# ROYALTY FAIRNESS ACT

# HEARING

BEFORE THE

## SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

OF THE

## COMMITTEE ON RESOURCES HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

ON

## H.R. 1975

**A BILL TO IMPROVE THE MANAGEMENT OF ROYALTIES FROM FEDERAL AND OUTER CONTINENTAL SHELF OIL AND GAS LEASES, AND FOR OTHER PURPOSES**

JULY 18, 1995—WASHINGTON, DC

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# ROYALTY FAIRNESS ACT

**TUESDAY, JULY 18, 1995**

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON ENERGY & MINERAL RESOURCES, COMMITTEE ON RESOURCES
*Washington, DC.*

The subcommittee met, pursuant to call, at 2:50 p.m., in room 1324, Longworth House Office Building, Hon. Ken Calvert [chairman of the subcommittee] presiding.

**STATEMENT OF HON. KEN CALVERT, A U.S. REPRESENTATIVE FROM CALIFORNIA AND CHAIRMAN, SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES**

Mr. CALVERT. The subcommittee will come to order. The subcommittee meets today to take testimony on H.R. 1975, a bill to improve the management of royalties from Federal and Outer Continental Shelf oil and for other purposes. The official short title of H.R. 1975 is "The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995." My short title for it is simply "Royalty Fairness," because that is what my co-sponsors and I believe the bill is all about, getting to a level playing field for Federal lessee and lessor alike.

Other committees of the 104th Congress are examining ways to reform Federal taxes to be simpler and fairer, and I believe the time is here for similar reform for the Federal Government's second or third largest source of revenue, Federal oil and gas royalties totaling nearly $4 billion annually. That is a large sum of money, indeed, but that is no reason to put it off-limits to revisions. There is plenty of evidence the royalty program is an overly complex morass for oil and gas companies who seek to do business with the Feds both onshore and offshore. As I see it, the current system is so entangling and tilted in Uncle Sam's favor it is a wonder to me smaller companies even choose to hold to Federal leases. Of course, in so much of the West there is little fee land as an alternative, which leaves the Department of the Interior as the only game in town, practically speaking.

But, if you were a small oil and gas company, or for that matter a mid-sized or major producer, that is attempting to produce this Nation's resources and pay its royalty obligation correctly and on time, would you like to be subject to volumes of bureaucratic accounting instruction, discriminatory money management practices, and the possibility of a Federal audit decades later? Well, that is what lessees face today when dealing with MMS.

To be fair, the Royalty Management Program has evolved since the passage of the Federal Oil and Gas Royalty Management Act

of 1982 at the direction of successive Congresses which gave MMS the marching orders to build the system existing today. As documented by the Linnowes Commission, which recommended wholesale changes in royalty management and which led to the creation of MMS during the Reagan Administration's first term, there were major problems with royalty collections, especially onshore leases, at that time.

Since then, MMS has demonstrated to Congress significant improvements in the "error rate" of royalty collection from the 40 percent range to the 90 percent and more. Now a bureaucracy appears to have become entrenched which says it supports efforts to administratively streamline royalty management, but it never gets the job done. The mountain of paperwork required of lessees grows larger, not smaller. H.R. 1975 would put an end to these practices and reverse the trend of the Federal Government to seek "improvements" by exercising more and more enforcement measures, like assessment and penalties, in order to police cryptic reporting requirements. These requirements were designed to capture royalty dollars slipping through the cracks, but instead have become a drain on the Federal Government's fiscal and human resources as dollars are spent to collect dimes.

That is why simplification is needed, but fairness is just as important. When I took over this subcommittee chairmanship, I could not believe it when I learned that no statute of limitation exists to protect lessees from the Federal Government seeking to audit royalties owed, as one judge said, "back to the creation of the Republic." As a former small business owner myself, I am quite aware of the need to hold onto records for possible IRS auditing, but at least they are barred from looking back more than seven years.

H.R. 1975 would impose the requirement that both the Federal Government and companies complete their royalty accounting transactions within six years. I know that this is within the goal that MMS has set for itself administratively, so there ought to be no argument from the Administration that this provision is unreasonable. And remember, where fraud is alleged, the time bar to claims does not apply, nor is it retrospectively applied. In other words, only royalty obligations on production after the date of enactment of this bill are subject to this limitation. I believe a reasonably competent agency ought to be able to do its job without any impact from this provision while at the same time a great burden is lifted from the oil and gas industry. My guess is that warehouse owners will oppose this provision because it means that thousands of cubic feet of older records can finally be disposed of, but I am sure other use can be made of the space to be emptied.

There are many other provisions of H.R. 1975 which I won't mention now. Suffice it to say, on June 8 of this year the subcommittee took testimony from the Deputy Assistant Secretary of the Interior for Land and Mineral Management in support of the REGO II proposal to devolve royalty collection to the States. At that hearing just six weeks ago, Ms. Baca testified that the cumulative funds to run that royalty program would be just $7 million, about one-seventh of what MMS spends today, because it would be done under a "simplified" system. While I realize many are skeptical that it can be done for so little, Secretary Babbitt apparently is not among

that group. I am not prepared to say the royalty program envisioned in H.R. 1975 can be implemented for as little as $7 million, but I do believe it will save the taxpayers significant amounts without reducing collections. Indeed, implementation of this bill should increase participation of smaller oil and gas operators who are rightfully fearful of becoming Federal lessees under the current system. And the increased competition for Federal leases can only be good for the country.

Before I turn to other members of the subcommittee for any opening statements they may have, let me first welcome our witnesses and thank them for traveling here to present their views.

Again, let me welcome the witnesses. Mr. Abercrombie should be here shortly. While we are waiting, some of you probably have seen these documents before and this isn't the yellow pages for the L.A. Times area, but these are the forms that you need to fill out to pay royalties to the United States Government, and certainly we can simplify that system better than it is today.

While we are waiting for Mr. Abercrombie and other members of the committee, I would first like to go ahead and welcome panel one, Ms. Cynthia Quarterman, Director of the Mineral Management Service, Department of Interior, and Mr. Cody Graves, Commissioner, Oklahoma Corporation Commissioner.

Ms. Quarterman, if you would like to go ahead and start your testimony, and I apologize if I have to leave while your testimony is being given, but go ahead, Ms. Quarterman.

**STATEMENT OF MS. CYNTHIA QUARTERMAN, DIRECTOR, MINERALS MANAGEMENT SERVICE, DEPARTMENT OF THE INTERIOR**

Ms. QUARTERMAN. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you to discuss how we can make improvements to the Nation's program for the fiscal management of public mineral resources. The Department of the Interior supports many of the objectives that underlie the subject of this hearing, H.R. 1975, the Federal Oil and Gas Royalties Simplification and Fairness Act, and has taken steps to meet many of those objectives. However, many aspects of this legislation go far beyond the objectives that we support and would seriously compromise our ability to ensure that royalties are properly paid on Federal oil and gas leases. Consequently, we cannot support this bill. However, we believe that we do share with you several important objectives and we would welcome the opportunity to work with you to develop less costly mechanisms for properly collecting Federal oil and gas royalties.

My testimony goes into detail about MMS's background in royalty collection, which I believe will shed light on how the program evolved to where it is today. It also highlights the major accomplishments that we have achieved over the short life of MMS.

Despite past improvements, MMS also realizes that the challenges the Bureau faces today are different from those of the previous decade. In response to these challenges, we have focused our efforts over the past several years on finding ways to carry out our programs more efficiently and effectively, to improve our level of service to both the regulated community and the public and to

treat our various constituents, including State governments, Indian communities and the minerals industry as partners in decisions which affect them.

Finally, before getting into the specifics regarding H.R. 1975, my testimony sets forth several new initiatives that we are pursuing to meet the new challenges facing the royalty collection program today. As you will see, many of the initiatives parallel provisions of H.R. 1975. These are only steps along the way to continuous its improvement. Concurrent with this hearing we are holding a meeting in Denver with all of our constituents to discuss these streamlining ideas. We will also be convening the first meeting of our Royalty Policy Committee soon to ensure continuous improvement in the Royalty Management Program. I believe that it is the most appropriate vehicle to address many of the issues raised in this bill. In fact, I would be happy to take your suggestions from this subcommittee back to that body for analysis and report back to you in the future.

Now with respect to H.R. 1975, we fully support faster audits. In fact, only last week I issued guidelines on audit timing and resource allocation to the Associate Director of the Royalty Management Program requesting that orders on all Federal and most Indian leases be issued within six years of the date the royalty becomes due or an adjustment is made with few exceptions. However, I cannot support this bill because it does not recognize all the exceptions that we view necessary. It does not extend the limitations period for adjustments near the end of the six-year period and it does not recognize the traditional statute of limitations standard that the period does not begin to run until the government knows or reasonably should know that an obligation is due.

We also support faster decisions on appeals. In fact, we are piloting a number of initiatives to streamline that process, including alternative dispute resolution, and writing shorter decisions. I have delegated my decisionmaking authority down to the lowest levels feasible within the Bureau and we are beginning to streamline our field reporting. In 1994 we resolved more appeals than in the previous two years combined. I believe we can achieve the same goals in H.R. 1975 without some of its deleterious effects of encouraging more appeals, of changing the standard of review by the higher court and requiring the Secretary to prove a bond is necessary to secure orders during appeal.

We also support easier offshore refunds. We have circulated draft legislation to permit companies to receive these funds beyond the two years currently required by law. However, H.R. 1975's combination of refunds with its offsetting of over and underpayments would create a substantial accounting burden. It would require significant changes to our computer systems. It would make it virtually impossible for us to keep track of the transactions to ensure that proper payments are being made. It would exclude these leases from the Debt Collection Act and it would not provide adequate time for the Secretary to review refund requests.

We support limited interest on overpayments, as well. For example, when a payor pays and wins on appeal and when we are the cause of delay, we would support payment of interest if appropriations are made available to cover those costs. However, we do not

support H.R. 1975 because it would decrease the rate of interest companies pay so that payers would no longer be encouraged to pay on time. Because of the offsetting provisions, interest payments to the government would be substantially decreased. The interest would be paid to payers who have control over whether overpayments are being made without giving the same latitude to the government.

During fiscal year 1994 interest payments were at least—and I don't know the full scope of this—$45 million, of which the States shared as appropriate. This bill would substantially decrease those collections. We support the provisions of the bill that would permit us to collect royalty in kind.

Finally, while we generally support efforts to streamline forms, processes, and reporting, we cannot support H.R. 1975 because it changes our direction from one of trying to collect the correct amount of royalty the first time to one that would almost rely exclusively on back-end audits to ensure that royalty payments are correct. The bill's provisions on reporting would not provide us with sufficient information in the first instance. It would then, in some instances, prohibit us from doing automated checks on the information received and substantially limit assessments if the information is in error or late, all of which leads to the need for additional audit.

In addition, the audit provisions appear to limit the information we can access during audit and require us to do a cost benefit analysis based on our best guess of what would be obtained from an audit. And the bill would make it very difficult, if not impossible, to implement the provisions of the Federal Gas Negotiated Rulemaking that we have worked so hard with State and industry to develop.

In sum, H.R. 1975, as currently drafted, would decrease Federal income revenues. It would increase administrative costs to both the government and industry because of increased audit, computer system changes and the need to maintain two separate systems for royalty collections, one for Indian lands and one for Federal lands, and it would seriously compromise the Federal royalty collection system by legislating accounting practices that make the system less flexible and less adaptable to changes that may occur in the industry.

In closing, I applaud the subcommittee for taking an interest in streamlining royalty collections and I offer my commitment to establish a working group of all affected parties under the Royalty Policy Committee to work through our differences and report back to you. Thank you.

Mrs. CUBIN. Thank you, Ms. Quarterman.

[The prepared statement of Ms. Cynthia Quarterman can be found at the end of the hearing.]

Mrs. CUBIN. MR. GRAVES.

## STATEMENT OF MR. CODY GRAVES, COMMISSIONER, OKLAHOMA CORPORATION COMMISSION

Mr. GRAVES. Thank you, Madam Chairman. I appreciate the opportunity to address the subcommittee today. My name is Cody Graves and I currently serve as Chairman of the Oklahoma Cor-

poration Commission. The Corporation Commission is an elected three-member panel that regulates oil and gas production and exploration, public utilities and transportation in the State of Oklahoma. I am also a former Chairman of the Legal Committee of the Interstate Oil and Gas Compact Commission.

I am pleased to have this opportunity to testify today on H.R. 1975—legislation that, in my opinion, will improve the management of royalties from Federal and outer continental shelf oil and gas leases.

This bill promotes certainty and simplicity in the laws and policies that govern Federal royalties. The goal of H.R. 1975 is not a partisan one, rather it is the goal of providing a better environment for our domestic energy industry to conduct business. H.R. 1975 will help remove just some of the red tape our domestic oil and gas producers are faced with each and every day, which will in turn promote continued domestic oil and gas production by encouraging production on all Federal lands.

I think it is important for all of us as public officials to listen closely to those in the domestic oil and gas industry so that we can have a better understanding of what the real problems are. As you know, a significant problem for the oil and gas industry has been the lack of an adequate, sustained price signal. Given that unfortunate scenario, as public policymakers, we must then consider what we can do to reduce the regulatory and administrative burdens on our domestic producers.

This bill will go a long way in reducing some of those regulatory burdens. Currently the Department may collect royalty underpayments as far back as it wants, yet lessees are barred from seeking refunds of overpayments after as little as two years have elapsed. Under H.R. 1975, a clear, certain statute of limitations will be in place for both industry and government for the bringing of judicial and administrative proceedings on leases administered by the Secretary of the Interior. Record keeping requirements will conform with the statute of limitations. The reporting and collection of unnecessary information that is now required is costly and a drain on the Federal Government's and the industry's fiscal and human resources. Producers should not be faced with unnecessary mountains of accounting instructions, bills, assessments, penalties, audits and litigation. This legislation will provide accounting and enforcement relief for energy producers.

Additionally, this legislation will allow producers to collect interest payments in the event of an overpayment. Currently producers must pay the Federal Government interest on underpayments, but the Federal Government is not required to pay producers interest on overpayments. This reciprocal interest is the only way to deal with the estimated payment situation in a fair and impartial manner.

This bill is a small step toward abolishing the bureaucratic nightmare that our domestic energy industry faces. As a result, it will encourage business investment and development of our Federal resources by preventing the premature abandonment of marginal wells.

I am afraid that the general public does not realize the effect that marginal wells have on our economy. Because of this, I would

like to make you aware of a study done by the Interstate Oil and Gas Compact Company (IOGCC) on the impact that marginal wells have on our domestic economy.

In 1993, the IOGCC released a study that showed in 1992 over 6000 marginal oil wells were abandoned, with the resulting impact on our Nation's economy being a reduced economic output of over $400 million, an earnings reduction directly to the industry of $55 million and a loss of 2300 jobs. This report also said that every dollar of stripper oil production creates an additional 51 cents of economic activity throughout our economy and that 9.1 jobs are dependent on every $1 million of stripper oil produced.

When we consider this information, and the fact that in Oklahoma over 60 percent of all the oil that has ever been discovered in our State is still in the ground, we must come to the conclusion that we cannot allow the premature abandonment of oil and gas wells to continue. If we do not act now to stop this premature abandonment of marginal wells, we will foreclose forever our ability to produce significant amounts of the abundant domestic reserves of crude oil and natural gas that underlie our Federal lands. Every well that producers are forced to plug means that we as a nation will be forced to import that much more foreign oil on foreign flag tankers through ports and harbors in the United States and run an increasing risk of another Exxon-Valdez type incident.

We are not running out of natural resources. However, because of the increasing regulatory costs and decreasing prices, it becomes less and less economic to produce marginal leases. The resulting abandonment and plugging of those wells will create additional job loss and additional revenue loss throughout the economy.

I am not sure that we will ever be able to convince the general public of the value that our domestic industry has on our economy and the significant national security implications that exist. For whatever reason, those arguments have fallen on deaf ears. However, as State and Federal officials we must continue to do what we can to maintain the viability of our domestic energy industry. When you consider all that we can do as regulators to encourage the industry, this legislation is but one simple step to make the system more equitable.

The basic reform measures of H.R. 1975 will result in a simple, fair and more cost-effective way to conduct business for our energy industry. There will be no reduction in royalty collections as a result of this bill. As a matter of fact, royalty collections may well increase as a result of increased productions on Federal lands. This bill will preserve accounting integrity and ensure that the Department has the necessary enforcement tools for the proper collection of royalties.

Thank you for your time. I would be happy to answer any questions that you might have.

[The prepared statement of Mr. Cody Graves can be found at the end of the hearing.]

Mrs. CUBIN. Thank you, Mr. Graves. First of all, I have some opening remarks that I will just have put in the record.

[Statement of Hon. Barbara Cubin follows:]

STATEMENT OF HON. BARBARA CUBIN, A U.S. REPRESENTATIVE FROM WYOMING

Mr. Chairman, thank you for holding this hearing today. I congratulate you for putting together what I believe to be a very good bill. The Royalty Fairness Act is a simple, cost-effective approach to promoting increased resource development on Federal lands while maintaining accounting integrity.

The statute of limitations provision and the interest reciprocity provision are both, in my opinion, long overdue. While the Department of the Interior has attempted to correct these and other inconsistencies in current regulation through policy directives, there will be no permanent solution until legislation is enacted. I look forward to working with the members of this subcommittee to eliminate these regulatory barriers to oil and gas production and create a level playing field for industry and the Federal Government.

I thank the witnesses for being here and have little doubt that we will benefit from their expertise in this area.

Mrs. CUBIN. But then I would like to begin my questioning with Ms. Quarterman. Why do you think that reciprocal interest should not be allowed? That is, when you pay in you don't get interest on your money but you are charged interest when you owe money. Why do you think that should not be allowed?

Ms. QUARTERMAN. Let me clarify. I do support interest in certain instances. In the instance where a company has paid in on appeal an amount and then wins, we should pay interest on that, or an instance where we are the cause of delay we should pay interest on that. However, the reason that I don't generally support interest is because payments are within the hands of the industry. We do not send them a bill and ask them to pay a certain amount every month. They pay into us what they think is appropriate. If we were to give them interest for mispaying their bills or overpaying them, in some instances—I don't think at the rate that is in the Act—companies might be enticed to pay in extra money just for those interest payments. I don't think that is the case here. However, I think we should be encouraging correct reporting rather than incorrect reporting in our process.

Mrs. CUBIN. Do you have a response to that, Mr. Graves?

Mr. GRAVES. Well, I think that when you look at the concept of paying for the use of the money, I mean, the IRS standard, I think, is a fair standard that would apply in this situation. If you overpay and the government owes you money on it, then they ought to pay you interest on it. I don't think that very many people are going to systematically overpay the moneys that are going to the Federal Government in terms of royalties at this point, primarily because the capital structure is such that independent producers are looking for every dollar they can find to rework and drill new and existing wells.

Perhaps if you really want to get into the situation, if you could change the whole estimated payment mechanism to reflect the realities of the gas market today as opposed to 15 years ago when the system was generally developed, you would have less of a problem with underpayments and overpayments when you allow for the first purchaser to remit royalties on a more reasonable basis that really reflects what is going on out there in the marketplace today. But the bill doesn't address that particular problem because of the controversial nature of the situation.

Ms. QUARTERMAN. Can I respond to one thing?

Mrs. CUBIN. Sure.

Ms. QUARTERMAN. With respect to the IRS, I just thought it should be noted that in certain instances the IRS does pay interest on overpayments, but it is after a 45-day period. If they are beyond that period, they pay interest and the interest on which they pay is less than the interest that you would pay if you were to underpay them, which is not the situation here.

Mrs. CUBIN. Thank you. Another thing I would like to know, why is the MMS holding $32.5 million in overpayments and tying up $225 million in appeals of industry's money which could otherwise be invested in further development of Federal lands?

Ms. QUARTERMAN. I think there are two parts to that question. First, with respect to overpayments, we are holding refunds, and I don't know that the dollar amount is $32 million. We are holding refunds to certain companies if they have alleged that the statute of limitation applies to their cases since the current law as it exists—and there is a difference in the circuits as to what the appropriate statute of limitations is, whether there is one at all. In the Fifth Circuit they seem to assume that there is no statute of limitations that applies. In the Tenth Circuit they assert that it could be as much as 12 years. If a company comes in, given the state of the law, and argues the statute of limitations has run and refuses to pay our bills, it is our obligation to hold those refunds until we can take over those funds.

As to appeals, we do not hold moneys on appeal. Those are bonded by companies, unless a company wants to pay in, which is extremely rare.

Mrs. CUBIN. But they are not charged penalties and interest if they don't pay in when there is an appeal, is that correct?

Ms. QUARTERMAN. If they lose in the end, they do have to pay interest, but they generally don't just pay in.

Mrs. CUBIN. OK. You said that the Fifth Circuit and the Tenth Circuit have different definitions for the statute of limitations, and it was my understanding from your testimony that you thought a statement of policy would be adequate to define the statute of limitations. But I, having been a legislator for ten years now, wonder why you think it shouldn't be in statute. To me that makes it certainly clear and binding by all the courts. Why do you disagree with that?

Ms. QUARTERMAN. Well, I think there continues to be a difference of opinion among the circuits as to whether or not the existing statute of limitations of six years applies. The Supreme Court refused to take certiorari on that issue, so it still is a question. I came forward with a policy statement, not as to the statute of limitations, but as to when we would issue our orders, which in many people's minds is equivalent to a statute of limitations, that is within a six-year period, because I think that companies should have certainty on when they can expect to see us coming to them and issuing orders. It not only helps them, it helps us, quite frankly.

Mrs. CUBIN. Well, are you opposing the statute of limitations or not?

Ms. QUARTERMAN. I am opposing the statute of limitations as it is currently drafted, yes.

Mrs. CUBIN. And could you explain that to me again why?

