral production volumes and quality at the level of individual well and producing formation is troubling insofar as it appears to be a retrenchment to the "We'll catch it on the audit mentality" of the original 1988 valuation regulations. Much deliberation and consultation went into developing the requirements that well-level production reports be made available to the royalty accounting arm of the Department, as well as to the resource management agencies.

The proposal to eliminate entirely the Form 3160 Report of Monthly Operations in favor of complete reliance on the Form 4054 Oil and Gas Operations Report (OGOR) contemplates an integrated, computerized comparison of production and fiscal reports "to verify that proper royalties are received for the minerals produced," as MMS explained in an earlier information collection request to the Office of Management and Budget.

The current proposal to eliminate other forms that are designed to provide information necessary for that comparison to yield accurate royalty information, however, raises concerns that the objective described to OMB might be defeated by increasing reliance on the occasional look-back review, as opposed to the contemporaneous comparison or "front-end accounting" that Indian lessors have sought since the oil and gas litigation of the 1970's.

One example is the proposal to eliminate the Gas Analysis Report, Form 4055, in preference to a periodic, subsequent reliance on obtaining a copy of gas sample reports, "if necessary, during our compliance verification or audit processes." This proposal reflects an agency determination that routine, automatic review or verification of gas quality information is neither necessary nor important. Yet, 30 CFR § 206.173(b)(2)(ii) continues to dictate that this precise datum can affect the amount of royalties due by as much as 35.5%. At least for Indian gas, it is imprudent to eliminate a requirement that this information be reported routinely, with appropriate sanctions for failure, misrepresentation, or other willful attempts to avoid reporting this data element in a timely and accurate manner.

A second example is the proposal to eliminate the Gas Plant Operations Report, Form 4056. Information from this form permits a timely determination of quantities and quality of gas attributable to a reported lease. Where most gas is delivered to a gas plant prior to determining royalties, this information is simply critical. The proposed rule would once again place reliance for making these determinations on gas plant reports obtained "during our compliance verification or audit processes..." The ineluctable inference from this proposed rule change is

that the agency has reverted to its once-discarded policy of an "audit-based strategy" for collecting the information necessary for an accurate determination of royalties due for production from Indian lands.

Collecting "Necessary" Information

When MMS described the notice for extending the information collection request for Forms 4054 and 4058, OMB Control Number 1010–0139, the agency explained that the Secretary oof Interior has an Indian trust responsibility to Indian beneficiaries of production from Indian trust lands. The Secretary discharges this responsibility through an automated accounting system that permits comparison of production and royalty volumes, including production information by API well number and sales by product. These data are collected and "... used as a method of cross-checking reported production with reported sales."

Furthermore, the agency advised OMB:

> "Failure to collect this information will prevent MMS from ensuring that all royalties owed on lease production are paid. Additionally, the data is [sic] shared electronically with the Bureau of Land Management, MMS's Offshore Minerals Management, Bureau of Indian Affairs, and tribal and state governments so they can perform their lease management responsibilities."

MMS Agency Information Collection Activities: Notice of an extension of a currently approved information collection (OMB Control Number 1010-0139) at 3.

The purposes served by MMS' responsibility to collect this information are not limited to the agency's own automated routines. Tribal and state governments have responsibilities, too, the discharge of which is significantly reliant on the proper functioning of MMS in collecting the necessary information. The agency should carefully consider the impacts of its decisions in eliminating information collection regimes that were arduously arrived at over a period of many years in collaboration with tribal and state governments.

The re-engineering processes described in the proposed rulemaking might serve the purposes of increased automation and "efficiency" contemplated or mandated by RSFA. Those considerations, however, and any requirements of the statute that support the "simplification" of royalty reporting for federal leases, emphatically do not apply to Indian lands.

History of RSFA implementation

The early attempts to revise MMS regulations in the wake of enactment of the Royalty Simplification and Fairness Act led to a realization that the Secretary's duties under federal and Indian leases, especially in light of the exemption of Indian lands from the RSFA amendments, counseled sufficiently different reporting regimes that separate regulations were required for enforcing the terms of federal and Indian leases. The current proposal to force reporting for federal and Indian mineral production back into a singular reporting regime constitutes a significant reversal of the very purpose of those separate regulations for federal and Indian leases.

Likewise, the retreat to increased reliance on "compliance verification or audit procedures" represents a significant retreat to the "audit-based strategy" that attended the agency's first attempts to implement product verification regulations in the first instance. The resurrection in the current proposal of that strategy which was largely abandoned in the development of the current, separate regulations for Indian oil and gas production is unwise and unwarranted.

The current proposal will result in forcing Indian oil and gas lease production into a reporting regime designed primarily to implement RSFA, which by its terms exempts Indian leases from its coverage.

The approach contemplated by the proposed rule will result in increased litigation and increased liability of the Secretary and the government for failure to enforce the terms of Indian oil and gas leases.

While Indian tribes may well be able to mitigate the damage that will result from promulgation of this proposal in a final rule, the hundreds of individual Indian lessors who lack the capabilities of tribes and states to monitor royalty obligations will be left without a remedy at all in the proposed retreat from contemporaneous production/revenue verification.