Ms. QUARTERMAN. Well, there are several exceptions to the statute of limitations that I don't believe the current bill addresses. The first, and perhaps the most important, is the general provision that is in the existing statute, if it were to apply, which requires the government to make a payment at a time when they should—when they know or should know that a royalty payment is due that applies to the rest of the government. If a statute applies, certainly that statute should apply here as well.

Second, there are some other exceptions. For example, the bill tries to treat both industry and the government in the same manner by giving both a six-year time period in which to make corrections or within which to issue an order. As a practical matter, the government does not have the information available to them that the industry does, so on the 365th day of the fifth year a company could make an adjustment and the government would have no right whatsoever to go in and audit that. That would be beyond our scope.

In addition, if they got additional revenues beyond a six-year period, again, that would be beyond the statute of limitations. We would not be entitled to royalties on that. That is of concern to me.

Mrs. CUBIN. I think that could be handled, but nonetheless I think my time is up for now.

Mr. Abercrombie, did you have a statement?

Mr. ABERCROMBIE. Yes, thank you very much. I do have a statement that I would like permission to submit for the record.

Mrs. CUBIN. Without objection.

[Statement of Hon. Neil Abercrombie follows:]

STATEMENT OF HON. NEIL ABERCROMBIE, A U.S. REPRESENTATIVE FROM HAWAII

The concept of applying greater fairness and simplification to the Federal Oil and Gas Royalty Collection Program is, of course, an attractive one in these days of reinvention and less government.

I have appreciated the discussions with industry officials that have come to my office to argue for reform of the Federal Royalty Program. And, I commend Chairman Calvert for taking a proactive role by introducing H.R. 1975 and promptly scheduling a legislative hearing on that bill. It is unfortunate that given the short lead time, we were unable to entice a representative from the State-Tribal Royalty Audit Committee to testify, however, I have received a letter from them, which I ask be included in the record.

When this issue first came to my attention, I was led to believe that the bill would impartially apply the concepts of fairness, certainty and clarity in the Federal Royalty Management Program. However, the bill as introduced is clearly prejudiced towards industry, and in this case, that means against the American taxpayer. I carefully considered the option to co-sponsor the legislation; however, my concerns about the details of the bill led me to decline signing onto the bill at its introduction. Since that time two weeks ago, I have heard from the State-Tribal Royalty Audit Committee that there are many serious problems with the bill. The Administration is also opposing the bill, so, clearly, a number of changes must be made before we report the bill to the Full Committee.

In developing our position, I believe we need to keep the following points in mind:

1. The Minerals Management Service was created to correct a long-standing national concern over the mismanagement of Federal oil and gas leases. We should not undo the progress which MMS has made in the last 13 years to correct a multi-billion dollar enterprise which in 1982 Congress deemed a "failure".

2. The Federal Royalty Program is not a small endeavor. Since its creation by former Secretary Watt, MMS has collected $72 billion in mineral revenues; with over $1.5 billion in underpaid royalties and late payment charges. In FY 1996 alone, MMS expects to collect about $5.2 billion from 101,000 Federal and Indian leases. In addition, about $165 million will come from unpaid and underpaid royalties. Any

reform must not hamper MMS's ability to collect what is rightfully owed the American taxpayer.

3. MMS is in the business of collecting royalties—or the costs—that the American people expect to receive for the use of their assets. Oil and gas companies are in business to make a profit. Thus, the question of reciprocity—or the need for an even playing field—must be weighed carefully.

4. Any reform of the Federal Royalty Program must assure that oil and gas companies are paying every royalty that is due to the American people.

H.R. 1975 is a highly technical and complex bill. We must be careful and cautious in our deliberations in order to assure that we do not take the Federal Royalty Program "back to the future" when the previous Federal Royalty Program was found by the bi-partisan Linnowes Commission to be "in disarray" and "a failure".

As the Interior Appropriations Committee report for fiscal year 1996 noted: "The Royalty Management Program, in particular, has made tremendous strides over the past few years to improve the effectiveness and timeliness of its activities and has reduced error rates and timeliness to an admirable extent....the program is very well run and should not be dismantled simply for the sake of change.

I am confident that we can work together under the leadership of Chairman Calvert to devise a bill that meets industry's concerns while ensuring that the American taxpayer is fairly represented in ensuring that all royalties owed are paid.

Mr. ABERCROMBIE. And included with that, a letter from Wanda Fleming, First Vice Chair, State and Tribal Royalty Audit Committee. If I could submit that as well as part of the statement, I would be grateful.

I have no questions at this time, but I would just like an amplification, if I might. I missed some of the earlier part of the hearing, so you may have gone over this. Did you make a statement with respect to at what point you think the clock should begin to run on the limitation period? If you did not make such a statement, could you make it clear now if you have an opinion or an observation?

Ms. QUARTERMAN. Before you came in I mentioned that last week I had put forward a policy document that will be published in the **Federal Register** in the next day or so which requests that my Associate Director for Royalty Management ensure that we send out all orders within six years of the date that a royalty is due.

Mr. ABERCROMBIE. OK, thank you very much.

Mrs. CUBIN. Representative Dooley, do you have any questions?

Mr. DOOLEY. Thank you, and I apologize that I don't have the level of expertise on this issue yet that I would like, but that is what this hearing is all about, I guess. I have a hard time understanding, from the practical side of things, why six years is going to result in some problems in terms of the billing for royalties and the way that they are collected. Mr. Graves, I guess you would contend that that six-year period should be more than enough time.

Mr. GRAVES. We have recently adopted in Oklahoma a five-year statute of limitations for State royalty interests.

Mr. DOOLEY. And has that, I mean, from your perspective, resulted in any loss or leakage of royalties?

Mr. GRAVES. Quite frankly, we don't have as big a problem as we would appear to have on the Federal level because our collection practices more closely follow industry practices, the normal course of doing business, particularly in the gas. And with oil, you pump your oil, it sits in a tank, a pumper truck comes by, pumps the oil, takes it away and you get a check cut pretty regularly. You can control when that sale occurs and when the transaction occurs.

With natural gas, with the developing free market and the deregulation that is there you have split connections, you have all sorts of questions about balancing for transportation contracts and the rest. And a lot of times you don't know for 30 or 45 or 60 days what exactly your obligations and responsibilities are, even how much you are going to receive for your gas. And we have built in through the School Land Commission the ability to monitor that so we don't have this underpayment-overpayment problem that you have on the Federal level. Therefore, it is a much clearer picture that you are trying to audit and you don't worry about trying to pitch together where all these adjustments came from and what number it is that we are really looking for, which I think is one of the problems we have on Federal lands, because of the requirement to file a number by a certain time whether you have actually received payment for your gas or not.

Mr. DOOLEY. Well, Ms. Quarterman, if we have Oklahoma that has obviously implemented a system like this which they have confidence in, is allowing them to collect the revenues, they obviously have the same interest that the Federal Government does, they are fairly satisfied with it, what do you see as the inadequacies of that system and why shouldn't we move to something that is more simplified in that manner?

Ms. QUARTERMAN. Well, I won't comment on the adequacy or inadequacies of the Oklahoma system. It sounds like they may be unusual in their statute. My understanding is that most States don't have any statute of limitations. However, the question of estimated payments is a good one that we have thought about in the past in terms of perhaps moving the date on which royalties are collected into the future. There is always the question in everyone's mind then about that one month that slips. When do you actually collect for that month later? And for the Federal Government it is less of an issue than it is for some of the States that we provide these funds to, as well as the Indian tribes who would like to see their moneys as soon as possible.

Mr. DOOLEY. Now the comment you made on one month slipping, what do you mean by that?

Ms. QUARTERMAN. I mean that currently a payor is required to pay the month after production and then we are required to send in our moneys to treasury or to States or to tribes within 30 days. With tribes it may be even sooner than that. Because of that timing situation, it becomes difficult for companies in some instances to pay the exact amount that is due. If that period were to slip by a month, they would know more information and would be able to pay on a more certain amount.

Mr. DOOLEY. If you move from a 30-day to a 60-day timeframe, wouldn't that only be a revenue impact on to where you are distributing the funds for just that transition period and then you would be back on a normal footing in terms of a cash-flow?

Ms. QUARTERMAN. You would always be one month behind, essentially.

Mr. DOOLEY. Well, yes, basically we would have a problem in transition that if we went from a 30-day to a 60-day, of a 30-day shortfall in revenues, which is in effect just a cash-flow problem for 30 days, is that not correct?

Ms. QUARTERMAN. That is accurate.

Mr. DOOLEY. I guess then what I am concerned about a little bit is some of the arguments against moving in that direction, that some of the primary concerns is the impacts on distribution of revenues, which is overshadowing the importance of moving to a policy that would allow more accurate reporting, which would create more efficiencies within the system. I have a hard time understanding. Is that really justified by the cash-flow problem that we are going to have for just one month?

Ms. QUARTERMAN. Well, the current bill as drafted doesn't address that problem.

Mr. DOOLEY. And that would be something that would need to be added to the legislation?

Ms. QUARTERMAN. It would need to be addressed, yes.

Mr. DOOLEY. Thank you.

Mrs. CUBIN. Thank you. Mr. Thornberry, do you have any questions?

Mr. THORNBERRY. Thank you, Madam Chair. Just one question that I hope has not already been asked. Mr. Graves, do you have an opinion as to what extent the difficulties in sorting out these royalties have an effect on gas production and drilling and new exploration?

Mr. GRAVES. Well, I think that in the subsequent panel you will hear some real world examples of the regulatory and administrative burden that is placed on companies. Larger companies are better able to absorb those costs, perhaps. It is certainly a tremendous burden on small producers. But every dollar you spend filling out forms that doesn't result in any economic activity are dollars you are taking away from pursuing the development of natural resources. Quite frankly, if we want to pursue an aggressive policy of developing domestic energy supply, one of the things we ought to consider as a policy is some sort of royalty holiday until payback is achieved, for example, on a well, particularly on marginal properties where you are going to develop it, because at $15 a barrel for oil, for example, or $1.30, or $20 in some instances, for natural gas, you are not going to have a lot of people willing to risk their capital in a situation where they are constantly going to be assessed penalties and fines for failure to fill out a form in an appropriate manner submitted by an appropriate time.

Mr. THORNBERRY. As you say, with our growing dependence on foreign oil, it seems to me we are cutting off our nose to spite our face, the more difficult we make it to develop energy sources in this country.

Mr. GRAVES. We certainly have tried to do that within Oklahoma and within our own jurisdiction, to find out how can we reduce our own administrative burden that we placed on marginal producers. And I would just like to add that I visited with Barry Williamson, who is Chairman of the Texas Railroad Commission, who would like to have been here today but they had a docket scheduled and could not attend and will be submitting a formal statement from the Texas Railroad Commission in support of H.R. 1975 within the comment period as authorized by the notice.

Mr. THORNBERRY. Thank you, Madam Chairman.

Mrs. CUBIN. Well, as you know, we have another vote, so I think we will dismiss the panel for now and the legislators. If you wouldn't mind taking another round of questions when the chairman is able to return and we will be back as soon as we vote. Thank you very much.

[Recess]

Mr. CALVERT. The committee will be in order. Again, I apologize. That amendment is completed, unfortunately, the way the vote turned out. We can move onto the hearing.

Ms. Quarterman, as I understand, you are asking this subcommittee to turn H.R. 1975 over to MMS to perform further studies, investigations, and consultations. The 104th Congress was elected to achieve results as quickly as possible and I know studies are important, but I understand that we have been looking into reform for the past ten years. I must reject that type of business as usual. Will you and the Administration accept my offer and support H.R. 1975 as a vehicle for the much needed reform that this agency needs?

Ms. QUARTERMAN. Sir, I never meant to imply that we would study this issue to death. That is not the way that I operate. I think many people in this room can attest to that. Unfortunately, the Administration cannot support H.R. 1975 as it is currently drafted.

Mr. CALVERT. However, the Administration is willing to move the collection of all the royalties over to the States?

Ms. QUARTERMAN. That is a proposal that is being considered, yes.

Mr. CALVERT. Isn't that a proposal made by your Secretary of Interior?

Ms. QUARTERMAN. It is.

Mr. CALVERT. Isn't that much more radical than what we are talking about in H.R. 1975?

Ms. QUARTERMAN. Well, it is a proposal at this point in time and there is nothing in that proposal that would lead one to believe that the attention that is given to royalty management at the Federal level should be any less at the State level. I certainly wouldn't want to see that happen. I don't think the Secretary would either.

Mr. CALVERT. So you indicate that MMS knows better how to manage the Nation's resources than the Congress and certainly the States who represent the American people, the owner of the Federal lands? Why are you standing in the way of this legislative reform that the American public desires for all public agencies, reform that MMS wants based upon its numerous reinventing studies and reform the Administration supports based on the devolution proposal for simplified system to transfer to the States as I just mentioned?

Ms. QUARTERMAN. MMS is not perfect. I don't want to leave that impression in anybody's mind. Our employees don't think that. We are on the move in terms of continuing to improve ourselves. There are extremely complex issues related to royalty collection that are tried to be dealt with by your piece of legislation that I believe are more appropriate to be dealt with by the administrative agency, and I would like to see not only industry but the States, the tribes

and representatives of the general public have involvement when we make significant changes to the royalty management program.

Mr. CALVERT. I have before me a list of six reports, studies conducted by the MMS. For the record, would you provide a copy of each report and the projected cost savings and implementation schedule for each one? I have a list of these: January 27, the National Performance Review Phase II; May 1995, the Common Reference Data Reengineering Laboratory; March 1994, Reinvent Government Report for MMS; December 3, 1993, the Administration of Transportation and Processing Allowances; September 1993, MMS Royalty Management Reinvention Laboratory Report. So it seems there have been a lot of studies already completed to change MMS.

Ms. QUARTERMAN. I would be happy to submit those for the record. I believe that we have acted on all of those things and either have improvements in place or are well on the road to putting improvements in place.

[Information supplied by Ms. Quarterman can be found at the end of the hearing.]

Mr. CALVERT. Let us talk about the devolution proposal to transfer a greatly simplified royalty collection system to the States, a system costing only $7 million per year according to the Administration. Won't MMS need legislation similar to H.R. 1975 to reach this type of system by October 1 of 1995, or is this proposal simply an Administration trial balloon that will just float away in a couple of months?

Ms. QUARTERMAN. As I mentioned earlier, we are in the process of holding a meeting in Denver today to talk about just that, whether or not the proposal the Administration floated forward is one that we can actually achieve and achieve the savings that are demonstrated there that the State of Wyoming thought was feasible. If so, we will be going forward with that. If not, we hope to gain from that meeting more improvements that we can put in place.

Mr. CALVERT. As I read through your testimony, not once did you mention the relationship between the burdensome and unfair, in my opinion, reporting requirements and their impact on domestic energy production. Am I correct in assuming that MMS sees its duty only to collect every last penny by imposing more and more accounting requirements without concern for the effect that it may have on a company's decision to develop more Federal lands and, in effect, create more revenue?

Ms. QUARTERMAN. MMS has a very difficult job, I believe, in trying to balance the requirements, for example, on the OCS in ensuring development of the OCS and in collecting a fair amount of royalties. It has never been my goal to go forward and try to collect every last penny. There are occasions when my auditors come to me with large potential dollars that could be achieved if we were to go in one direction, and I look at the law supporting that and the accounting principles and determine that, in fact, it is not supportable, and I say to them no, we are not going to pursue that because it is not appropriate where it may bring in more dollars to this country. If the legal standards or the accounting standards do not support it, we would not go forward with it. Similarly, if industry were to come forward to me with a proposal that I thought

could not be supported by the legal analysis or by audit and accounting principles, we would not go forward with that. However, there is some room in the middle, and that is what I am trying to achieve.

Mr. CALVERT. Then you would agree that legislation like H.R. 1975, that I think would stimulate Federal production, increase revenues to the treasury and the States and obtain total payment sooner, I believe, by creating a simpler system that would allow companies to pay their royalties right the first time——

Ms. QUARTERMAN. I believe there are some provisions of H.R. 1975, if reformed, that are appropriate. I believe that there are some provisions of H.R. 1975 that have the inkling of a very good idea that should be achieved administratively. The goals are laudable and we should go forward with that. I cannot support the bill as currently drafted, however.

Mr. CALVERT. Well, I know the companies face extreme difficulties in getting wells drilled on Federal lands without even having to face the mountains of accounting instructions, cumbersome bills and years of payment uncertainty once production begins. If you were a small producer, would you want to face three volumes of instructions on how to submit a royalty check to the Federal Government? And I put this up earlier and I know you have seen this many times before, but this is what a small royalty producer, as well as large producers, need to accomplish before they can even send you a check.

Ms. QUARTERMAN. For the record, that, I believe, is a copy of the payor handbook, which includes not what I would call instructions but rather a reference book. It tries to deal with every possible situation that an industry person might have and give them an answer. The first volume deals with one form, the second with the second form and goes into great detail. We use it as a teaching guide when we hold seminars for small industry people or large ones who would like to know how to work within our system. And I frankly have an open-door policy, if anybody would like to come in and complain to me and tell me what is wrong with the system, I would love to hear it so that we can fix it.

Mr. CALVERT. I have been told that in the private sector things are a lot simpler, and I suspect that a private landholder wants to be assured of the fact that he receives every dollar that is due him or her on their land, just as the Federal Government should receive every dollar due to the Federal Government. I don't think anyone disagrees with that concept. We all want to collect every dollar that is due, but at the same time we want to do it as efficiently as possible. And it seems to me royalty payments should be based upon basic math and not calculus. Royalty payment is the amount of production times a royalty times a value, now—and I have heard all the arguments on how do we establish a value and I think we need to get there. But how does H.R. 1975 prevent you from verifying the payor has done the math correctly?

Ms. QUARTERMAN. Attached to my testimony is an early draft of some of the problems that we have with H.R. 1975. Most of what you said just then I agree with 100 percent. We should be as effective and efficient as possible and not create calculus or logarithms for companies to contend with. However, we do have an obligation

on behalf of the American people to ensure that we do receive what is due to them for the royalty collection on their lands.

Mr. CALVERT. And again, no one disagrees with that goal. It is just that we need to get there more efficiently.

Mr. Graves, what Federal regulatory scheme for royalties would best help promote production for the States? Does H.R. 1975 make a significant step in the right direction, in your opinion?

Mr. GRAVES. Mr. Chairman, anything that would serve to reduce the administrative burden on small, independent producers, the vast majority of producers in my State, would be welcome relief and would result in additional developmental activity going on on State, Federal and privately held lands. We have got to find a way to get past the presumption of guilt that everybody is going to try to do less than what they are expected to do unless we are out there watching closely. The way to solve the domestic energy problem, in my personal opinion, is to have a clear sustained price signal of some mechanism to allow for adequate capital to go back into the market. Barring that for any number of political economic reasons, as regulators we have got to find a way to lower the cost of doing business. And unfortunately, what we tend to do on the State and certainly on the Federal level is apply layer after layer of additional administrative costs that yield no economic benefit. And I think you will hear in the next panel some examples of the administrative burdens of trying to correct the system that yield no real benefits. I think this is certainly the first step in the right direction. It doesn't, I think, go far enough in terms of reflecting the operational realities of the natural gas market today. The natural gas industry has changed dramatically since MMS was created. There are a myriad of new players that were never there before, and sorting out whose interest is what and who owes whom how much and when it is due and how do you account for the transportation and the processing costs are things that need to be considered, and the Royalty Payment Program for Federal lands needs to be adapted to reflect that. We are striving and have made some significant changes in Oklahoma to reflect that on State lands.

Mr. CALVERT. And getting back to you, Ms. Quarterman, one thing I don't understand that it seems from reading your testimony that you are misreading my legislation. Could you explain the basis for your claim that H.R. 1975 will compromise the system? How would it compromise the system?

Ms. QUARTERMAN. I think the most significant problem that I have with the bill and one which hasn't been dealt with very much so far is the reporting requirements that are changed from this bill. My reading of the bill is that the reporting requirements would be significantly decreased, and I assume that this is an oversight by the drafter of the bill. It doesn't even mention the month in which the lease payment is being made. Production data which we currently receive is not mentioned in the list of items that we can request, which means that we would no longer be able to do automated exception processing, which we do to determine whether or not we have been receiving royalties based on the production that actually occurred. In talking to some of the older folks in the royalty program, it is their opinion that the information that this bill would provide is less than what was available to them before the

Linnowes Commission came forward with their report. That is of great concern to me.

Mr. CALVERT. So you believe, then, that the simplified system of collection would reduce revenues?

Ms. QUARTERMAN. Yes, I do.

Mr. CALVERT. Why? Do you believe that the industry is not honest in the reporting of their production or the royalties and that this simplified system would be easier to get around? Is that the implication?

Ms. QUARTERMAN. I don't want to pass judgment on industry as a group or as individuals. I can tell you that since MMS has been created we have had an audit effort which is beyond what would normally be reported from industry that has brought in about $1.5 billion. Last year we collected over $200 million through those efforts. We collected additional revenues from our exception processing that I described where we compare royalty data to production data. I just think as the stewards of the government's land and collecting for their resources, we are obligated to do some spot checking to make sure that we are getting the moneys that we should be. And right now we don't always get that in the first instance.

Mr. CALVERT. So it is your testimony, then, that the complex system that is in existence, in fact, works better and that a simplified system would allow revenues to decrease and that this type of system is a prudent system and should be continued?

Ms. QUARTERMAN. I think the system is prudent. I think it requires many changes. I don't think the changes that H.R. 1975 suggests are appropriate ones. I think a simplified system is a great idea.

Mr. CALVERT. What about your Secretary of Interior on moving it back to the States? Do you think the States are capable of collecting the royalties or do you think that they are not as competent as the Federal Government in doing such a task?

Ms. QUARTERMAN. I am certain they are as competent. All of the folks who work for us live in the States.

Mr. CALVERT. So you wouldn't disagree that, maybe, the States should take over the responsibility?

Ms. QUARTERMAN. I think the proposal that Wyoming put forward should be studied to determine whether or not those savings can be achieved. I think we should go forward in trying to simplify the royalty collection program so that the payor handbook that you have in front of you there does not exist into the future to the same extent that it does today.

Mr. CALVERT. Mr. Graves, in the context of H.R. 1975, would you address what is needed to prevent the premature abandonment of marginal and stripper wells through regulatory relief? Do you believe that the reporting relief provided the marginal wells in H.R. 1975 can keep marginal wells producing?

Mr. GRAVES. Mr. Chairman, anything that will reduce the cost of operating will prolong the life of marginal wells that we currently have on Federal lands. And I have got to believe that the steps outlined in this legislation will serve to reduce the operating costs on small, independent operators who by and large operate the vast majority of marginal wells that are out there, that if given the opportunity will produce for a number of years. In my written testi-

mony I indicated that in the State of Oklahoma over 60 percent of all the oil that we have ever discovered is still in the ground and will be accessible over time, given advances in technology and hopefully reasonable price signals to allow us to extract it. But every time we plug and abandon a marginal property, even though it may be making a barrel and a half or two barrels a day, operators are not going to spend $50,000 or $100,000 to reopen that well to go get something that may make five or six barrels with new technology. If we can keep the wells up and operating, over time we will become much more efficient and we will extract in a much more efficient manner the abundant natural resources that are still underlying State, Federal and privately held lands. And I believe strongly that when we can free up dollars, the limited dollars operators have, instead of paying bookkeepers and accountants to file paperwork, much like we did when we finally repealed the windfall profit tax, when there were five, six, seven years when operators had to spend hundreds of thousands of dollars filling out forms with zeros on it and the IRS had to spend millions of dollars employing people to calculate forms with zeros on them. We finally recognized the fallacy of that and repealed it. These kinds of revisions and a critical analysis of how we do our job will yield, I think, positive economic results.

Mr. CALVERT. So you believe, Mr. Graves, then, that simplifying the system would keep marginal wells in operation and then they would be paying royalties and so the Federal Government would have increased royalties?

Mr. GRAVES. Much longer. Instead of plugging a well today and not having any royalty income next year, you are likely to have a well that will produce for five or ten years and yield a much longer revenue stream to the Federal Government. It is a question of short-term versus long-term outlook, quite frankly.

Mr. CALVERT. So, if in fact, the States were given the responsibility to collect royalties, do you believe that the States would want to simplify the system and do you believe it is in the interest of the State to collect one dollar less in royalties?

Mr. GRAVES. Well, the States in our experience, have simplified the process for the way we handle royalties on State lands. And we have recognized the operational realities of the industry and we have tried to work closely with operators. One of the suggestions we have is we don't have an estimated payment mechanism in Oklahoma in terms of natural gas. We accept payments on actual amounts received, and then you don't get into the whole problem of did you overestimate or underestimate and all the resulting assessments and penalties that may come from that. And clearly, a more direct approach yields a more efficient economic result.

Mr. CALVERT. Well, I thank you both for your testimony, and again I apologize for the delay today, but it is hectic around here at this time of year. So thank you very much and we will ask our second panel to come up.

The four industry witnesses are testifying on behalf of the American Association of Professional Landmen, the American Petroleum Institute, the Domestic Petroleum Council, the Independent Petroleum Association of America, the Independent Petroleum Association of Mountain States, Mid-Continent Oil and Gas Association,

National Ocean Industries Association, Natural Gas Supply Association and Rocky Mountain Oil and Gas Association. Good afternoon. I am grateful it is not evening, but sorry for the delay. First let me introduce all four representatives: Mr. Nichols, President of Devon Energy Corporation; Ms. Cookie Nitz, OXY USA; Mr. J.B. Rollins, Accounting Coordinator for Chevron USA Production and Mr. Thomas Dugan, President of Dugan Production Corporation. First Mr. Larry Nichols.

**STATEMENT OF MR. LARRY NICHOLS, PRESIDENT, DEVON ENERGY CORPORATION**

Mr. NICHOLS. Thank you, Mr. Chairman. My name is Larry Nichols. I am president of the Domestic Petroleum Council and chairman of the Public Lands Committee of the Independent Petroleum Association of America. The organizations for whom I and the other industry panelists speak today represent virtually all of the domestic oil and gas industry. Collectively the members of our organization pay anywhere between 3–1/2 and 4 billion dollars a year to the Federal Government in royalties. These associations, which again represent all of the industry, are unanimous and unqualified in their support for your proposed testimony. We wish to commend you for authoring this bill. It has been 13 years since Congress last reviewed the laws that govern royalty collection and it is long overdue for them to be reviewed.

At the outset, let me emphasize that this bill is royalty neutral. It does not change by one penny the amount of royalty that Federal agencies will collect from the industry. What it does attempt to change is the process. It seeks to make the process simpler and more efficient. It seeks to make it fairer, more predictable and more cost effective both from the industry standpoint and from the government standpoint. Since the bill was circulated, the MMS has put forth several initiatives to go part way in readdressing some of these problems.

Unfortunately, many of the reforms that we seek can only be solved by legislation, such as the statute of limitations. An administratively imposed statute of limitations, particularly when it merely addresses audit guidelines, does not provide anyone with a certainty that are typically associated with a statute of limitations. While there are statutes of limitation governing the mineral management service, the curious way in which they were written has allowed the MMS to persuade the courts to agree that the MMS can go back literally forever in assessing stale claims. Listen to the language of a judge here in the District of Columbia, a Federal judge, just last month who while ruling for the MMS stated, "Although there is a sound underpinning for each conclusion of law, the outcome when considered in toto may seem anomalous, especially if extended beyond the context of FOGRMA (the statute that governs Federal royalties). Executive departments can engage in a timeless quest to enforce claims back to the founding of the Republic. The government will not be hobbled with a statutory limit as long as it files in court within a year of the final agency action regardless of when the administrative process is launched. It is possible to question the wisdom of Congress, but the court, proclaimed Justice Cardozo, does not 'pause to consider whether a statute dif-

ferently conceived and framed would yield results more consonant with fairness and reason'."

That sounds like an invitation to Congress to fix what at least that court viewed as a statute of limitation that was not consonant with fairness and reason. Statutes of limitation are not simple technicalities. This Congress has provided statute of limitations for numerous agencies. The Internal Revenue Service, for example, lives with a three-year statute of limitation. It is difficult to see why the MMS cannot live with a six-year statute of limitations. A statute of limitations encourages the prompt collection of money. It is an incentive for the MMS to go out and collect funds as they become due. It is costly both for the MMS and the government to try and collect stale claims as it is now doing, claims that go back 15 and 18 years. The records, the memories of people are all difficult to find and to locate.

The States are also in agreement with this principle. Senator Nichols over in the Senate introduced Senate Bill S. 451, which has a similar provision. At a recent meeting the Interstate Oil and Gas Compact Commission, which has representatives for the governors of all of the producing oil and gas States, passed a resolution dated June 13, 1995, urging Congress, "to conduct immediate hearings on this vital legislation and move the principles embodied in this legislation to the floor of each House for consideration before the end of the year". The governors of the member States of the IOGC have requested Congress to do exactly what your bill is doing, Chairman.

Just as there is a need to provide finality through a statute of limitations, there is a need to eliminate the endless delays that can exist in administrative appeals. There are currently over 1,000 appeals pending before MMS amounting to over $226 million, almost a quarter of a billion dollars, that are sitting at the MMS. The agency itself has repeatedly recognized that its own process needs streamlining and its decisionmaking takes far too long. Many of those appeals have been sitting there for years and years and years with no action. If the MMS believes that the Government is fairly entitled to the money, then decide so. If it believes that it is not, then decide so, but decide one way or another and not let those appeals sit there forever. It is not fair to the taxpayers of the country or to the agencies.

On a related matter, both the indefinite statute of limitations and the endless appeals require industry to maintain records forever. Your bill would tie record retention requirements to a new statute of limitations that would be meaningful as well as a timely requirement for appeals.

One of the important provisions in here is that the statute of limitations is reciprocal. Just as the government can only go back six years to try and claim more money, industry can only go back six years to try and claim refunds. So there is reciprocity there. There is fairness there. The same thing is true for the right to interest. A lot of this interest is caused because the government tries and does collect money before the industry has information so that it can accurately and timely file for its royalties. As a consequence, because we make estimated payments all the time, we occasionally make overpayments and occasionally make underpayments. Under

the existing rules we do not collect interest on the overpayments, even though the government does collect interest on our underpayments, a clear lack of reciprocity that this legislation would fix.

One other important thing to remember on the effective data is that this is not retroactive. We are not trying to deprive the government of the right to go back and collect stale appeals as it is now doing, because that would have an adverse impact on the financial situation of the Government, but at least going forward. Surely it is fair that going forward the Government, the MMS can organize itself to have timely assertions of its claims.

In summary, we would like to thank you for sponsoring this legislation. We think it is a well-deserved step in the right direction of providing efficiency in an agency that needs it. Thank you.

[The prepared statement of Mr. Larry Nichols can be found at the end of the hearing.]

Mr. CALVERT. Thank you. Ms. Cookie Nitz, is that how you pronounce that?

Ms. NITZ. Yes. We have to get our visual aids.

Mr. CALVERT. OK. I wore my contacts this morning, so——

Ms. NITZ. Holler when.

Mr. CALVERT. Anytime.

Ms. NITZ. Can you hear me?

Mr. CALVERT. Yes.

**STATEMENT OF MS. COOKIE NITZ, OXY USA, INC.; ACCOMPANIED BY MS. PATTY PATTEN, CORPORATE COUNSEL, OXY USA, INC.**

Ms. NITZ. My name is Cookie Nitz. I am with OXY USA in Tulsa, Oklahoma. I have been responsible for payments and compliance of Federal royalties since 1973. Joining me is Patty Patten, Corporate Counsel, OXY. Patty has been responsible for legal issues on Federal leases since 1985. We wish to offer three examples that demonstrate the need for cost effective, fair and simple reporting.

The first example is a late royalty payment interest invoice I analyzed last year. The invoice is representative of invoices we receive every month. The invoice is billing $21,000, has 112 pages and 1,117 lines of data. We get these every month. The analysis that I did showed that 795 lines were 99 cents or less, totaling $132. I sent the analysis and a letter to MMS that clearly expressed my frustration and provided recommendations to eliminate this type of administrative waste.

Ms. NITZ. The MMS did not respond to my letter, by the way. The second example has to do with offsetting royalties. OXY paid all of its royalties on lease A, $972,000. The MMS advised that we should have paid half on lease A and half on lease B. When we did the adjustment and MMS received the report, they invoiced OXY for $110,000 in interest on lease B. Then six years later they disallowed the recoupment on lease A and ordered us to repay $486,000 because we hadn't filed a refund request.

Ms. PATTEN. And so in this case, even though we had paid 100 percent of the royalty, we had paid a total of $486,000 because we reported on the wrong lease number. We resulted in getting a bill for $596,000 as a penalty, and had we paid the additional $486,000 we would have owed interest because it was a late payment of our

failure to recoup under Section 10 for a total of $1 million in penal interest because we neglected to put the right lease number. Again, the government was made whole. They never lost any kind of value of the money. They had the 100 percent royalty and they wanted an additional bill for $1 million.

And this is an example of Section 4, the offset provision. If we could simply offset debts or if we had received interest on our overpayment, this would have resulted in a zero. It is not that we want to get out of paying interest for a late payment. This simply was something that never should have happened. It was just an accidental reporting error.

Ms. NITZ. The third example are unauthorized recoupment billings MMS sent to OXY, six of them totaling $461,000. Their letter stated that there was no evidence in their records that we had prior approval before we took recoupments. MMS was challenging over 100 of our recoupments that were four to six years old. I had to go back into our records, copy all the refund requests, the backup detail and the MMS approvals and send all that back to them before they would credit the bills.

Ms. PATTEN. If this had been beyond a six-year limitation where we would have destroyed the records and they had sent this letter and stated there was no evidence in their records, we would had to have paid not only this $461,000, because we would have no evidence to refute it, but again the late payment. We would have owed an additional $461,000. This is about $1 million simply because they neglected to look in their own files and determine that we had properly complied with regulations.

Ms. NITZ. We have just demonstrated over $1 million of OXY's money that the MMS has either held or claimed. My question is what do the over 1,700 payors that are smaller than OXY, they don't have our resources, they don't have our experience, how do they stay solvent on Federal leases? OXY only represents one percent of the Federal royalties. We have four people who work on payment reporting full time.

Ms. PATTEN. And if you multiply that one percent by 100 times, which would be representative of the entire payor calculation of Federal royalties, and realize that these are just a very few examples we could have presented—we could have gone on for eight hours on these. And if you multiply that by our examples times 100 you have an idea why industry is so much behind your bill on this and why every major trade association producer we have talked to encourages and supports this bill. It is long overdue and we very much appreciate the opportunity to testify.

[The joint prepared statement of Ms. Cookie Nitz and Ms. Patricia Patten can be found at the end of the hearing.]

Mr. CALVERT. Thank you very much. Thank you for your testimony. Mr. J.B. Rollins, Accounting Coordinator for Chevron.

## STATEMENT OF J.B. ROLLINS, ACCOUNTING COORDINATOR, CHEVRON USA PRODUCTION COMPANY

Mr. ROLLINS. Good afternoon, Mr. Chairman. My name is Joel Rollins and I am Accounting Coordinator for Chevron USA Production Company. I appreciate the opportunity to offer testimony to

this subcommittee. I will be focusing my comments today on the accounting and simplification implications of H.R. 1975.

Incorporation of these simplification ideas and suggestions achieve administrative efficiency and simplicity without compromising the royalty paid to the Federal Government or MMS's tools to collect those revenues. Let us be very clear on this point, H.R. 1975 does not reduce the amount of royalties to be paid to the Federal Government. What we are talking about is how best to collect, report and pay those amounts due in an efficient, timely and cost-effective manner. Without this bill we are left with the current inflexible and costly system.

I would like to now highlight some of the accounting savings H.R. 1975 would immediately effectuate. For example, the bill eliminates costly, unnecessary and redundant data by eliminating the transportation and processing allowance forms. If I may, Mr. Chairman, I would like to demonstrate what I am talking about. H.R. 1975 would eliminate the Gas Processing Allowance form. As well, it would eliminate Schedule 1, Gas Product Allowance Computation Sheet; Schedule 2, Non-Arm's-Length Processing Facilities; Schedule 2A, Non-Arm's-Length Processing Facilities; Supplemental Schedule 2A, Non-Arm's-Length Processing Facilities; and Schedule 2B, Non-Arm's-Length Processing Facilities. Also, it would eliminate the Oil Transportation Allowance Report, as well the Associated Schedule 1, Oil Transportation Facility Summary Sheet; Schedule 1A, Non-Arm's-Length Transportation System; Supplemental Schedule 1A, Non-Arm's-Length Transportation System; Schedule 1B, Non-Arm's Length Transportation System. As well, it would eliminate the Gas Transportation Allowance Report along with Schedule 1, Gas Transportation Facility Summary; Schedule 1A, Non-Arm's-Length Transportation System; Supplemental Schedule 1A, Non-Arm's Length Transportation System; Schedule 1B, Non-Arm's-Length Transportation System; and last, Schedule 1C, Allowance for Non-Arm's-Length Transportation.

Elimination of this redundant and unnecessary information would eliminate the filing of over 5 million data elements by industry to the MMS every year. As well it will eliminate the filing of over 6,600 of these forms, which equates to over 91,000 individual line items. And I might add, on many of these forms, in many cases, we are required to take the exact same data element and place it on the same form as many as six different times.

H.R. 1975, Mr. Chairman, greatly streamlines one of the key reports filed to the MMS, the Report of Sales and Royalty Remittance, by eliminating unnecessary information that is contained on this report. Elimination of this unnecessary information will eliminate the reporting of over 13–1/2 million data elements filed to the MMS every year. H.R. 1975 also greatly streamlines the manner and way in which we are to report retroactive adjustments. This will eliminate an additional 11 million data elements filed to the MMS every year as well as over 700,000 individual line items.

Now I ask you to consider, Mr. Chairman, the savings not only to industry that can be achieved by the passage of H.R. 1975, but also to the Federal Government by not having to input, file, maintain, compile, store, audit or review in excess of 30 million data elements every year.

I would also like to illustrate these savings in a different way, if I may, sir. Before you I have the three volumes of MMS-developed manuals that report how we are to pay Federal royalties which you have before you. As well, I have the manuals that interpret these manuals. Passage of H.R. 1975 would immediately eliminate one and a half of these manuals and one and a half of the manuals that interpret the manuals. This is more simple, Mr. Chairman.

These are just a few examples of the immediate savings that would be achieved with the passage of H.R. 1975. Additionally, the bill institutionalizes the concepts used in business every day that keep a lid on costs by implementing the use of thresholds. This recognizes the costs expended pursuing small dollar claims. In other words, the Federal Government would not use dollars to collect dimes. As well, this provides much needed relief for marginally economic production for small producers. In short, Mr. Chairman, thousands of work hours and corresponding dollars for both the Federal Government and industry will be saved with the passage of H.R. 1975 while not reducing the royalties paid to the Federal Government by a single dollar.

Thank you, Mr. Chairman and all the co-sponsors, for your support of this bill and for the opportunity to speak before you today. I will be pleased to answer any questions you may have.

[The prepared statement of Mr. J.B. Rollins can be found at the end of the hearing.]

Mr. CALVERT. Thank you, Mr. Rollins. Mr. Dugan.

## STATEMENT OF MR. THOMAS DUGAN, PRESIDENT, DUGAN PRODUCTION CORPORATION

Mr. DUGAN. Good afternoon. My name is Tom Dugan. I am from Farmington, New Mexico, and I am the President of Dugan Production Corporation. We are a small, independent, mom and pop oil company that we operate on about 450 Federal leases and we have about 40 additional undeveloped leases. We have been in the San Juan Basin 42 years and been an independent for 36 years.

I want to discuss some of the problems associated with current regulations and practices of the Mineral Management Service. Mineral Management Service's regulate for royalty reporting regulations are cumbersome and difficult to comply with, especially with the rapidly changing gas market. Many small producers such as myself spend a tremendous amount of time and effort devising ways to reduce costs, maximize profit and extend the life of leases to benefit all interested parties. We should be commended by the MMS for these efforts instead of constantly being overburdened with unnecessary reporting requirements, excessive auditing procedures and unfair penalties. The bottom line is that the MMS lacks reasonableness and basic common sense.

Some of the examples that I have, in January of 1992 I got a bill from the MMS for $7,650 and almost fell out of my chair when I got that bill. And we had to figure out what was wrong, and it was the report for October was filed through Federal Express and it was supposed to have been there on the night of Halloween, which was October 31. And Denver had an unusual snowstorm and Federal Express was not able to deliver the package until 10 o'clock

the next day. So because we had so many lines, we were fined $10 per line for late reporting. We talked to MMS about this and told them we thought it was unfair, but they said well, the regulations are regulations, you have got to pay the bill. So of course we paid the bill and then appealed it and that went on for quite some time.

Finally we got Senator Domenici to help us, and through the Secretary of the Interior the bill was finally rescinded. We found out that we weren't the only one. There were around 100 companies that do the same thing, send their reports in by Federal Express, so it was really a bad thing to happen to us and it took lot of work and effort on our part and other people's part to get it corrected.

Another problem we had was that we were selling gas to Bannon Energy through a compressor and gasoline plant, and they had failed to pay for some condensate that they had separated out and then paid us later and then we calculated the royalty that was due on this. Of course, this was no fault of ours because as soon as we found out about it, why, we calculated and paid our royalty, but because it was late, we got a penalty for $9,200 for a late filing. There again, that is $10 a line. Our penalty was $9,200 and the royalty we paid was $319.63. So they had to get the smelling salts out for me when that bill came in. Finally, after a lot of discussion about it, we did get that rescinded.

We also were audited back in 1992 for the period 1985 through 1990 and the only thing they came up with was that we should have paid royalty on a higher price than we actually received, so, according to the MMS, owed $80,000. So we, of course, had to put up a letter of credit to cover that $80,000 and then we appealed that and it has been laying dormant since 1992. It never has been settled. MMS never has answered our appeal.

We are again being audited by the MMS for a later period and the auditor is out of Oklahoma City. And we are having to xerox all of our information and send it to him, and that is really a burdensome task. We also are being audited by the Bureau of Land Management on individual wells, so we spend a lot of our time just answering audits.

That is just a few of the problems that we have had in trying to live with the rulings of the MMS. And we sure do need to simplify it in some way and we thank you very much for allowing us to be here.

[The prepared statement of Mr. Thomas Dugan can be found at the end of the hearing.]

Mr. CALVERT. Thank you, Mr. Dugan. I guess you are using UPS nowadays. I think this question is for the entire panel—we have heard a lot of allegations from the Department of Interior about the intent and the impact of my legislation, H.R. 1975. Given that this is a legislative hearing, we will have a markup later. I want to give you and the panel representing all of the oil and gas companies, large and small, that came here today time to comment on some of those allegations. Let us start with the first one I think I heard was, "This bill is royalty unfairness." How do you respond to that? Any of you can respond.

Mr. NICHOLS. Well, let me take a stab at that one. I think we have given examples here that you heard about the unfairness that we perceive in the way that the system works. As we said at the

outset, this only changes the process. It has no impact on the royalties that are due. The MMS studies themselves show that there is a lot of their own system that they acknowledge needs fixing. And I think a lot of the provisions in this bill will fix it. If the MMS comes up with any specific things that need addressing in this bill, the industry, I am sure, would be most interested in sitting down and talking. However, what I heard today from the Director's testimony was absolutely no, we are opposed to anything and everything in this legislation. That is disappointing.

Mr. CALVERT. Anyone else? I heard that the bill will cause a loss of revenue because companies are possibly dishonest and you will game the system by intentionally underpaying royalties and waiting years to pay royalty revenues. How would you respond to something like that?

Ms. PATTEN. Well, I have to say that Cookie and I took that a little personally, because as you can see by the size of the volumes of these manuals, my management couldn't begin to figure out how to game the system unless Cookie and I sat down with them and told them how to do it. We have looked at this bill and we don't know how we would game the system with it because all we are trying to do is effectuate fairness. The concept that we would delay receiving revenues for six years, I think for OXY that is something like $300 million. We would have shareholder derivative suits. I would probably get fired on the spot if I went into my management and suggested anything like that. Basically this whole area is so complex all we try to do is pay fairly and properly the first time. That is all we are trying to do. The examples we have given today are examples that I don't think anyone would agree that we owe the additional interest or revenues that they are attempting to collect. And that is what we are trying to achieve. The notion that we sit around and try to figure out ways to manipulate the system and overpay royalties to get a whopping five percent based upon the bill's current treasury value of funds rate, first of all, we are in the business to drill oil and gas wells and explore and produce. We are not into financial paper, and if we were into financial paper I think I could find a better investment than five percent.

Ms. NITZ. Amen.

Mr. NICHOLS. Some of the comments in the testimony were directed to the statute of limitations with the implication that you would sell gas in one month and then delay your collection of cash for over six years. Any company that would do that would go bankrupt, and it is pure and simple. No business could produce a product and not collect your cash for six years. You would simply go bankrupt in the process. Furthermore, the way their system works is that obligation to pay is triggered by the month you produce the gas. As it is now, we already pay the MMS before we collect the cash, so whether we actually collect the cash six days, six weeks, six months, six years, whenever, after the production, there is no opportunity to game the system there even if there were a way to do that because the obligation to pay is triggered by the production of the money. And there is no way that you could game that system and collect money just after the six years. Their own system prevents that.

Furthermore, your bill, Mr. Chairman, has a provision in there that says anyone who gains in fraud or deceit, that they can go after, and clearly that would be fraud or deceit and we would welcome the MMS going after any bad actor like that.

Mr. CALVERT. I was going to bring that up. There is apparently some question on the part of MMS that the records need to be kept beyond six years. I am curious, as the industry, you must have warehouses full of material. I suspect especially the larger companies, but all of you. Do you just lease warehouses and store this stuff?

Mr. NICHOLS. We do.

Ms. PATTEN. We do.

Mr. NICHOLS. We do have warehouses full, and your comment at the opening is right, the warehouse business may suffer if this bill passes. And the problem is particularly acute when you recognize the turnover that has existed within the industry. There were 400 publicly traded companies in 1982. Of those 400 public companies in 1982, only 117 still exist. A lot of those companies have been merged or traded or gone out of business, and so the records for those companies would be particularly difficult to find and locate.

Mr. CALVERT. Mrs. Cubin, would you like to ask a couple of questions?

Mrs. CUBIN. Yes, I would. Thank you, Mr. Chairman. Although I was not here to listen to your testimony, I did have a chance to look at your remarks and I appreciate that. There may be staff here from the MMS, I don't know, but it never ceases to amaze me that they don't hang around to listen to legitimate complaints, legitimate concerns that people bring in front of them. And that always bothers me. I will ask them to stay the next time.

I did want to ask a couple things. We have been so busy today it is terrible. Let me ask this of Ms. Patten. Can you give me an example of how long it takes MMS to get rid of a form or change a form and do you know what the costs associated with that are? Is it just pretty ridiculous?

Ms. PATTEN. I don't know of any form they have ever gotten rid of. I just know that when they discussed earlier about changing regulations, which I think you could probably equate to getting rid of a form because one usually is implemented pursuant to a regulation, I have regulations—when I was Chairman of the Subcommittee on Exploration and Production Law in 1990 we were structuring our meetings around the imminent release of a regulation in reporting to entitlements accounting on production from Federal units, a pretty complex issue. We rescheduled that meeting five times in 1990 due to the imminent release. It had been a problem since 1988. It is now 1995 and there is still no regulation.

There was an affiliated valuation issue, when you sell to an affiliated company how do you value that production, recognized in 1988, yes, that is a problem. There was a lawsuit. MMS said don't worry, we are going to fix it, we have a regulation forthcoming. It is 1995, no regulation.

The offsetting that they discussed that they made some minor changes in under Section 10 was the subject of an industry effort in 1987 to get changes in. They finished a very minor revision in a regulation in 1994.

My experience in the ten years I have been doing this is it seems to approximate seven or eight years, to do any of these things because you go through changes in directors, and no matter how well intentioned any individual director may be, they are here today and they are gone tomorrow and the education process starts anew. Each one has different agendas. This one may think this form is unnecessary. This one may think it is the most important form in the world. You have different Secretaries of the Interior. I mean, all we want to do is we just want to know what the rules are and we want them to be simple. And we want to pay, but this chaotic state of uncertainty that, in the ten years I have been doing this, that gives you absolutely no ability to advise your management on what the risk is, and as Mr. Nichols said, you hang onto every piece of paper you have.

Mrs. CUBIN. Ms. Quarterman stated that, I think, yesterday or the day before yesterday she issued a policy saying that these things needed to be completed in—the statute of limitations would be six years, essentially. I wondered if that was coincidental with this hearing for one thing, but additionally I was on the committee that helped codify or recodify, I should say, all the minerals valuation and taxation laws for the State of Wyoming, and I couldn't imagine that she believed that her policy letter would be superior to a statute stating a statute of limitations. And I just open that up to anyone or all of you and ask you what your opinion is on your preference.

Mr. NICHOLS. Well, we agree with that. What the Director has proposed is an audit policy so that for matters of internal audit policy the MMS as a general rule will not go back more than six years. That is not a statute of limitations at all. It is merely an internal audit policy. It might become an internal audit policy which could be changed any time any director of the MMS wanted to change it. It is merely policy that they can make exceptions to whenever they want. It is not a statute of limitations, and because it is not a statute that is binding upon anyone, then the need to retain records goes on ad infinitum.

Ms. PATTEN. And no matter how well intentioned the policy, if you rely on it and they have no authority under law to engage in that policy—we had a situation in 1987 where Senator Nichols had to introduce the NTL–5 Natural Gas Royalty Act as legislation, which passed immensely near, to retroactively collect unfavorable to industry. I mean, it provided that you pay royalty on the price of gas you received when NTL–5 said that you pay on the highest ceiling price. Well, that wasn't fair and the MMS said it is our policy, you pay on the price of gas you receive from an arm's-length purchase and everyone said great, that is reasonable, that is right. So subsequently the States and Indian auditors said well, you can't do that, you can't by policy change this regulation, you can't do this, you have no authority. So we went through an entire year to get legislation through to correct the policy that favored this. No matter how favorable the policy may be, it is absolutely no guarantee whatsoever that the same thing won't happen again.

Mrs. CUBIN. Thank you all very much. Thank you for coming here to testify for us also. I have nothing further, Mr. Chairman.

Mr. CALVERT. Thank you. I would like to thank the witnesses for attending today and I apologize once again for the delays, but there are lots of things going on, so I appreciate your coming out and God bless. This meeting is adjourned.

[Whereupon, at 4:55 p.m., the subcommittee was adjourned, and the following was submitted for the record:]

104TH CONGRESS
1ST SESSION

# H. R. 1975

To improve the management of royalties from Federal and Outer Continental Shelf oil and gas leases, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

JUNE 30, 1995

Mr. CALVERT (for himself, Mr. BREWSTER, Mr. DOOLEY, Mr. TAUZIN, and Mr. LUCAS) introduced the following bill; which was referred to the Committee on Resources

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# A BILL

To improve the management of royalties from Federal and Outer Continental Shelf oil and gas leases, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

(a) SHORT TITLE.—This Act may be cited as "The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

**SEC. 2. DEFINITIONS.**

Section 3 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1701 et seq.) is amended as follows:

(1) In paragraph (5), by inserting "(including any unit agreement and communitization agreement)" after "agreement".

(2) By amending paragraph (7) to read as follows:

"(7) 'lessee' means any person to whom the United States issues a lease.".

(3) By striking "and" at the end of paragraph (15), by striking the period at the end of paragraph (16) and inserting "; and"; and by adding at the end the following:

"(17) 'administrative proceeding' means any agency process for rulemaking, adjudication or licensing, as defined in and governed by chapter 5 of title 5, United States Code (relating to administrative procedures);

"(18) 'assessment' means any fee or charge levied or imposed by the Secretary or the United States other than—

"(A) the principal amount of any royalty, minimum royalty, rental, bonus, net profit share or proceed of sale;

"(B) any interest; and

"(C) any civil or criminal penalty;

"(19) 'commence' means—

"(A) with respect to a judicial proceeding, the service of a complaint, petition, counterclaim, cross-claim, or other pleading seeking affirmative relief or seeking offset or recoupment;

"(B) with respect to an administrative proceeding—

"(i) the receipt by a lessee of an order to pay issued by the Secretary, or

"(ii) the receipt by the Secretary of a written request or demand by a lessee, or any person acting on behalf of a lessee which asserts an obligation due the lessee;

"(20) 'credit' means the method by which an overpayment is utilized to discharge, cancel, reduce or offset an obligation in whole or in part;

"(21) 'obligation' means a duty of the Secretary, the United States, or a lessee—

"(A) to deliver or take oil or gas in kind; or

"(B) to pay, refund, credit or offset monies, including (but not limited to) a duty to calculate, determine, report, pay, refund, credit or offset—

"(i) the principal amount of any royalty, minimum royalty, rental, bonus, net profit share or proceed of sale;

"(ii) any interest;

"(iii) any penalty; or

"(iv) any assessment,

which arises from or relates to any lease administered by the Secretary for, or any mineral leasing law related to, the exploration, production and development of oil or gas on Federal lands or the Outer Continental Shelf;

"(22) 'offset' means the act of applying an overpayment (in whole or in part) against an obligation which has become due to discharge, cancel or reduce the obligation;

"(23) 'order to pay' means a written order issued by the Secretary or the United States which—

"(A) asserts a definite and quantified obligation due the Secretary or the United States; and

"(B) specifically identifies the obligation by lease, production month and amount of such obligation ordered to be paid, as well as the reason or reasons such obligation is claimed to be due,

but such term does not include any other communication by or on behalf of the Secretary or the United States;

"(24) 'overpayment' means any payment (including any estimated royalty payment) by a lessee or by any person acting on behalf of a lessee in excess of an amount legally required to be paid on an obligation;

"(25) 'payment' means satisfaction, in whole or in part, of an obligation due the Secretary or the United States;

"(26) 'penalty' means a statutorily authorized civil fine levied or imposed by the Secretary or the United States for a violation of this Act, a mineral leasing law, or a term or provision of a lease administered by the Secretary;

"(27) 'refund' means the return of an overpayment by the Secretary or the United States by the drawing of funds from the United States Treasury;

"(28) 'underpayment' means any payment by a lessee or person acting on behalf of a lessee that is less than the amount legally required to be paid on an obligation; and

"(29) 'United States' means—

"(A) the United States Government and any department, agency, or instrumentality thereof, and

"(B) when such term is used in a geographic sense, includes the several States, the District of Columbia, Puerto Rico, and the territories and possessions of the United States.".

**SEC. 3. LIMITATION PERIODS.**

(a) IN GENERAL.—The Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1701 et seq.) is amended by adding after section 114 the following new section:

**"SEC. 115. LIMITATION PERIODS.**

"(a) IN GENERAL.—

"(1) SIX-YEAR PERIOD.—A judicial or administrative proceeding which arises from, or relates to, an obligation may not be commenced unless such

proceeding is commenced within 6 years from the date on which such obligation becomes due.

"(2) LIMIT ON TOLLING OF LIMITATION PERIOD.—The running of the limitation period under paragraph (1) shall not be suspended or tolled by any action of the United States or an officer or agency thereof other than the commencement of a judicial or administrative proceeding under paragraph (1) or an agreement under paragraph (3).

"(3) FRAUD OR CONCEALMENT.—For the purpose of computing the limitation period under paragraph (1), there shall be excluded therefrom any period during which there has been fraud or concealment by a lessee in an attempt to defeat or evade payment of any such obligation.

"(4) REASONABLE PERIOD FOR PROVIDING INFORMATION.—In seeking information on which to base an order to pay, the Secretary shall afford the lessee or person acting on behalf of the lessee a reasonable period in which to provide such information before the end of the period under paragraph (1).

"(b) FINAL AGENCY ACTION.—The Director of the Minerals Management Service shall issue a final Director's decision in any administrative proceeding before the Director within one year from the date such proceeding was

commenced. The Secretary shall issue a final agency decision in any administrative proceeding within 3 years from the date such proceeding was commenced. If no such decision has been issued by the Director or Secretary within the prescribed time periods referred to above:

"(1) the Director's or Secretary's decision, as the case may be, shall be deemed issued and granted in favor of the lessee or lessees as to any nonmonetary obligation and any obligation the principal amount of which is less than $2,500; and

"(2) in the case of a monetary obligation the principal amount of which is $2,500 or more, the Director's or Secretary's decision, as the case may be, shall be deemed issued and final, and the lessee shall have a right of de novo judicial review and appeal of such final agency action.

"(c) TOLLING BY AGREEMENT.—Prior to the expiration of any period of limitation under subsections (a) or (c), the Secretary and a lessee may consent in writing to extend such period as it relates to any obligation under the mineral leasing laws. The period so agreed upon may be extended by subsequent agreement or agreements in writing made before the expiration of the period previously agreed upon.

"(d) LIMITATION ON CERTAIN ACTIONS BY THE UNITED STATES.—When an action on or enforcement of an obligation under the mineral leasing laws is barred under subsection (a) or (b), the United States or an officer or agency thereof may not take any other or further action regarding that obligation including (but not limited to) the issuance of any order, request, demand or other communication seeking any document, accounting, determination, calculation, recalculation, principal, interest, assessment, penalty or the initiation, pursuit or completion of an audit.

"(e) OBLIGATION BECOMES DUE.—

"(1) IN GENERAL.—For purposes of subsection (a), an obligation becomes due when the right to enforce the obligation is fixed.

"(2) SPECIAL RULE REGARDING ROYALTY OBLIGATION.—The right to enforce any royalty obligation is fixed for the purposes of this Act on the last day of the calendar month following the month in which oil or gas is produced, except that with respect to any such royalty obligation which is altered by a retroactive redetermination of working interest ownership pursuant to a unit or communitization agreement, the right to enforce such royalty obligation in such amended unit or communitization agreement is fixed for the purposes of this Act on the last day of

the calendar month in which such redetermination is made. The Secretary shall issue any such redetermination within 180 days of receipt of a request for redetermination.

"(f) JUDICIAL REVIEW OF ADMINISTRATIVE PROCEEDINGS.—In the event an administrative proceeding subject to subsection (a) is timely commenced and thereafter the limitation period in subsection (a) lapses during the pendency of the administrative proceeding, no party to such administrative proceeding shall be barred by this section from commencing a judicial proceeding challenging the final agency action in such administrative proceeding so long as such judicial proceeding is commenced within 90 days from receipt of notice of the final agency action.

"(g) IMPLEMENTATION OF FINAL DECISION.—In the event a judicial or administrative proceeding subject to subsection (a) is timely commenced and thereafter the limitation period in subsection (a) lapses during the pendency of such proceeding, any party to such proceeding shall not be barred from taking such action as is required or necessary to implement the final unappealable judicial or administrative decision, including any action required or necessary to implement such decision by the recovery or recoupment of an underpayment or overpayment by means of refund, credit or offset.

"(h) STAY OF PAYMENT OBLIGATION PENDING REVIEW.—Any party ordered by the Secretary or the United States to pay any obligation (including any interest, assessment or penalty) shall be entitled to a stay of such payment without bond or other surety pending administrative or judicial review unless the Secretary demonstrates that such party is or may become financially insolvent or otherwise unable to pay the obligation, in which case the Secretary may require a bond or other surety satisfactory to cover the obligation.

"(i) INAPPLICABILITY OF THE OTHER STATUTES OF LIMITATION.—The limitations set forth in sections 2401, 2415, 2416, and 2462 of title 28, United States Code, section 42 of the Mineral Leasing Act (30 U.S.C. 226–2), and section 3716 of title 31, United States Code, shall not apply to any obligation to which this Act applies.".

(b) CLERICAL AMENDMENT.—The table of contents in section 1 of such Act (30 U.S.C. 1701) is amended by adding after the item relating to section 114 the following new item:

"Sec. 115. Limitation period.".

**SEC. 4. OVERPAYMENTS: OFFSETS AND REFUNDS.**

(a) IN GENERAL.—The Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1701 et seq.) is amended by adding after section 111 the following new section:

"SEC. 111A. OVERPAYMENTS: OFFSETS AND REFUNDS.

"(a) OFFSETS.—

"(1) MANNER.—For each reporting month, a lessee or person acting on behalf of a lessee shall offset all underpayments and overpayments made for that reporting month for all leases within the same royalty distribution category established under permanent indefinite appropriations.

"(2) OFFSET AGAINST OBLIGATIONS.—The net overpayment resulting within each category from the offsetting described in paragraph (1) may be offset and credited against any obligation for current or subsequent reporting months which have become due on leases within the same royalty distribution category.

"(3) PRIOR APPROVAL NOT REQUIRED.—The offsetting or crediting of any overpayment, in whole or part, shall not require the prior request to or approval by the Secretary.

"(4) EXCLUSION OF CERTAIN UNDER- AND OVERPAYMENTS.—Any underpayment or overpayment upon which an order has been issued which is subject to appeal shall be excluded from the offsetting provisions of this section.

"(b) REFUNDS.—

"(1) IN GENERAL.—A refund request may be made to the Secretary not before one year after the subject reporting month. After such one-year period and when a lessee or a person acting on behalf of a lessee has made a net overpayment to the Secretary or the United States and has offset or credited in accordance with subsection (a), the Secretary shall, upon request, refund to such lessee or person the net overpayment, with accumulated interest thereon determined in accordance with section 111. If for any reason, a lessee or person acting on behalf of a lessee is no longer accruing obligations on any lease within a category, then such lessee or person may immediately file a request for a refund of any net overpayment and accumulated interest.

"(2) REQUEST.—The request for refund is sufficient if it—

"(A) is made in writing to the Secretary;

"(B) identifies the person entitled to such refund;

"(C) provides the Secretary information that reasonably enables the Secretary to identify the overpayment for which such refund is sought.

"(3) TREATMENT AS WRITTEN REQUEST OR DEMAND.—Service of a request for refund shall be a 'written request or demand' sufficient to commence an administrative proceeding.

"(4) PAYMENT BY SECRETARY OF THE TREASURY.—The Secretary shall certify the amount of the refund to be paid under paragraph (1) to the Secretary of the Treasury who is authorized and directed to make such refund.

"(5) PAYMENT PERIOD.—A refund under this subsection shall be paid within 90 days of the date on which the request for refund was received by the Secretary.

"(c) LIMITATION ON OFFSETS AND REFUNDS.—

"(1) LIMITATION PERIOD FOR OFFSETS AND REFUNDS.—Except as provided by paragraph (2), a lessee or person acting on behalf of a lessee may not offset or receive a refund of any overpayment which arises from or relates to an obligation unless such offset or refund request is initiated within six years from the date on which the obligation which is the subject of the overpayment became due.

"(2) EXCEPTION.—(A) For any overpayment the recoupment of which (in whole or in part) by offset or refund, or both, may occur beyond the six-

year limitation period provided in paragraph (1), where the issue of whether an overpayment occurred has not been finally determined, or where recoupment of the overpayment has not been accomplished within said six-year period, the lessee or person acting on behalf of a lessee may preserve its right to recover or recoup the overpayment beyond the limitation period by filing a written notice of the overpayment with the Secretary within the six-year period.

"(B) Notice under subparagraph (A) shall be sufficient if it—

"(i) identifies the person who made such overpayment;

"(ii) asserts the obligation due the lessee or person; and

"(iii) identifies the obligation by lease, production month and amount, as well as the reason or reasons such overpayment is due.

"(d) PROHIBITION AGAINST REDUCTION OF REFUNDS OR OFFSETS.—In no event shall the Secretary directly or indirectly claim any amount or amounts against, or reduce any offset or refund (or interest accrued thereon) by, the amount of any obligation the enforcement of which is barred by section 115.".

(b) CLERICAL AMENDMENT.—The table of contents in section 1 of such Act (30 U.S.C. 1701) is amended by adding after the item relating to section 111 the following new item:

"Sec. 111A. Overpayments: offsets and refunds.".

**SEC. 5. REQUIRED RECORDKEEPING.**

Section 103 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1713(b)) is amended by adding at the end the following:

"(c) Records required by the Secretary for the purpose of determining compliance with an applicable mineral leasing law, lease provision, regulation or order with respect to oil and gas leases from Federal lands or the Outer Continental Shelf shall be maintained for six years after an obligation becomes due unless the Secretary commences a judicial or administrative proceeding with respect to an obligation within the time period prescribed by section 115 in which such records may be relevant. In that event, the Secretary may direct the record holder to maintain such records until the final nonappealable decision in such judicial or administrative proceeding is rendered. Under no circumstance shall a record holder be required to maintain or produce any record covering a time period for which a substantive claim with respect to an obligation to which the record relates would be barred by the applicable statute of limitation in section 115.".

**SEC. 6. ROYALTY INTEREST, PENALTIES, AND PAYMENTS.**

(a) INTEREST CHARGED ON LATE PAYMENTS AND UNDERPAYMENTS.—Section 111(a) of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721(a)) is amended to read as follows:

"(a) In the case of oil and gas leases where royalty payments are not received by the Secretary on the date that such payments are due, or are less than the amount due, the Secretary shall charge interest on a net late payment or underpayment at the rate published by the Department of the Treasury as the Treasury Current Value Of Funds Rate. The Secretary may waive or forego such interest in whole or in part. In the case of a net underpayment for a given reporting month, interest shall be computed and charged only on the amount of the net underpayment and not on the total amount due from the date of the net underpayment. The net underpayment is determined by offsetting in the same manner as required under paragraphs (1) and (2) of section 111A(a). Interest may only be billed by the Secretary for any net underpayment not less than one year following the subject reporting month.".

(b) CHARGE ON LATE PAYMENT MADE BY THE SECRETARY.—Section 111(b) of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721(b)) is amended to read as follows:

"(b) Any payment made by the Secretary to a State under section 35 of the Mineral Leasing Act, and any other payment made by the Secretary which is not paid on the date required under such section 35, shall include an interest charge computed at the rate published by the Department of the Treasury as the Treasury Current Value of Funds Rate. The Secretary shall not be required to pay interest under this paragraph until collected or when such interest has been waived or is otherwise not collected. With respect to any obligation, the Secretary may waive or forgo interest otherwise required under section 3717 of title 31, United States Code.".

(c) PERIOD.—Section 111(f) of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721(f)) is amended to read as follows:

"(f) Unless waived or not collected pursuant to subsections (a)(2) and (b)(2), interest shall be charged under this section only for the number of days a payment is late.".

(d) LESSEE INTEREST.—Section 111 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721) is amended by adding the following after subsection (g):

"(h) If a net overpayment, as determined by offsetting as required under section 111A(1) and (2) for a re-

porting month, interest shall be allowed and paid or credited on such net overpayment, with such interest to accrue from the date such net overpayment was made, at the rate published by the Department of the Treasury as the Treasury Current Value of Funds Rate.".

(e) PAYMENT EXCEPTION FOR MINIMAL PRODUCTION.—Section 111 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721) is amended by adding the following after subsection (h):

"(i) For any well on a lease which produces on average less than 250 thousand cubic feet of gas per day or 25 barrels of oil per day, the royalty on the actual or allocated lease production may be paid—

"(A) for a 12-month period, only based on actual production removed or sold from the lease; and

"(B) 6 months following such period, for additional production allocated to the lease during the period.

No interest shall be allowed or accrued on any underpayment resulting from this payment methodology until the month following the applicable 12-month period.".

**SEC. 7. LIMITATION ON ASSESSMENTS.**

Section 111 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721) is amended by adding the following after subsection (i):

"(j) The Secretary may levy or impose an assessment upon any person not to exceed $250 for any reporting month for the inaccurate reporting of information required under subsection (k). No assessment may be levied or imposed upon any person for any underpayment, late payment, or estimated payment or for any erroneous or incomplete royalty or production related report for information not required by subsection (k) absent a showing of gross negligence or willful misconduct.".

**SEC. 8. COST-EFFECTIVE AUDIT AND COLLECTION REQUIREMENTS.**

Section 101 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1701 et seq.) is amended by adding the following after subsection (c):

"(d)(1) If the Secretary determines that the cost of accounting for and collecting of any obligation due for any oil or gas production exceeds or is likely to exceed the amount of the obligation to be collected, the Secretary shall waive such obligation.

"(2) The Secretary shall develop a lease level reporting and audit strategy which eliminates multiple or redundant reporting of information.

"(3) In carrying out this section, for onshore production from any well which is less than 250 thousand cubic feet of gas per day or 25 barrels of oil per day, or for offshore production for any well less than 1,500,000 cubic feet of gas per day or 150 barrels of oil per day, the Secretary shall only require the lessee to submit the information described in section 111(k). For such onshore and offshore production, the Secretary shall not conduct royalty reporting compliance and enforcement activities, levy or impose assessments described in such section 111(k) and shall not bill for comparisons between royalty reporting and production information. The Secretary may only conduct audits on such leases if the Secretary has reason to believe that the lessee has not complied with payment obligations for at least three months during a twelve month period. The Secretary shall not perform such audit if the Secretary determines that the cost of conducting the audit exceeds or is likely to exceed the additional royalties expected to be received as a result of such audit.".

**SEC. 9. ELIMINATION OF NOTICE REQUIREMENT.**

Section 23(a)(2) of the Outer Continental Shelf Lands Act (43 U.S.C. 1349(a)(2)) is amended to read as follows:

"(2) Except as provided in paragraph (3) of this subsection, no action may be commenced under subsection

(a)(1) of this section if the Attorney General has commenced and is diligently prosecuting a civil action in a court of the United States or a State with respect to such matter, but in any such action in a court of the United States any person having a legal interest which is or may be adversely affected may intervene as a matter of right.".

**SEC. 10. ROYALTY IN KIND.**

(a) IN GENERAL.—Section 27(a)(1) of the Outer Continental Shelf Lands Act (43 U.S.C. 1353(a)(1)) and the first undesignated paragraph of section 36 of the Mineral Leasing Act (30 U.S.C. 192) are each amended by adding at the end the following: "Any royalty or net profit share of oil or gas accruing to the United States under any lease issued or maintained by the Secretary for the exploration, production and development of oil and gas on Federal lands or the Outer Continental Shelf, at the Secretary's option, may be taken in kind at or near the lease upon 90 days prior written notice to the lessee. Once the United States has commenced taking royalty in kind, it shall continue to do so until 90 days after the Secretary has provided written notice to the lessee that it will resume taking royalty in value. Delivery of royalty in kind by the lessee shall satisfy in full the lessee's royalty obligation. Once the oil or gas is delivered in kind, the lessee shall not be subject to the reporting and recordkeeping require-

ments, including requirements under section 103, except for those reports and records necessary to verify the volume of oil or gas produced and delivered prior to or at the point of delivery.".

(b) SALE.—Section 27(c)(1) of the Outer Continental Shelf Lands Act (43 U.S.C. 1353(c)(1)) is amended by striking "competitive bidding for not more than its regulated price, or if no regulated price applies, not less than its fair market value" and inserting "competitive bidding or private sale".

**SEC. 11. TIME, MANNER, AND INFORMATION REQUIREMENTS FOR ROYALTY PAYMENT AND REPORTING.**

Section 111 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1721) is amended by adding the following after subsection (j):

"(k)(1) Any royalty payment on an obligation due the United States for oil or gas produced pursuant to an oil and gas lease administered by the Secretary shall be payable at the end of the month following the month in which oil or gas is removed or sold from such lease.

"(2) Royalty reporting with respect to any obligation shall be by lease and shall include only the following information:

"(A) identification of the lease;

"(B) product type;

"(C) volume (quantity) of such oil or gas produced;

"(D) quality of such oil or gas produced;

"(E) method of valuation and value, including deductions; and

"(F) royalty due the United States.

"(3) Other than the reporting required under paragraph (2), the Secretary shall not require additional reports or information for production or royalty accounting, including (but not limited to) information or reports on allowances, payor information, selling arrangements, and revenue source.

"(4) No assessment may be imposed on retroactive adjustment with respect to royalty information made on a net basis for reports described in paragraph (2).

"(5) The Secretary shall establish reporting thresholds for de minimis production, which is defined as less than 100 thousand cubic feet of gas per day or 10 barrels of oil per day per lease. For such de minimis production, the lessee shall report retroactive adjustments with the current month royalty payment, and the Secretary shall not bill for, or collect, comparisons to production, assessments, or interest.

"(6) If the deadline for tendering a royalty payment imposed by paragraph (1) cannot be met for one or more leases, an estimated royalty payment in the approximate amount of royalties that would otherwise be due may be made by a lessee or person acting on behalf of a lessee for such leases to avoid late payment interest charges. When such estimated royalty payment is established, actual royalties become due at the end of the second month following the month the production was removed or sold for as long as the estimated balance exists. Such estimated royalty payment may be carried forward and not reduced by actual royalties paid. Any estimated balance may be adjusted, recouped, or reinstated, at any time. The requirements of paragraph (2) shall not apply to any estimated royalty payment.".

**SEC. 12. REPEALS.**

(a) FOGRMA.—Section 307 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1755), is repealed. Section 1 of such Act (relating to the table of contents) is amended by striking out the item relating to section 307.

(b) OCSLA.—Effective on the date of the enactment of this Act, section 10 of the Outer Continental Shelf Lands Act (43 U.S.C. 1339) is repealed.

**SEC. 13. 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 apply after such date only with respect to Indian lands.

**SEC. 14. EFFECTIVE DATE.**

This Act, and the amendments made by this Act, shall take effect on the date of the enactment of this Act with respect to any obligation which becomes due on or after such date of enactment.

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

**Before the**
**House Subcommittee on Energy and Minerals Resources**

**July 18, 1995**

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you to discuss how we can make improvements to the Nation's program for the fiscal management of public mineral resources. The Department of the Interior supports many of the objectives that underlie the subject of this hearing--H.R. 1975, "The Federal Oil and Gas Royalty Simplification and Fairness Act"--and has taken steps to meet those objectives. However, many aspects of this legislation go far beyond the objectives that we support and would seriously compromise our ability to ensure that royalties are properly paid on Federal oil and gas leases. Consequently, we cannot support this bill. Nevertheless, we believe that we do share with you several important objectives, and we would welcome the opportunity to work with you to develop less costly (both for industry and Government) mechanisms for properly collecting Federal oil and gas royalties.

Before discussing the specifics of the bill, I would like to take a few minutes to talk about the background of this matter and some of the things that the Minerals Management Service (MMS) is doing to reduce the costs associated with royalty collections while ensuring that the public gets a fair return on production of minerals from Federal leases.

**Background**

The Nation's public mineral leases annually produce some $4 billion in royalty, bonus and rental revenues collected and disbursed by MMS for the U.S. Treasury, and state governments. (MMS also collects mineral revenues on behalf of Indian tribes and allottees.) This represents one of the largest annual revenue sources to the U.S. Treasury after taxes and customs. Since its inception, MMS has collected about $72 billion in mineral revenues.

The MMS is a relatively new bureau. It was created 13 years ago by Secretarial order following the Commission on Fiscal Accountability's (Linowes Commission) recommendations on proper fiscal accountability and management of the public's mineral

resources. Throughout the 1980's, MMS established the regulatory and program framework to fulfill these recommendations. Our early efforts in royalty accounting, auditing, and enforcement led to a large number of royalty orders, bills, and associated enforcement actions and appeals. Moreover, a significant number of unresolved legal and policy questions emerged; first, from the interpretation of the valuation regulations in effect in 1982; second, from implementation and interpretation of the Federal Oil and Gas Royalty Management Act's (FOGRMA) enforcement authority; third, from implementation of new royalty valuation regulations promulgated in 1988 and 1989; and fourth from major restructuring of the natural gas industry that accompanied deregulation. The end result has been situations where royalty obligations are still contested for periods well in excess of the 6 year FOGRMA records retention requirement.

Since 1982, the bureau has made major strides in the royalty collection process, including:

- designing and implementing automated fiscal and production accounting systems that are centralized and integrated;
- reducing recurring errors caused by data discrepancies and payor mistakes from almost 40 percent in 1982 to less than 5 percent in 1994;
- steadily increasing the percentage of revenues being disbursed on time--from 92 percent in 1985 to 99 percent in 1994;
- increasing the frequency of disbursements to the Federal Treasury and states from semi-annually in 1982 to monthly; and,
- implementing comprehensive and systematic audit and compliance programs to enhance the revenue collection effort. Since 1982, these programs have generated over $1.4 billion, with over 20% ($268 million) collected in fiscal year 1994.

These accomplishments have not gone unrecognized. The MMS Royalty Management Program has received three national awards from the Federal Quality Institute.

Meeting New Challenges

Despite past improvements, MMS also realizes that the challenges the bureau faces today are different from those of the previous decade. In response to these new challenges, we have focused our efforts over the last several years on finding ways to carry out our programs more efficiently and effectively; to improve our level of service to both the regulated community and the public;

and to treat our various constituencies--including state and local governments, Indian, environmental and academic communities, and the minerals industry--as partners in decisions which could affect them. MMS continues to investigate innovative options for reinventing itself.

The MMS is actively examining ways to streamline many aspects of the complex mineral collection process, including:

- creating the Royalty Policy Committee, an advisory committee chartered by the Secretary, which will bring together industry, state, tribal, and other interested parties to resolve issues and improve systems for collecting royalties.

- piloting innovative and cost-effective ways to collect royalties. MMS is currently conducting a pilot project in which MMS collects offshore royalty gas in-kind rather than in cash. The MMS then sells the royalty gas to marketing companies with the proceeds going directly to the Treasury. This approach has the potential to reduce administrative costs significantly for both the Government and industry;

- implementing a multi-constituent team approach to resolve royalty issues. Examples include Federal and Indian Gas Valuation Committees engaged in negotiated rulemaking efforts to improve MMS regulations. These new regulations should better reflect the marketplace and simplify royalty valuation, reporting, and payment;

- increasing the use of negotiated settlements to resolve disputes faster and at lower cost to all parties;

- implementing an electronic data interchange for easier exchange of royalty data in conjunction with the minerals industry, other Federal agencies, and some State agencies;

- staffing three service-oriented Offices of Indian Assistance located near Indian tribes and allottees to better serve their needs; and,

- expanding the delegated audit program with states and tribes, both in terms of dollars and number of participants.

MMS also is working on several initiatives that parallel provisions in H.R. 1975:

- reducing the time necessary to complete audits. In contrast to MMS' early years, MMS now accomplishes most of its audits within 6 years from the date of production. The MMS is currently affirming this goal as a formal agency policy to limit bills and orders to within 6 years from the royalty payment due date, with limited exceptions;

- speeding up the administrative appeals process. The large volume of audits after MMS was established and a number of difficult legal issues combined to create a significant backlog in our appeals system. We are making progress in clearing up these older cases and are instituting new procedures to speed up the processing of appeals in the future;

- facilitating refunds. MMS is examining ways to make it easier for companies to obtain refunds of overpayments made on offshore leases--the OCS Lands Act requires a burdensome procedure and allows refunds only if requested within two years of making the overpayment; and,

- paying interest on overpayments. MMS also is looking at how companies could earn interest on certain overpayments.

In keeping with MMS' philosophy of continuous improvement and with the need to reduce costs, we have identified additional areas where we could improve service to our customers at less cost to the Treasury. The list below provides some examples of ideas identified by our employees and our customers that could reduce industry costs associated with their royalty payments:

- streamline allowance systems. Many of the forms payors file to document deductions from their royalty payments can be eliminated or significantly streamlined;

- evaluate audit residencies and eliminate redundancies between MMS residencies and state/tribal auditors;

- find ways to significantly reduce the reporting and payment burden for marginal leases, by for example reducing the payment frequency, reducing the reporting frequency and detail, or allowing royalty pre-payment (buy-out);

- integrate databases in order to avoid duplicate reporting;

- continue to review, streamline, and/or eliminate all applicable reporting functions and forms. Find easier ways to report adjustments from prior months and to report reallocations among leases once units are approved;

- renegotiate terms of unusual leases, such as sliding step scale or net profit share leases; and,

- hold meetings with states, tribes, and industry, concurrent with this hearing, to discuss streamlining ideas.

Comments on H.R. 1975

The primary intent of H.R. 1975 as we understand it is to clarify and make reciprocal the rights and obligations of both lessees and the United States regarding royalty payment and verification responsibilities. The legislation includes:

- A 6-year limitation period for both lessees and the United States
- A process for offsetting of overpayments and underpayments across leases
- Payment of interest to lessees when refunding/crediting overpayments
- A 3-year limitation on the Secretary to issue final appeals decisions
- Restrictions on the types of data to be reported to the Department, and
- Provisions for royalty relief for de minimis producers

As I stated above, we support several of the objectives of H.R. 1975: faster audits and appeals, easier offshore refunds, and interest for certain overpayments. However, we cannot support the bill as drafted. It would have several consequences that would not serve either the royalty payors or the taxpaying public well:

1. The cumulative effect of the provisions of this legislation, some of which are subtle but important, would seriously compromise the Federal royalty collection process. We do not believe that a collection system based on this bill would provide the public with adequate controls to ensure they receive a proper return on production of their minerals. Under this legislation, the Department's royalty collection system for Federal oil and gas leases would be less detailed and less effective than the system used prior to the Linowes Commission report and the passage of FOGRMA. This inevitably would lead to future findings of significant under-collected royalties, which would be seen as a failure both by the Federal Government and the minerals producing industry.

2. The bill would reduce Federal revenues. The manner in which the legislation establishes the six-year time frame during which the Government must bill for any royalties due opens up many avenues for companies to avoid paying royalties. For example, any adjustment made by a company near the end of the six year period would be almost immune from verification. Similarly, a company receiving a payment for oil or gas produced many years earlier (a relatively common occurrence) could easily escape paying royalties on that payment. Other provisions which would negatively affect the Federal (and state) treasuries include the exemption for

small producers, the interest provisions, and the various provisions that make it more difficult to ensure that companies pay the proper amount of royalties.

3. Many aspects of the legislation would lead to more administrative costs and burdens rather than less. For example, the requirement that MMS prepare bills for definite and quantitative amounts within six years from the date of production would require MMS to institute a broader audit coverage of companies' royalty payments, requiring companies to provide more records covering more leases. It also would require substantial investments to change current computer systems. Furthermore, the bill's prohibition on collecting certain critical data elements would require MMS to rely more on audit, rather than computerized verification methods, to check companies' royalty payments. The ultimate burden for industry to comply with after-the-fact audits rather than more contemporaneous verification may be greater. MMS costs for audit relative to computerized verification certainly are higher. Furthermore, the reductions in data provided to MMS would undermine MMS' ability to implement the provisions of the new valuation regulations for natural gas, as developed by a negotiated rulemaking team composed of industry, state, and Federal representatives.

We welcome the fact that this bill would not apply to Indian leases, but we question why the Federal Government's obligation to the taxpayer for its oil and gas resources should be substantially less than it is to the Indian community for its oil and gas resources.

**Summary**

In summary, we agree with the industry that we need to provide more certainty and faster audit closure. However, we believe that our recent proactive efforts to clarify valuation regulations, administratively limit audit timeframes, and streamline royalty reporting/processing will better serve the collective interests of industry, states, tribes, and the general public than will this legislation.

We have numerous other specific comments and reactions to the proposed legislation, a preliminary version of which I am attaching to this testimony. We will provide the Subcommittee with more detailed comments in the near future. I urge you to consider the importance of mineral revenues to the Federal Treasury and the legitimate interests of the United States and its state partners for assurance that these revenues have been properly paid. Again, we agree with many of the goals of this bill and are working hard to make improvements that will serve royalty payors as well as the general public. With that in mind,

I offer - Mr. Chairman - our commitment to establish a working group of all affected parties, under the Royalty Policy Committee, to work out our differences and report back to you on our progress if you wish, so that we can properly address these issues.

This concludes my prepared remarks. I will be pleased to answer any questions the Subcommittee may have.

**Attachment**

This paper outlines preliminary MMS comments on the provisions of H.R. 1975.

**PERIOD OF LIMITATIONS/OFFSETTING**

The legislation would establish for Federal oil and gas leases a separate regime governing the limitations period for actions to collect debts directly or through administrative offset, essentially creating a new statute of limitations and repealing certain provisions of the Debt Collection Act with respect to royalty payments due on these leases. For the reasons described below, these actions would seriously hamper the Government's ability to collect all royalties due on these leases and therefore would reduce Government revenues.

The bill purportedly would apply the same 6-year limitation period on both the lessor and the lessee. Applying the same limitations period for both parties is not as equitable as it may appear, since the lessee has all the records and the on-the-ground knowledge applicable to specific sales transactions having royalty implications. The United States, as lessor, is in an unequal position relative to this information. Furthermore, the legislation allows lessees to extend the period beyond 6-years in cases where they can identify a potential overpayment that has not yet been finally determined, yet it includes no reciprocal provision for the lessor. It also appears to grant lessees unilateral authority to perform administrative offset, without providing the lessor with a similar authority.

MMS agrees that its audits and reviews generally should be completed within 6 years of original payment and has prepared administrative guidance to that effect. However, there are certain circumstances in which a 6-year period is insufficient. H.R. 1975 starts the 6-year clock running at the end of the month following the month in which the oil or gas is produced. This is in marked contrast to the traditional limitations periods that start when all facts are known or reasonably could have been known. There are several royalty implications to this provision:

- The provision eliminates the requirement for lessees to pay royalties due on certain proceeds they receive more than 6 years after the month of production. A clear incentive would be provided for lessees to structure transactions to result in receipt of proceeds after the limitations period expires. This is a major loophole in the current bill. Many of the royalties MMS is currently collecting under its contract settlements initiative fall into this category. Lessees still would be required to pay royalties on proceeds received prior to the expiration of the 6-year period, but MMS would have little time to review whether the lessee actually made such payments with respect to proceeds received near the end of the period.

- The legislation also places credit adjustments taken by lessees near the end of the 6-year period effectively beyond MMS review. A company could take a credit adjustment immediately before the end of the 6-year period, and MMS would have no time to verify the validity of the transaction. By contrast, the Internal Revenue Service is granted an additional 3-year audit period for the entire year's income when any adjustment is made.

- In certain, limited circumstances, where the facts and law are not well settled, it is in both the Government's and the lessee's interest not to proceed with royalty bills until further fact-finding efforts are completed and legal determinations are made. The current issue involving the valuation of crude oil produced in and offshore California provides an example of this. A strict 6-year period would force MMS to issue bills in such circumstances or obtain specific tolling agreements.

The legislation includes helpful provisions for tolling any potential limitations period for cases of fraud or concealment or where mutually agreed to by both parties. However, the bill lacks an additional tolling provision that is absolutely necessary if a statute of limitations is put in place, namely for cases where MMS is denied or obstructed from access to records necessary to audit or review a company's royalty payments. A rigid limitations period without this kind of tolling would provide an incentive for certain companies to drag their feet in providing MMS access to records. Such tolling is especially important given that the legislation appears to limit MMS' use of general orders requiring companies to calculate and pay royalties in situations where MMS access to records is difficult or where systemic royalty reporting and payment deficiencies are present.

**ACTION REQUIRED WITHIN LIMITATION PERIOD**

By requiring a definite and quantified bill to be issued within 6 years of the production month, the legislation appears to limit MMS' ability to order companies to correct their own royalty reporting once an MMS audit has identified systemic or recurring errors in the companies' royalty computations. The MMS is taking steps to increase the use of orders to pay specific amounts and concomitantly reduce reliance on orders for the company to perform their own calculations. However, orders to require companies to perform recalculations of their royalties may continue to be an important tool for MMS to ensure royalty compliance, especially in situations where companies obstruct MMS access to their records.

If MMS is required to bill for definite and quantified amounts within 6 years of the date of production, its response will likely be to expand its audit coverage and demand more records from the lessees. This approach is likely to be more burdensome, both for MMS and for the lessees.

**OFFSETS AND REFUNDS**

With respect to offsets, the legislation proposes that underpayments and overpayments be netted across all leases on the Outer Continental Shelf or within a particular state by report month. This would lead to significant accounting complications, both for lessees and for MMS. Cross-lease netting within a state will remove the ability of states to distribute revenues based on actual county production. It also would reduce the incentive for companies to pay properly for each lease, each month, thereby complicating audit efforts. The legislation appears to place the burden on MMS to find all of a lessee's mistakes that have resulted in overpayments in a particular state or on the OCS before MMS can charge the lessee interest with respect to a mistake that has caused an underpayment. This would create significant costs for MMS and would reduce interest collections.

Regarding refunds, the proposed language would deny the Secretary's ability or discretion to effectively review or deny refunds. This is principally because the bill does not require the lessee to provide very much detail about the refund, yet requires the Secretary's approval within a relatively short timeframe. Thus, the lessee is provided with essentially a unilateral capability to withdraw funds from the Treasury.

**INTEREST PROVISIONS**

MMS has no objection to paying interest to lessees that have overpaid in certain situations (e.g., if they have paid pending an appeal which they ultimately win, or if their recoupment of an overpayment has been delayed by MMS) if an appropriations mechanism is provided and financial implications to the Treasury are assessed.

The interest provision in this proposal could reduce the incentive for companies to pay royalties correctly upon original payment. If a company earns interest on any overpayments, it has less incentive to pay correctly the first time. An increase in royalty adjustments could ensue, which would increase MMS' administrative costs. To the extent that more adjustments lead to successive reviews by MMS, the industry also may have to respond to more MMS inquiries (or bills) regarding the proper amount of royalties due.

Although streamlined reporting and payment systems may be appropriate for lessees with small volumes of production, MMS does not support the legislation's proposal to allow royalties

for low production wells to be paid in arrears on an annual basis with no interest. This appears to be merely a subsidy for such production. Royalty relief currently is available and is the appropriate mechanism to consider easing the financial burdens on marginal properties.

Another effect of the bill would be to reduce the interest rate that MMS charges lessees who are late in making their payments. The Treasury current value of funds rate specified in this bill is significantly lower than the Internal Revenue Service rate currently authorized by FOGRMA. This lower interest rate will reduce the incentive for companies to pay their royalties on time.

**FINAL AGENCY ACTION**

The MMS agrees that the Secretary should issue final administrative decisions as soon as possible and is working to accomplish this goal. However, the detailed language of the bill relating to the MMS and Departmental appeals processes will constrain the breadth of options available to the Secretary in improving this process, including the possibility of collapsing two levels of administrative appeals into one level. The MMS also is concerned that these strict timeframes could provide an incentive for lessees to flood the administrative appeals process with "nuisance" appeals.

The provision requiring the Secretary to "demonstrate" financial insolvency before requiring a bond or other surety in appeals cases could lead to financial losses to the Federal government in cases where a company appears solvent at the time of the appeal but becomes insolvent prior to final adjudication of the issue. MMS already allows alternative surety instruments that reduce lessees' costs, and this legislation would allow lessees to earn interest on any overpayments they make (including payments made pending appeal). Given that these options would be available to lessees, the burden of providing surety would be small--thus it is not unreasonable for MMS to require posting of a surety without any demonstration of financial insolvency. Furthermore, there could be substantial administrative costs to the Government if the Secretary must "demonstrate" financial insolvency.

**ROYALTY REPORTING AND ASSESSMENTS**

The MMS has several concerns regarding the proposed restrictions on the Department's authority to require data explaining royalty payments:

- Royalty Data. The list of allowable data items to be reported is too restrictive for an accounting system regarding public assets. A comprehensive accounting system needs significantly more data than included in the proposal, including transaction month, transaction

type, lessee/payor identification, and allowance data. MMS is particularly concerned that the bill would provide for allowances to be reported on a net basis within the reported royalty value--this greatly reduces MMS' ability to verify and audit payments. (Even if allowance forms are eliminated, MMS still needs to know when an allowance is being deducted.) Furthermore, the limited data allowed would be insufficient for MMS to implement the negotiated rulemaking committee's recommendations for Federal gas valuation, which were supported by a consensus of state, industry and Federal representatives.

- Lease-Level Reporting. The legislation requires lease-level reporting of royalties. It is not clear how this would affect reporting by multiple lessees on a single lease or how it would affect reporting for leases dedicated to units or communitization agreements. Also, lease level reporting is inconsistent with the exemptions this bill would establish for low production wells. Further, unless provisions are made for unit and communitization agreements, lease-level reporting would eliminate many of MMS's automated compliance checks, including those recommended by the Linowes Commission and otherwise required by FOGRMA, requiring more reliance on audit to verify royalty payments.

- Adjustments. The proposal appears to allow a company to net a prior month adjustment within a current month's reported data. MMS objects to this provision because it would permit the unilateral modification of current month royalty data and payment. MMS would have no ability to determine the identity or validity of either the current month royalties or the prior month adjustment. A company could reduce current month royalties by netting out with a completely fictitious prior month amount with little or no consequence.

- Assessments. The $250 ceiling on assessments in any reporting period removes MMS's ability to encourage correct reporting by large companies. MMS currently assesses industry to compensate the Government for the costs of correcting royalty data reported to MMS. These assessments, which are usually $10 per error, have been very successful at reducing errors that would prevent MMS from distributing royalties to the proper recipients in a timely manner, a primary goal of FOGRMA. The error rate for data reported to MMS dropped from almost 40 percent in 1982 to under 5 percent in 1994.

This change would undermine the integrity of data in MMS' reporting systems, because a $250 assessment would be trivial for large companies. Although the restrictions of H.R. 1975 would have little effect on many small producers, any incentive for accurate reporting would be removed for the large companies who report tens of thousands of data lines to MMS. It would be difficult for MMS to perform the functions envisaged for it under the negotiated rulemaking proposal for Federal gas valuation if the quality of data were to deteriorate as a result of this proposal. Faulty data could compromise the integrity of the "safety-net" calculation developed as a part of the negotiated rulemaking.

- Other Information. It is not clear what effect the proposed prohibition on requiring information other than that routinely reported would have on the existing provisions in Section 107 of FOGRMA, which authorizes the Secretary to require affidavits and other information as necessary to verify royalties. This authority has made a significant contribution to MMS' ability to collect royalties in certain situations (e.g., gas contract settlements and dual accounting reviews).

The proposal would require extensive changes to MMS' automated systems and those of the industry. These changes could involve significant costs.

The restrictions on data reported to MMS, including the prohibition on performing computer reasonableness checks on small producers, will likely increase burdens on industry. Currently, the data reported to MMS allow for comprehensive computer checks on all leases to assure that substantial compliance is occurring. This takes place at minimal cost and with little participation of companies. The restrictions on reported data in this proposal will make it difficult for MMS to conduct such computer screening, and thus MMS would need to contact many more lessees to manually conduct such reasonableness checks and audits. Costs for both industry and MMS would increase.

Further, there does not seem to us to be any legitimate public policy reason for placing small producers off-limits to automated compliance reviews as proposed in the bill.

**BUDGET SCORING**

H.R. 1975 would reduce receipts; therefore it is subject to the pay-as-you-go requirements of the Omnibus Budget and Reconciliation Act of 1990. The bill does not contain provisions to offset the reduction in receipts. Therefore, if the bill is enacted, its deficit effects could contribute to a

sequester of mandatory programs. Some of the elements to be considered in scoring the bill include:

- the impact of a strict 6-year limitations period.
- payment of interest to lessees on overpayments.
- netting of underpayments and overpayments among leases in each state prior to calculating interest.
- waivers of interest on de minimis production.
- reduced computerized verification.

**OTHER CONCERNS**

MMS has many concerns about the details of this legislation. For example, even the definition of lessee--a fundamental legal concept in the collection of royalties--appears to be written in such a way that it would undermine MMS' enforcement efforts. As another example, the savings provision for Indian leases could be interpreted to repeal FOGRMA with respect to all Federal leases for the time period prior to enactment of the proposed bill. The provision for allowing royalty-in-kind collections improves MMS' ability to collect gas royalties in-kind offshore, but it fails to make a parallel improvement with respect to oil royalties and it imposes a new 90-day notification requirement on the Secretary. There are many other questions and concerns that need to be carefully examined in order to fully evaluate the potential impacts of this legislation.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

JUN 13 1995

Ms. Charlotte LeGates
Director, Public Relations
Natural Gas Supply Association
1129 20th Street, NW., Suite 300
Washington, D.C. 20036

Dear Ms. LeGates:

Enclosed is a draft paper describing the policy that the Minerals Management Service proposes to adopt with regard to application of time limits to MMS audits and enforcement actions.

We are aware that there is considerable interest in this issue on the part of industry and would appreciate your review and comment.

Please provide any comments by June 23, 1995. If you have any questions, please contact Ms. Lucy R. Querques on (202) 208-3398.

Sincerely,

Director

Enclosure

DRAFT DRAFT DRAFT DRAFT DRAFT

MINERALS MANAGEMENT SERVICE
Policy Guidance -- Audit Timing and Resource Allocation

The extent of the time periods covered by MMS audits and resulting royalty orders have been a matter of considerable controversy between MMS and the industry for several years. During the 1980's, the MMS substantially increased its audit activities in compliance with the Federal Oil and Gas Royalty Management Act (FOGRMA). The resulting orders issued to royalty payors often covered periods more than 6 years old.

As a result, many lessees challenged MMS orders on statute of limitations grounds, asserting that the general federal statute of limitations at 28 U.S.C. 2415(a) barred any claims for unpaid royalties more than six years after the royalties were first due. The lessees' limitations theories have been asserted in numerous cases in Federal courts as well as in a substantial backlog of administrative appeals of orders arising from the audits of those earlier periods.[1]

MMS's goal, more recently, as reflected in the Contemporaneous Audit Initiative, has been to conduct all audits on a contemporaneous basis consistent with the most effective and efficient use of audit resources, to provide industry with earlier closure, to streamline the royalty collection process and to be more responsive to the public we serve.

Accordingly, this is to affirm that it is the MMS's policy to complete reviews and audits of royalty payments made on Federal and Indian leased lands, including issuance of enforcement documents for underpayments (orders to pay or to recompute and pay), within the FOGRMA principal document retention period, that

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[1] Thus far, the courts have not accepted the lessees' time bar claims, albeit on different grounds in different judicial circuits. As we understand the present state of the law, the Tenth Circuit up to this time has assumed that the six year statute of limitations applies, although the question of the statute's applicability has not been squarely presented to that court. However, because of the tolling provision at 28 U.S.C. 2416(c), the Tenth Circuit has held that the MMS, in net effect, has a reasonable amount of time to begin and conduct an audit plus six years in which to issue an appealable order. The Fifth Circuit has ruled that the statute of limitations does not apply to MMS orders to pay or recompute royalties or to judicial counterclaims to enforce them. The Supreme Court recently declined to review the Fifth Circuit's decision.

is, within 6 years of the royalty payment due date.[1] Because royalty payors make many adjustments (both debit and credit) to their monthly reports and payments, often long periods of time after the production month, such adjustments are also subject to audit and issuance of enforcement documents for up to 6 years after the adjustment transaction date.

This policy guidance should be strictly adhered to by all RMP and STRAC personnel. On a case-by-case basis, some limited exceptions to this policy may be appropriate. These are discussed below.

Access to Records/Tolling Agreements: When a lessee/agent refuses or delays access to the records necessary for MMS to determine the accuracy of royalty payments, the general 6-year period will be extended to allow sufficient time to perform the audit. In addition, when agreed to by MMS and the payor, the 6-year period will be extended to any mutually agreed date.

Indian Leases: For companies or leases with no prior audit activity, payment violations may be pursued beyond 6 years to protect the interests of Indian tribes and allottees.

California Crude Oil: MMS is conducting a special review of allegations concerning companies' use of posted prices to value California crude oil. The findings of this review may require examination of records and issuance of enforcement actions for periods exceeding 6 years.

Contract Settlement Audits: Audits of a small number of contract settlement agreements executed in the early to mid 1980's have not been completed within 6 years of the royalty due date. In these instances, payors will be required to pay additional royalties for periods extending beyond 6 years.

Malfeasance: For those instances where there is evidence of fraud, collusion or concealment of pertinent facts, the 6-year period will be extended to a period necessary to conclude an audit or investigation.

Successful completion of the current audit cycle and issuance of enforcement documents within 6 years is important to ensure that audits remain contemporaneous and on schedule for current periods and for the future. It will demonstrate that, in fact, MMS has

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[1] This policy does not affect compensatory royalty determinations resulting from reviews performed by the Bureau of Land Management.

accelerated its compliance process. While the 6-year audit cycle is appropriate for now, we should strive to shorten this period whenever possible by working smarter.

MMS is committed to numerous performance improvement goals designed to reduce the total time required to complete the audit process and adjudicate related appeals. For example, new automated processes are being developed to expedite audits and increase the numbers of orders issued with requirements to pay specified amounts, rather than ordering companies to recalculate the additional royalty due. We are working with States, Indian tribes, and industry to streamline royalty valuation procedures and add certainty to the royalty reporting and payment process. We have also proposed a new rule that would require credit adjustments to be submitted within 5 years after the date of the original royalty payment unless approved, in advance, by MMS. Additionally, steps have been taken to expedite resolution of the appeals backlog and decrease the time required to adjudicate appeals in general using new methods such as alternative dispute resolution. All of these performance improvement efforts along with the expected benefits of a new MMS initiative to take gas royalties from offshore leases in-kind should make it possible for us to further shorten the audit cycle in future years.

Implementation of this policy directive represents sound public policy and is important to the continued success of MMS's audit and compliance activities. It adds certainty to the audit process and is compatible with the general audit strategy being implemented by MMS and its audit partners. Moreover, providing royalty payors with a clear time beyond which they would no longer need to maintain records or be subject to MMS audits makes good business sense.

Identical letter is being sent to:

Mr. David Deal
American Petroleum Institute
1220 L Street, NW.
Washington, D.C. 20005

Mr. Richard Lawson
President
National Mining Association
1130 17th Street, NW.
Washington, D.C. 20036

Mr. Alex Woodruf
Independent Petroleum
Association of Mountain States
280 Denver Club Building
518 17th Street
Denver, Colorado 80202-4167

Mr. Darrell Gingerich
Chairman, Revenue Committee
Council of Petroleum Accountant
Societies
Conoco, Inc.
Ponca City, Oklahoma 74602-1267

Ms. Denise Bode
Independent Petroleum
Association of America
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Washington, D.C. 20036

Mr. Wayne Gibbens
President
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Gas Association
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Washington, D.C. 20004-2615

Mr. Charlotte LeGates
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Environmental and Employee
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Mr. Greg J. Washington
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Mr. Jeffrey A. Fritzlen
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Ms. Carla Wilson

Ms. Marilyn A. Harris
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Ms. Amy R. Hammer
Legislative--House
EXXon Corporation
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Suite 300
Washington, D.C. 20006

Mr. Larry J. Nichols
President
Devon Energy Corporation
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Oklahoma City, Oklahoma 73102

bcc:
MMS Gen. File
AS/LM (2)
Dir. Chron
RM File
AD/RM
RM Chron--Lkwd/DC
MS:RM:RLO:MS-3020:AEwell:mwj:6/13/95:(202)208-3512:
f:\home\johnsonm\data\transcom.fin

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

1101 SIXTEENTH ST., N. W.
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(202) 857-4722

THOMAS A. ROONEY
PRESIDENT
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July 7, 1995

Ms. Cynthia Quarterman
Director, Minerals Management Service
Department of the Interior
1849 C Street, NW
Washington, DC 20420

Re: Request for comments on MMS draft policy of the Application of time limits on MMS Audits and enforcement actions and MMS draft legislative proposals

Dear Cynthia:

The Independent Petroleum Association of America (IPAA) appreciates the opportunity to provide comments on the MMS' draft policy statement of the application of time limits on MMS audits and enforcement actions and the MMS draft legislative proposal.

As you know, the IPAA represents the over 5000 small businessmen and women who produce oil and natural gas in all thirty three producing states. Our members are very active on public lands and are becoming a major force in the offshore. Independents' sole source of income is at the wellhead, they do not receive proceeds from marketing or retailing, or any other downstream activities. Because of there unique position in the industry, cost saving and streamlining procedures are very important to the independents businesses.

While the IPAA applauds the agency's recognition of problems that exist in royalty collection, the IPAA believes that neither the MMS' draft policy statement nor the MMS' draft legislative proposals fully address the problems currently faced by public lands users. The IPAA fully supports the congressional efforts proposals HR 1975 and S 1014 the Federal Oil and Gas Royalty Simplification and Fairness Act of 1995. These legislative proposals provide clarity, certainty, simplicity, reciprocity, and most importantly fairness in the royalty collection process.

The IPAA believes the MMS' statement of policy in regard to audit time does not adequately achieve the necessary closure in royalty proceedings needed by the industry. The Department's failure to honor any time limits in royalty collection caused the IPAA to file suit against the Department in 1993. The recent decision in that case stated there is effectively no

statute of limitations. This decision only underscores the need for a firm statute of limitations. The MMS' draft legislation does not go far enough in addressing the problems faced by many oil and gas producers on federal lands. The draft recognizes only a minority of problems producers encounter.

All of industry has been working together to find the solutions to many of the problems with royalty collection. Industry believes the solution lies with the congressional legislative efforts and their recently introduced Federal Oil and Gas Royalty Simplification and Fairness Act of 1995. IPAA urges the MMS to work with Congress and support prompt passage of this important legislation.

Sincerely,

Denise A Bode

Denise A. Bode


Carla J. Wilson
Director
Tax, Finance & Accounting

775 Sherman Street, Suite 2501 • Denver, CO 80203-4313
Telephone 303/860-0099
FAX 303/860-0310

July 7, 1995

Ms. Cynthia Quarterman
Director
Minerals Management Service
Main Interior Building
1849 "C" Street, N.W.
Washington, DC 20240

Dear Cynthia:

On behalf of the Rocky Mountain Oil & Gas Association (RMOGA), I would like to respond to the Minerals Management Service's request for comments on its Draft Policy Guidance on Audit Timing and Resource Allocation. RMOGA has worked with the Minerals Management Service for many years seeking ways to achieve simplicity, clarity, certainty and reciprocity in the federal royalty management process. We appreciate the opportunity to continue this dialogue and to provide you with our comments on the proposed policy.

We are extremely pleased to see MMS's commitment to perform audits on a contemporaneous basis, provide industry with earlier audit closure, and streamline the royalty collection process. Certainly, MMS has already accomplished its goal of being more responsive to the public by involving industry in such efforts as the Federal and Indian Gas Valuation Negotiated Rulemaking Committees, the new Royalty Policy Committee, and in seeking industry's comments on this policy statement. Other steps which the MMS is taking, such as those outlined in the draft policy, will go a long way toward streamlining and simplifying the federal royalty management process.

RMOGA members have several issues regarding the policy statement which require discussion.

- The draft policy fails to address a stipulation for MMS to provide the lessee with an audit closure letter. Industry requires the certainty of a procedure that mandates MMS to officially close an audit period. Such requirement would fulfill the MMS's stated goals of providing industry with earlier closure and "providing royalty payors with a clear time beyond which they would no longer need to maintain records or be subject to MMS audits".

- A simple policy statement does not sufficiently obligate the agency to a specific course of action. Industry's experience has been that oftentimes policy enacted by one administration is easily modified or nullified by another. For example, the draft policy provides for several exceptions to the time limitations. The agency would be free to add exceptions to retroactively address issues that may later be determined. In the same manner, a policy can be unilaterally changed, suspended or rewritten. This does not achieve the goal of certainty for the industry. Only legislation can best address these and other longstanding issues and provide the surety industry requires.

- MMS recognizes that "While the 6-year audit cycle is appropriate for now, we should strive to shorten this period whenever possible by working smarter". We acknowledge MMS has made strides toward accelerating its compliance process. However, we urge MMS to adopt the recommendations outlined in RMOGA's testimony concerning the Department's Devolution Proposal, and certain provisions of H.R. 1975, The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995, introduced by Congressman Ken Calvert on June 30th. In so doing, MMS will indeed be "working smarter" and, as a result, will be able to shorten the audit cycle to considerably less than the proposed six years.

- Likewise, as MMS indicates in the draft policy, industry makes adjustments to monthly reports and payments which MMS needs time to audit. However, if those audits were limited to a specific transaction on a specific lease, they could be easily accomplished in a much shorter time frame.

As you are well aware, the issues raised in the draft policy have long been the subject of industry concern. RMOGA members, in cooperation with other industry association members, have endeavored for the past six months to develop an effective solution to the endless audits and records retention which now constrain the industry. The product of that effort, H.R. 1975, addresses the issues raised in the draft policy paper along with several others. The bill is an excellent compromise that provides essential certainty and closure for industry and MMS and we urge your support for its swift passage.

July 7, 1995

Ms. Cynthia Quarterman
Director
Minerals Management Service

Page 3

We applaud the MMS for undertaking progressive approaches to improve its performance and respond to the needs of the industry. We strongly advocate the MMS's outreach and involvement practices that pursue meaningful resolution of the issues surrounding the federal royalty management program.

Thank you for your consideration of our comments. Please do not hesitate to contact me if you would like to discuss our comments in further detail.

Sincerely yours,

Carla J. Wilson
Director
Tax, Finance & Accounting

NATURAL GAS SUPPLY ASSOCIATION

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1129 20th Street, N.W.
Washington, DC 20036
(202) 331-8900

Raymond E. Galvin
Chairman

Nicholas J. Bush
President

Patricia A. Hammick, Ph.D.
Vice President

July 6, 1995

Ms Cynthia Quarterman, Director
Minerals Management Service
Department of the Interior
1849 C Street NW, Mail Stop 4013
Washington, D.C. 20240

RE: Request for Comment on MMS Draft Policy on the Application of Time Limits to MMS Audits and Enforcement Actions

Dear Ms Quarterman:

The Natural Gas Supply Association (NGSA) is pleased to comment on the draft policy on the application of time limits to MMS audits and enforcement actions, which is aimed at improving business climate certainty in the collection of royalty payments owed on natural gas and other minerals production from federal lands. As an association that represents producers of approximately 90 percent of U.S. natural gas production, NGSA has a significant interest in this proposed policy.

NGSA members very much appreciate the responsiveness of the Minerals Management Service (MMS) to problems in royalty management and collection. You have consistently demonstrated a willingness to examine issues and move toward reasonable solutions. In addition, your efforts to clear up backlogs, to move expeditiously through appeals, and to use alternative dispute resolution procedures have helped government and producers better use resources and minimize the cost of resolving disagreements.

Based on our experience, however, the issues you are attempting to address cannot be effectively handled by means of a policy statement. Policies put forward by one administration can be changed by another, thus undermining the shared goal of providing certainty to the lessees. Furthermore, neither certainty nor clarity results from a policy that contains a significant number of exceptions that could be unilaterally expanded.

NGSA believes that a legislative solution is required to meet the goals of both MMS and industry. The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995, as introduced in the Senate by Senator Don Nickles and in the House by Representative Ken Calvert on June 30, 1995, is therefore needed; we strongly support it.

We look forward to working with you on upcoming legislation, royalty valuation, and other issues of common concern in the future.

Sincerely,

Nicholas Bush
President

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8000

July 7, 1995

Cynthia Quarterman, Director
United States Department of the Interior
Minerals Management Service
1849 C Street, N.W.
Mail Stop 4013
Washington, D.C. 20240

American Petroleum Institute Comments on
Draft MMS Policy on Application of Time Limits to
MMS Audits and Enforcement Actions

Dear Ms. Quarterman:

API welcomes the opportunity to submit these comments on the draft Minerals Management Service's June 13, 1995 draft policy on the application of time limits to MMS audits and enforcement actions. Many of API's over 300 member companies are actively engaged in exploration and production on federal lands and have extensive experience with the MMS Royalty Management Program and all aspects of royalty reporting.

API commends MMS on its stated policy goal of conducting "all audits on a contemporaneous basis consistent with the most effective and efficient use of audit resources, to provide industry with earlier closure, to streamline the royalty collection process and to be more responsive to the public we serve." API supports any effort to achieve the goals of certainty, clarity, simplicity and reciprocality. However, the proposed draft policy on time limits for audit and enforcement actions does not achieve these goals.

It is API's experience that a mere policy statement will not achieve the required certainty in this area. The draft policy statement at hand certainly does not. For example, the draft policy contains several itemized "case-by-case" exceptions to the policy, leaving the MMS free to add to this list and reformulating the policy upon discovery of any issue that may have retroactive application. A policy that allows for

such unilateral modification is neither certain nor reciprocal.

The MMS draft policy also includes a statement of the goal "to provide industry with earlier closure". MMS draft policy at 1. Yet a glaring omission in the policy statement is the absence of any requirement that the MMS officially close out an audit period. The MMS should provide the lessee with a timely audit closure letter barring the MMS from any further audit activity within the period.

The MMS draft policy further notes that "while the 6-year audit cycle is appropriate for now, we should strive to shorten this period whenever possible by working smarter." MMS draft policy at 3. API concurs and believes that a 5-year statute of limitation is more appropriate and may facilitate prompter collection of royalties.

Finally, the proposed policy states:

> Implementation of this policy directive represents sound public policy and is important to the continued success of MMS's audit and compliance activities. It adds certainty to the audit process and is compatible with the general audit strategy being implemented by MMS and its audit partners. Moreover, providing royalty payors with a clear time beyond which they would no longer need to maintain records or be subject to MMS audits makes good business sense.

MMS draft policy at 3. Again, a mere policy statement can not achieve the required certainty. A policy can be unilaterally changed, suspended, or rewritten. Moreover, too often, goals and policies of one Director or Administration have been radically altered or totally recanted by a subsequent Director or Administration. Accordingly, API believes that real certainty and a meaningful resolution can only be achieved through legislation.

The issues raised by the draft MMS policy have been the subject of API and industry concern for years and extensive review during the last six months. The recent decisions in the Fifth Circuit in *Phillips v. Babbitt* (September 7, 1994) and the D.C. District Court in *Samedan v. Deer* (June 14, 1995) highlight and augment the need for immediate statutory redress. Given industry's recent detailed review and analysis on the questions of audit period and record retention period closure, API believes that sections 104 and 106 of the recently proposed Federal Oil and Gas Royalty Simplification and Fairness Act of 1995 ("Fairness Act") most effectively address and remedy the closure issues raised in the draft policy. Specifically, the Fairness Act provides needed certainty as to when a limitation period should begin to run and correctly prescribes that beginning point as the "date the obligation becomes due."

The legislative history of 28 U.S.C. §§ 2415 and 2416, the present statute of limitations legislation of general applicability, is noteworthy:

* * *

> The committee feels that the prompt resolution of the matters covered by the [statute of limitation] bill is necessary to an orderly and fair administration of justice. Stale claims can neither be effectively presented nor adjudicated in a manner which is fair to the parties involved. As time passes the collection problems invariably increase.
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>
> In the report filed in behalf of the General Accounting Office in this bill, the Comptroller General stated that as a matter of fairness, persons dealing with the Government should have some protection against an action by the which arose for a transaction occurring many years previously.
>
> * * *
>
> Another reason for proposing limitations is to reduce the costs of keeping records and detecting and collecting on Government claims - cost that after a period of years may exceed any return by way of actual collection.

S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2502-2514.

The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995 more appropriately and adequately addresses these issues and several others and API urges you to support its prompt passage.

API appreciates the opportunity to have commented on the MMS draft policy and will continue to work with MMS on issues of importance to the industry.

Sincerely,

David T. Deal
Managing Attorney
202-682-8261
202-682-9033 FAX

DTD:cea

Chevron

July 7, 1995

Chevron U.S.A. Production Company
1301 McKinney Street
Houston, Texas 77010-3029
Mail Address: P. O. Box 3725
Houston, Texas 77253-3725

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(713) 754-7809
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Cynthia Quarterman, Director
United States Department of the Interior
Minerals Management Service
1849 C Street, N.W.
Mail Stop 4013
Washington, D.C. 20240

**Draft Policy on Audit Timing and Resource Allocation**

Dear Ms. Quarterman:

Your letter dated June 13, 1995, to Dan Fager, requesting Chevron's comments on MMS' draft policy on audit timing and resource allocation, has been referred to me.

Chevron participated in the preparation of, and endorses in full, the comments submitted by the American Petroleum Institute (API) on this issue.

Chevron appreciates the opportunity to comment on the proposed policy.

Cordially,

George W. Butler

cc: D. L. Fager

James C Pruitt
Vice President
Federal Government Affairs

Corporate Communications
a Division of Texaco Inc

1050 17th Street NW
Suite 600
Washington DC 20036

July 7, 1995

Cynthia Quarterman, Director
United States Department of the Interior
Minerals Management Service
1849 C Street, N.W.
Mail Stop 4013
Washington, D.C. 20240

Re: Policy Guidance - MMS Audit Timing and Resource Allocation

Dear Ms. Quarterman:

Thank you for the invitation extended to Mr. Gregory J. Washington, to comment on behalf of Texaco on the draft Minerals Management Service (MMS) policy on the application of time limits to MMS audits and enforcement actions. Texaco recognizes the MMS commitment to continuing communication with its constituents and appreciates the opportunity to comment at this time.

Texaco adopts and reiterates those comments filed by the American Petroleum Institute on the MMS draft audit policy. In addition to those comments, however, Texaco underscores the need for *statutory* reform in this area. No mere *policy* can achieve the stated MMS goals of reciprocity and certainty. A policy can be changed to accommodate the goals and policies of a new Director or Administration or the development of additional "case-by-case" exceptions. Only a clear, concise and unambiguous statute of limitations will provide the federal lessee with the essential "closure" referenced in the draft policy statement.

The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995, as introduced in both the House and the Senate on June 30, 1995, properly addresses these and several other issues of critical importance to our industry. Texaco urges you to support its prompt passage.

Sincerely,

James C. Pruitt /gh

JCP:chm
K6/3

Acadiana
Anchorage
Canada
Coastal Bend
Colorado
Dallas
Fort Worth
Houston
Kansas
Los Angeles
Michigan
Mississippi

New Mexico
New Orleans
Ohio
Oklahoma City
Oklahoma-Tulsa
Permian Basin
Rocky Mountains
San Antonio
San Francisco
San Joaquin
Texas Panhandle
West Central Texas
Wichita Falls

June 29, 1995

Ms. Cynthia Quarterman, Director
United States Department of the Interior
Minerals Management Service
Mail Stop 4013
1849 C Street, N.W.
Washington, DC 20240

**Request For Comment On Draft MMS Policy Of The Application Of Time Limits To MMS Audits and Enforcement Actions Due July 7, 1995**

Dear Ms. Quarterman:

The Council of Petroleum Accountants Societies (COPAS) Federal Regulatory Affairs Subcommittee respectfully submits the following comments on behalf of COPAS pursuant to the subject request. We appreciate the opportunity to provide comments on this draft policy. Members of the subcommittee have extensive experience with the MMS's Royalty Management Program (RMP) regulations and handle royalty valuation, reporting and payment, allowance filings, OCS refund requests, adjustments, bills, audits and other aspects of royalty matters on a regular basis.

COPAS commends MMS on its stated policy goal of conducting audits on a contemporaneous basis and in the most efficient and effective manner. COPAS supports any effort that achieves certainty, clarity, simplicity and reciprocity. While COPAS believes that the draft policy is a step in the right direction, COPAS does not believe it achieves all of these goals.

COPAS believes establishment of a policy similar to that being proposed is a positive step on an interim basis. However, COPAS believes that a policy statement alone will not achieve certainty for lessees. A policy statement accepted by one administration can be changed at any time. The only way to achieve certainty in this arena is to legislatively mandate a clear and certain statute of limitations.

The draft policy addresses adjustments that are subject to audit and issuance enforcement for up to six years from the adjustment transaction date. COPAS believes this negates the benefits of a timely audit and the certainty associated with a clear statute of limitations. Accordingly, COPAS suggests that the MMS have the right to review these adjustments within the applicable statute of limitations' time limit or one year from the adjustment, whichever is later.

Additionally, the draft policy allows several exceptions on a case-by-case basis. COPAS believes that the more exceptions to a policy the greater the uncertainty. Therefore, any policy generated by the MMS should *minimize* exceptions. Also, the exception relative to "Access to Records/Tolling Agreements" should only be extended if delays occur that are within the reasonable control of the lessee.

In closing, COPAS appreciates the opportunity to comment on the MMS draft policy and applauds the MMS on drafting policy to address long-standing royalty problems facing both the MMS and Industry. Please call me at (713) 754-7677 if you have any questions or wish to discuss in more detail.

Sincerely,

J. B. Rollins
Chairperson, COPAS Federal
Regulatory Affairs Subcommittee

CORPORATION COMMISSION OF OKLAHOMA

CODY L. GRAVES
CHAIRMAN

Jim Thorpe Building
P.O. Box 52000-2000
Oklahoma City, Oklahoma 73152-2000
405-521-2267

# TESTIMONY OF

# CODY L. GRAVES

# CHAIRMAN

# OKLAHOMA CORPORATION COMMISSION

# JULY 18, 1995

# BEFORE THE HOUSE COMMITTEE ON RESOURCES SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

# REGARDING H.R. 1975, THE ROYALTY FAIRNESS AND SIMPLIFICATION ACT

Good afternoon. Thank you, Mr. Chairman, for giving all of us this opportunity to address the Subcommittee today. I am Cody Graves, and I serve as Chairman of the Oklahoma Corporation Commission. The Oklahoma Corporation Commission is an elected three-member panel that regulates oil and gas production and exploration, public utilities and transportation in the state of Oklahoma. I am also a former Chairman of the Legal Committee of the Interstate Oil and Gas Compact Commission (IOGCC).

I am pleased to have this opportunity to testify today on H.R. 1975, the Federal Oil and Gas Royalty Simplification and Fairness Act, to improve the management of royalties from federal and outer continental shelf oil and gas leases.

This bill promotes certainty and simplicity in the laws and policies that govern federal royalties. The goal of H.R. 1975 is not a partisan one, rather it is the goal of providing a better environment for our domestic energy industry to conduct business. H.R. 1975 will help remove just some of the red tape our domestic oil and gas producers are faced with each day, which will in turn promote continued domestic oil and gas production by encouraging production on all federal lands.

It is important for all of us as public officials to listen closely to

those in the domestic oil and gas industry so that we can have a better understanding of what their real problems are. As you know, a significant problem for the oil and gas industry has been the lack of an adequate, sustained price signal. Given that unfortunate scenario, as public policy makers, we must then consider what we can do to reduce the regulatory and administrative burdens on our domestic producers.

This bill will go a long way in reducing some of those regulatory burdens. Currently, the Department of the Interior may collect royalty underpayments as far back as it wants, yet lessees are barred from seeking refunds of overpayments after as little as two years has elapsed. Under H.R. 1975, a clear, certain statute of limitations will be in place for both industry and government for the bringing of judicial and administrative proceedings on leases administered by the Secretary of the Interior. Record keeping requirements will conform with the statute of limitations. The reporting and collection of unnecessary information that is now required is costly and a drain on the federal government's and the industry's fiscal and human resources. Producers should not be faced with unnecessary mountains of accounting instructions, bills, assessments, penalties, audits and litigation. This legislation will provide accounting and enforcement relief for energy producers.

Additionally, H.R. 1975 will allow producers to collect interest payments in the event of an overpayment. Currently, producers must pay the federal government interest on underpayments, but the federal government is not required to pay producers interest on overpayments. This reciprocal interest is the only way to deal with the overpayment-underpayment situation in an impartial manner.

This bill is a small step toward abolishing the bureaucratic nightmare that our domestic energy industry faces. As a result, it will encourage business investment and development of federal resources by preventing the premature abandonment of marginal wells.

I am afraid that the general public does not realize the affect marginal wells have on our economy. Because of this, I would like to make you all aware of a study done by the Interstate Oil and Gas Compact Commission on the impact of marginal wells on the economy.

In 1993, the IOGCC released a study that showed that in 1992, over 16,000 marginal oil wells were abandoned, with the resulting impact on our nation's economy being a reduced economic output of over $400 million, an earnings reduction directly to the industry of $55 million and a loss of 2,300 jobs. The report also said that every dollar of stripper oil production creates an additional 51 cents of economic activity throughout

the economy and that 9.1 jobs are dependent on every $1 million of stripper oil produced.

When we consider this information, and the fact that in Oklahoma alone over 60 percent of the oil that has been discovered is still in the ground, we must come to the conclusion that we cannot allow the premature abandonment of oil and gas wells to continue. If we do not act now to stop the premature abandonment of marginal wells, we will foreclose forever our ability to produce significant amounts of the abundant domestic reserves of crude oil and natural gas. Every well that producers are forced to plug means that we will be forced to import that much more foreign oil on foreign flag tankers through the ports and harbors in the United States and run the increasing risk of another Exxon-Valdez type accident.

We are not running out of natural resources. However, because of the increasing regulatory costs and decreasing prices, it becomes less and less economic to produce marginal leases. The resulting abandonment and plugging of those wells will create additional job losses and additional revenue loss throughout the economy.

I am not sure that we will ever be able to convince people of the value that our domestic industry has on the economy and the significant

national security implications that exist. For whatever reason, those arguments have fallen on deaf ears. However, as state and federal officials we must continue to do what we can to maintain the viability of our domestic energy industry. When you consider all that we can do as regulators to encourage the industry, this legislation is one simple step to make the system more equitable.

The basic reform measures of H.R. 1975 will result in a simple, fair and more cost-effective way to conduct business for our energy industry. There will be no reduction in royalty collections as a result of this bill. As a matter of fact, royalty collections may well increase as the result of increased production on federal lands. This bill will preserve accounting integrity and ensure that the Department of the Interior has the necessary enforcement tools for the proper collection of royalties.

Thank you for your time. I would be pleased to answer any questions you may have.

WRITTEN TESTIMONY

*OF*

**J. LARRY NICHOLS**
**COOKIE I. NITZ** *AND* **PATRICIA A. PATTEN**
**J.B. ROLLINS**
*AND*
**THOMAS A. DUGAN**

*ON BEHALF OF*

**AMERICAN ASSOCIATION OF PROFESSIONAL LANDMEN**
**AMERICAN PETROLEUM INSTITUTE**
**DOMESTIC PETROLEUM COUNCIL**
**INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA**
**INDEPENDENT PETROLEUM ASSOCIATION OF THE MOUNTAIN STATES**
**MID-CONTINENT OIL AND GAS ASSOCIATION**
**NATIONAL OCEAN INDUSTRIES ASSOCIATION**
**NATURAL GAS SUPPLY ASSOCIATION**
**ROCKY MOUNTAIN OIL AND GAS ASSOCIATION**

*SUBMITTED TO*

**UNITED STATES HOUSE OF REPRESENTATIVES**
**SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES**
**HOUSE COMMITTEE ON RESOURCES**

*HEARING ON*

# FEDERAL OIL AND GAS ROYALTY SIMPLIFICATION AND FAIRNESS ACT OF 1995

**(H.R. 1975)**

**July 18, 1995**

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# TESTIMONY

*of*

## J. LARRY NICHOLS

My name is Larry Nichols. I am President of the Domestic Petroleum Council and Chair of the Public Lands Committee of the Independent Petroleum Association of America. These organizations are comprised of both large and small independent oil and gas producers.

My background will explain my keen interest in this legislation. I hold a degree in geology from Princeton and a law degree from the University of Michigan. Part of my adult life was spent here in Washington, D.C. From 1967-68, I was a law clerk in the United States Supreme Court for the late Chief Justice Earl Warren. From 1968-1970, I was Special Assistant to Assistant Attorney General William H. Rehnquist at the Justice Department. Since leaving Washington in 1970, my family and I have resided in Oklahoma City to run Devon Energy Corporation. Devon is an independent oil and gas exploration, development and production company.

The organizations for whom I and the other industry panelists speak today represent virtually all of the domestic oil and gas production industry, all of the oil and gas production on federal lands, and essentially all of the over 1,800 payors of federal royalty. Collectively, the members of these associations pay approximately $3.5 billion annually in federal royalties. These associations offer their experience and expertise to you and your staff, and give their unanimous and unqualified support to prompt passage of the Federal Oil and Gas Royalty Simplification and Fairness Act of 1995.

I wish to commend you, Mr. Chairman, for authoring H.R. 1975. It has been 13 years since Congress passed the current law, the Federal Oil and Gas Royalty Management Act ("FOGRMA"), governing the collection of royalties on oil and gas production from federal lands. Until now, no Congress has taken a serious look at how the Act is working. FOGRMA, as our testimony today will demonstrate, is in serious need of reform. Your Bill makes much-needed and long-overdue revisions to the law while encouraging our industry to increase its already sizable investment in federal onshore and offshore oil and gas development.

The issues raised by this Bill have generated serious consideration on how best to create the most cost-effective, simple and fair method of collecting and paying federal royalties. You and others who have considered these issues have not been constrained by what is but rather have considered what should be. Because of your and this Subcommittee's efforts, a unique opportunity now exists to rethink and reshape the collection process of this, our nation's second largest source of revenue.

## GOALS OF H.R. 1975

The goals of Industry are goals shared by all. They are:

- **SIMPLICITY and EFFICIENCY which result in administrative cost savings,**
- **FAIRNESS and REASONABLENESS which encourage exploration and development in our natural resources,**
- **CERTAINTY, PREDICTABILITY and FINALITY which promote business investments, and**
- **COST-EFFECTIVENESS in the collection and reporting of federal royalties.**

**These goals are imprinted upon the underlying principle that royalties be collected and paid timely and accurately.**

## RELATIONSHIP OF GOVERNMENT AND INDUSTRY

**The underpinning of the Bill is the peculiar nature of the contractual relationship between the Federal Government as owner and lessor of oil and gas resources and industry lessees who obtain the right to explore for and develop the lessor's resources. All rights between the lessor and a lessee flow from the contract between them, which is the lease itself. Ironically, the lease contains little language on the subject of the payment of royalty, despite the fact that royalty is the primary monetary consideration flowing to the lessor. The statutes that govern the issuance of the lease and exploration activities contain scant language on the royalty issues addressed by H.R. 1975. The specific laws governing federal oil and gas leases are the Minerals Lands Leasing Act, passed in 1920 and last amended in 1987; the Outer Continental Shelf Lands Act, passed in 1953; and the Federal Oil and Gas Royalty Management Act, passed in 1983. The last comprehensive Congressional action taken was over 13 years ago. This is without regard to the fact that industry practices have changed dramatically and continue to change at an ever-increasing rate. There has not been a Congressional review to determine if, in this changing market place, the above-stated goals are being met. It is now time for such a review and for action. The Federal Oil and Gas Royalty Simplification and Fairness Act of 1995 would make major improvements in the Government's system of collecting royalties.**

Many of the concepts and efficiencies contained in the Bill have been recognized by MMS. The National Performance Review dated September 1993, the Study Group Report on the Administration of Transportation and Processing Allowances dated December 3, 1993, the National Performance Review Summary dated March 1994 and the Common Reference Data Reengineering Laboratory Report dated May 1995 all recommend simplification and endorse many of the reforms found in the Bill. In large measure, the recommendations of these reports have not been implemented to the detriment and cost of both Government and Industry. H.R. 1975 would codify these recommendations in a way that would reduce both the Government's cost of administration and the Industry's cost of compliance.

The MMS has recently put forward two initiatives to redress the inadequacies it concedes exist. Let me say very clearly that these initiatives, while laudable, simply do not do the job. Some four weeks ago, on June 13, the MMS circulated a draft policy on a six-year audit cycle. I have attached as Exhibit 1 the MMS proposal and Industry responses to it. The responses call for the reform found in H.R. 1975, not the proposed MMS policy. Likewise, last month, the MMS also requested comment on draft legislation. Industry responses were the same -- Industry supports passage the of Federal Oil and Gas Royalty Simplification and Fairness Act of 1995, not the proposed MMS legislation. For your review, the MMS legislative proposal and Industry's comments are found in Exhibit 2. The issues have long since been identified and studied. Regrettably, the MMS efforts fall short of the goals that have been set forth: simplicity, certainty, finality and fairness. The solution is the prompt passage of H.R. 1975, not the uncertain outcome of more MMS policies.

CERTAINTY: STATUTE OF LIMITATION

At this time, I would like to address several specific sections of the Bill. In particular, I wish to address the objectives of certainty and finality that would be achieved by passage of H.R. 1975. A statute of limitation, with a corresponding records retention provision, is required to achieve certainty and finality in the federal royalty arena. This certainty would encourage leasing and development of federal resources.

Recently, two courts have held that no statute of limitation applies to oil and gas leases on federal lands[1]. Despite several statutes of limitation of record, the court held in *Samedan* that there is no time bar to MMS' collection of royalties and associated interest due by the plaintiff oil company. The court said:

> This case raises abstruse and perplexing issues of statutory construction. Although there is a sound underpinning for each conclusion of law, the outcome when considered *in toto* may seem anomalous -- especially if extended beyond the context of FOGRMA. Executive departments can, to use Samedan's words, engage in a "timeless quest" to enforce claims "back to the founding of the Republic." The Government will not be hobbled with a statutory limit as long as it files in court within a year of final agency action, regardless of when the administrative process is launched. It is possible to question the wisdom of Congress. But the court, proclaimed Justice Cardozo, does "not pause to consider whether a statutes differently conceived and framed would yield results more consonant with fairness and reason."[2]

Based on these cases, MMS now takes the position that a lessee's royalty liability legally lasts forever. Further exacerbating the issue is the fact that multiple, conflicting statutes exist relative to any period of limitation and, thus, any application of these conflicting laws is difficult, if not impossible. As the President of an oil and gas exploration company, must I ask my shareholders to invest in developing federal resources when the royalty liability for doing so is uncertain and unlimited? Must I report unknown potential liabilities to my shareholders without any hope of finality or closure? The answer clearly should be "no."

---

[1] *Phillips v. Babbitt*, No. 93-1377 5th Cir. (Sept. 7, 1994) and *Samedan v. Dear*, No. 94-2123 D.C. District Court (June 14, 1995).

[2] *See Samedan*, U.S. Dist. Ct. D.C. (May 1995), Civil Action No. 94-2123.

**At this point, it would be well to remember the reasons for a statute of limitation. A Supreme Court decision and the legislative history of the principal statute of limitation[3] which governs actions by and against the United States state:**

> ***Statutes of limitations are not simply technicalities. On the contrary, they have long been respected as fundamental to a well-ordered judicial system.[4]***
>
> ***It is only right that the law should provide a period of time within which the Government must bring suit on claims just as it now does as to claims of private individuals. The committee agrees that the equality of treatment in this regard provided by this Bill is required by modern standards of fairness and equity.[5]***
>
> ***The emphasis on fairness referred to by the Comptroller General and by the Department of Justice in recommending the legislation is a very important consideration and the principal basis for the Bill.[6]***
>
> ***Another reason for proposing limitations is to reduce the costs of keeping records and detecting and collecting on Government claims--costs that after a period of years may exceed any return by way of actual collections.[7]***
>
> ***With the passage of this legislation, private litigants can be assured of a more fair and balanced treatment when dealing with the Government.[8]***

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[3]S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2502-2514

[4]*Board of Regents v. Tomanio, 446 U.S. 478, 64 L. Ed. 2d 440, 100 S. Ct. 1790 (1980).*

[5]S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2503.

[6]S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2508.

[7]S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2513.

[8]S. Rep. No. 1328, 89th Cong., 2nd Sess. 1-12 (1966), reprinted in 1966 U.S.C.C.A.N. 2503.

From the Government's perspective, a statute of limitation promotes the prompt collection of monies due the United States. It is an incentive to collect obligations as soon as they become due. To sit on claims for monies due is not good Government, especially when those claims are harder to collect as time goes by. In short, this statute should have a positive impact on collections and revenue. Good Government and good business alike require the early collection of all amounts due.

It should be noted that Senator Don Nickles introduced Senate Bill S-451, the Domestic Oil and Gas Preservation Act, in this, the 104th Congress. His Bill contains a statute of limitation. Responding to S. 451, The Interstate Oil and Gas Compact Commission, in its Resolution 95.601 dated June 13, 1995, a copy of which is attached as Exhibit 3, urged Congress to "conduct immediate hearings on this vital legislation and move the principles embodied in this legislation to the floor of each house for consideration before the end of the year." Thus, the Governors of the member States of the IOGCC have requested this Congress to do exactly what you are doing today.

## CERTAINTY AND FINALITY

On a related topic, Industry needs greater certainty when contractual disputes with the Government are litigated in the context of administrative proceedings within the Interior Department. The MMS itself has repeatedly recognized that its process needs streamlining and that decision-making within the agency takes far too long. While MMS is to be commended for this recognition, the time for action is long over due. We therefore, wholeheartedly endorse Section 3 of H.R. 1975 which requires the Secretary to issue a final agency decision within 3 years of its commencement. Currently, there are 1,008 appeals pending before the MMS. These appeals represent monetary amounts of over $226,324,526 at issue. Having potential claims for such large amounts of royalties pending for long periods of time does not serve the interests of the taxpayers, the revenue recipients or Industry. If the Federal Government is due the money, it should collect it.

This problem is further exacerbated by the fact that this limitless liability mandates the indefinite retention of records by companies to defend claims 5, 10, 15 or 20 years after the claims have arisen. This Bill correctly provides that a company is not required to maintain its records for any time period barred by the six-year limitation period. Like the limitation period, this finality in records retention should help provide an incentive to develop federal resources.

**FAIRNESS: RECIPROCITY**

**In the contractual relationship between lessor and lessee, the relationship should be reciprocal in some areas as a matter of basic fairness. Fairness dictates that when the Government enters into commerce through a contractual relationship with a private party, it is not acting in its sovereign capacity. The Government should not receive special advantages not available to private parties. When the Government contracts with a lessee, it should be subject to the obligations and limitations required by the law governing those contracts. This Bill applies this concept of fairness to federal royalty collection and payment through a statute of limitation which would be applied reciprocally to both Government and Industry.**

**The Bill additionally applies the concept of fairness through the reciprocal right to interest for both Government and Industry. When as now, the Government fails to act promptly on overpayments, it costs Industry large amounts in the loss of the time value of money. At the same time, Government's inaction or delay on underpayments costs Industry money under the inequitable laws that permit interest only in favor of the Government. There is no incentive for MMS to act promptly on overpayments. Currently underpayments are not reduced by overpayments except in limited circumstances. The Bill correctly remedies this situation by encouraging the prompt offsetting of overpayments and underpayments, with interest to accrue on both only after offsetting.**

**The issue of fairness also has application in the area of assessments levied by the Government. What is not understood or taken into account in the current system is that adjustments are the norm in the rapidly changing gas industry. Assessments are currently imposed on payors who act in good faith based on the best information available to them. Assessments are also imposed without notice and an opportunity to be heard. This Bill corrects current inequities by providing for assessments only on information which is critical to the correct reporting and payment of royalties, and prohibiting assessments on non-critical information absent a showing of willful misconduct or gross negligence.**

**Finally, it is important to note that H.R. 1975 would be effective on its date of enactment. Therefore, there would be no currently existing Government claims that would be cut off. There would be no retroactive application of the provisions of the Bill. The Bill would have no impact on current Government claims, including old and state claims now existing. The Bill would, on the other hand, encourage the more rapid collection of royalties in the future.**

**CONCLUSION**

In conclusion, the goals of simplicity, certainty, fairness and reasonableness achieved in this Bill are necessary to provide the fundamental reform required to correct an unfair and burdensome bureaucratic process. To paraphrase you, Mr. Chairman, at a time when Congress is determined to reform federal taxes to be simpler and fairer, Republicans and Democrats alike should strike for similar reform of this, the Federal Government's next largest source of revenue. Industry must be relieved of the volumes of bureaucratic accounting instructions, cost-ineffective practices and the possibility of a federal audit decades after the time of production. The trend of the Federal Government seeking "improvements" by exercising more and more enforcement measures must be reversed. In short, dollars should not be spent to collect dimes. Under the Bill, fairness and simplicity for lessee and lessor alike would be the outcome.

# TESTIMONY

*of*

## COOKIE I. NITZ *AND* PATRICIA A. PATTEN

My name is Cookie I. Nitz. I have been employed in OXY USA Inc.'s (OXY) Gas Revenue Accounting Federal Royalty Compliance division in Tulsa, Oklahoma, and have been responsible for payment of and compliance with federal regulations for royalty payments on federal onshore, offshore and Indian leases since 1973. Joining me is Patty Patten, Corporate Counsel with OXY who has been responsible for legal matters relating to royalties OXY pays on these leases since 1985.

OXY supports H.R. 1975 and encourages the Subcommittee to pass this Bill. OXY supports the testimony of Mr. Dugan, Mr. Nichols and Mr. Rollins on behalf of their companies and the designed trade associations and wishes to offer in support of their testimony three examples which highlight the need for statutory reform.

EXAMPLE 1

The first of these examples deals with a 112 page invoice to OXY, attached as Nitz/Patten Exhibit "1," which is representative of the monthly invoices from the MMS that assess interest for late royalty payments. The invoice totalled $21,098.15 and contains 1,117 lines of which 795 or 71.17% involve amounts of 99¢ or less. Once OXY received this invoice, I reviewed it to determine if OXY had made credits not recognized by MMS' computer system which would reduce the claimed interest amount. The difficulty with the MMS system is that it is not programmed to track credits and, consequently, the invoiced interest amount is not accurate. When OXY receives an interest bill from the MMS, the only question is to what degree is it inaccurate. As a general rule, OXY's experience is that the invoice is overstated by about 30%.

As can be determined by the size of this invoice, the administrative costs to the MMS in compiling and generating the invoice and to OXY in reviewing, and determining the inaccuracies of the invoice far exceeded the amounts to be collected for 90% of the lines. This resulted in a loss of administrative time which could be better utilized elsewhere by both the Government and OXY. This Bill would dramatically reduce the reporting requirements and give the MMS discretion to waive collection of these de minimis amounts where the MMS determines that the cost exceeds the revenue to be collected. Attached as Nitz/Patten Exhibit "2" is my letter to the MMS, which analyzes the invoice and asks for reform. It clearly expresses my frustration at the waste of time and money caused by billing de minimis amounts.

**EXAMPLE 2**

**The next example, attached as Nitz/Patten Exhibit "3," illustrates the need for revision in the laws dealing with Section 10 of the Outer Continental Shelf Lands Act and the need for reciprocal interest to lessees. In this example, as a result of confusing advice given OXY from the MMS, the royalties reported for two leases were reported as one due to the consolidation of underlying producing formations. The proper amount of royalty was timely paid; however, royalty was paid on only one instead of two leases.**

**When the MMS discovered this, OXY offset the overpayment on Lease 1 against the underpayment of Lease 2 and the entries netted to zero. Of course, once OXY tendered and showed an underpaid amount on Lease 2, the MMS system automatically generated an interest bill. OXY argued that the Government was made whole since it had the full use of 100% of the proper amount of royalties the entire time. OXY lost its appeal and subsequently paid the assessed interest (approximately $110,000). Six years later the MMS disallowed the offset since a refund request was not filed and demanded a repayment of $486,000 in royalties. This Bill would correct both errors by allowing recoupments to be taken without approval and would provide for offsetting prior to interest accruing.**

**EXAMPLE 3**

**A third example is a letter from OXY to the MMS, attached as Nitz/Patten Exhibit "4," which I drafted in response to an order from the MMS. The MMS order accused OXY of taking adjustments for overpayments on OCS leases without filing a refund request. Specifically, the MMS stated that "there is no evidence in our records indicating that a request was submitted for each recoupment indicated. As a result, you are directed to repay the unauthorized recoupments" (emphasis added). Subsequently, OXY received more orders and inquiries totalling $461,752.94 in allegedly unauthorized recoupments. I sent a copy of the attached letter with each response to the orders.**

**In my response I advised the MMS that substantial evidence did exist, as follows:**

> **I have enclosed for your records: 1) copies of the refund requests, 2) notification letters from the MMS that the request has been forwarded to Congress for review in accordance with Section 10 of the Outer Continental Shelf Lands Act of August 7, 1953 [43 U.S.C. 1339(a)], and 3) approval letters from the MMS authorizing OXY USA Inc. to recoup the overpayments in question.**

Apparently, your records are sadly lacking or MMS personnel did not make the effort to properly research said records. As a result, by issuing the Order to Pay, you placed the burden of proof on OXY.

The administrative effort to produce the enclosed copies was significant. OXY has neither the time nor the personnel to perform unnecessary work. I believe the MMS is exceeding its authority by demanding OXY 'prove' it complied with Section 10 of the Outer Continental Shelf Lands Act without initiating a review of its own records first. An even more pressing concern is the possibility that the records would have already been destroyed."

The MMS acknowledged in response that OXY was correct and dismissed the order.

The foregoing examples are only three of hundreds which OXY and others have relating to situations where the results obtained are unfair due to the lack of reasonableness and flexibility in the MMS collecting, reporting and enforcement system.

In closing, OXY appreciates the opportunity to testify and the committee's efforts to obtain simplicity, fairness and certainty in the royalty collection process.

OXY USA INC.
Box 300, Tulsa, OK 74102

May 20, 1992

**VIA AIRBORNE**

Mr. Theodore E. Hodkowski
Chief, Lessee Contact Branch
Minerals Management Service
Denver Federal Center, Bldg. 85
Denver, CO 80225

RE: Invoice #76920090 Dated 4/15/92
Payor Code 16922

Dear Mr. Hodkowski:

Your letter dated April 15, 1992 which accompanied the above invoice stated that;

> "This assessment is based on your submission of adjustments on Federal offshore leases on the Form MMS-2014 during the period April through September 1986, that resulted in recoupments being taken, with no prior approval by the Minerals Management Service (MMS)." (Emphasis added)
>
> "For the credits identified on the enclosed Report of Unauthorized Recoupments on Federal offshore leases, there is no evidence in our records indicating that a request was submitted for each recoupment indicated. As a result, you are directed to repay the unauthorized recoupments." (Emphasis added)

I have enclosed for your records: 1) copies of the refund requests, 2) notification letters from the MMS that the request has been forwarded to Congress for review in accordance with Section 10 of the Outer Continental Shelf Lands Act of August 7, 1953 (43 U.S.C. 1339 (a)), and 3) approval letters from the MMS authorizing Oxy USA Inc. to recoup the overpayments in question.

Apparently your records are sadly lacking or MMS personnel did not make the effort to properly research said records. As a result, by issuing the Order to Pay, you placed the burden of proof on OXY.

The administrative effort to produce the enclosed copies was significant. OXY has neither the time nor the personnel to perform unnecessary work. I believe the MMS is exceeding its authority by demanding OXY "prove" it complied with Section 10 of the Outer Continental Shelf Land Act without initiating a review of its own records first. An even more pressing concern is the possibility that the records would have already been destroyed.

Another unfavorable result of arbitrarily issuing OCS Recoupment Bills for Collection is the appeals that will be filed due to industry not being able to obtain all the documentation necessary to refute the invoices in the 30-day time period allowed.

In summary, OXY objects to this process and would appreciate the revocation of this Bill by the MMS immediately.

Sincerely,

Cookie Nitz

Cookie Nitz
Regulatory Accounting

CN:dr

Enclosures

cc: Arlene Langley
Oxy USA Inc.
P. O. Box 300
Tulsa, OK 74102

Leonard Norris
Oxy USA Inc.
P. O. Box 300
Tulsa, OK 74102

Patricia Patten
Oxy USA Inc.
P. O. Box 300
Tulsa, OK 74102

Joyce Stanley
Oxy USA Inc.
P. O. Box 300
Tulsa, OK 74102

Debbie Price
Liskow and Lewis
50th Floor, 1 Shell Square
New Orleans, LA 70139

Don Sant
Minerals Management Service
Royalty Management Program
Denver Federal Center, Bldg. 85
Room A-212
Denver, CO 80225

Milton Dial
Minerals Management Service
Royalty Management Program
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Jim Shaw
Minerals Management Service
Royalty Management Program
Denver Federal Center, Bldg. 85
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Denver, CO 80225

OXY USA INC.
Box 300, Tulsa, OK 74102

November 16, 1994

Mr. Milton Dial
Minerals Management Service
Royalty Management Program
Division of Verification
P. O. Box 173702
Denver, CO 80217-3702

Subject: OXY USA Inc.
Payor Code 16922
GBIL 07940182
Dated October 20, 1994

Dear Mr. Dial:

The attached worksheet represents an analysis I performed on the enclosed invoice. The analysis was intended to identify possible recommendations to MMS that would simplify and provide a less costly method of invoicing for insufficient estimates, late bills, and late royalty interest. The invoice is representative all GBILs issued for the above payor code.

The above captioned invoice comprises 113 pages, 1,117 lines of data and is billing $21,098.15. In addition, there is a 22-page supplementary report on the insufficient estimate lines. The analysis reflects over 71% of the lines are billing under 1% of the dollars and equates to 17 cents a line. It appears that a prudent and cost-effective decision could be made to eliminate these lines.

If the above is not possible, then maybe a system change could be made. I understand that system changes are not always as easy as they seem but it *certainly seems* like all values under a given amount (ie, $1.00, $25.00) could be summarized and added to the bottom of the (much shorter) invoice as "miscellaneous" without jeopardizing any income due from late interest. If the information is needed for distribution purposes it can be kept in your system and accessed when payment is made.

In the spirit of reinventing government, saving trees, and preserving my sanity, I would appreciate you giving serious consideration to the above recommendation.

Sincerely,

Cookie Nitz

Cookie Nitz
Regulatory Reporting

cn

Attach 1

cc: Dale Peterson w/attach 1
Minerals Management Service
Royalty Management Program
P. O. Box 173702
Denver, CO 80217-3702

Donna Irvin w/attach 1
Minerals Management Service
Royalty Management Program
P. O. Box 173702
Denver, CO 80217-3702

Deborah Gibbs Tschudy w/attach 1
Minerals Management Service
Royalty Management Program
P. O. Box 25165
Denver, CO 80225-0165

Joyce Stanley, OXY USA Inc. w/attach 1
Tony Sklet, OXY USA Inc. w/attach 1

# TESTIMONY
## *of*
## J.B. ROLLINS

My name is Joel Rollins. I am a Regulatory and Accounting Coordinator for Chevron U.S.A. Production Company. In past assignments I have been directly responsible for the reporting and payment of these royalties for Chevron and have extensive experience in this area. I am active in numerous industry trade associations and professional organizations that deal with federal royalty matters. In 1994, Chevron reported approximately 150,000 line items representing approximately 7% of the total royalty collections by the MMS.

As Mr. Nichols stated, I am providing testimony on behalf of a number of industry associations and appreciate the opportunity to offer testimony to this Subcommittee on a subject of great importance to the Federal Government and industry. The associations I represent today have extensive experience in all aspects of federal royalty reporting and collection processes. I will be focusing my comments today on the accounting implications of the Federal Oil and Gas Simplification and Fairness Act of 1995.

I would like to open my testimony by reading an MMS response to comments made to an MMS Final Rule on Offsets, Recoupments and Refunds of Excess Payments of Royalties, Rentals, Bonuses, or Other Amounts Under Federal Offshore Mineral Leases published in the Federal Register on July 28, 1994:

> "Permitting exceptions to the rule in an effort to be fair has the opposite effect . . . . To assure clear understanding and equal application to all leases, the rule provides for no exceptions and will be strictly applied."

The mindset of this response is indicative of today's problems. It is simply not cost-effective or reasonable not to permit or even consider how a rule should be applied to varying facts and situations. It is not reasonable to spend thousands of dollars to collect less than a dollar. This is symptomatic of what is wrong with the existing royalty collection and verification system.

I would like to commend the House Energy and Mineral Resources Subcommittee for reviewing the June 8, 1995 testimony on the Department of Interior's Devolution proposal submitted to this Subcommittee and for incorporating many of the ideas and suggestions offered in that testimony into the Bill being discussed today. As well, many of these same ideas have been recommended to the MMS by other industry organizations. I have attached a copy of these recommendations to this testimony as Rollins Exhibit 1 and 2.

Incorporation of these ideas and suggestions enhance the Bill by achieving many of the goals shared by all, such as administrative efficiency and simplicity, without compromising the royalty paid the Federal Government or MMS' tools to collect those revenues. Let's all be very clear on this point, H.R. 1975 does not reduce the amount of royalties to be paid to the Federal Government. What we are talking about is how best to collect, report and pay those amounts due in an efficient, timely and cost-effective manner.

CERTAINTY: THE NEED FOR LEGISLATION

Today there are many unique payment, reporting and collection problems and deficiencies associated with the collection of royalties on federal lands. Unfortunately many of these deficiencies cannot be adequately addressed and resolved by policy alone, but must be addressed legislatively to achieve simple, fair, certain and equitable solutions for both the Federal Government and Industry. We appreciate MMS' attempt to resolve many of these deficiencies through establishing and implementing various policies. Often such policies have been developed to address specific problems with current regulations or to generate administrative cost savings based upon the expertise of the MMS in royalty matters. Unfortunately policies developed by one administration can be subsequently changed by the next administration. Additionally, the MMS has little latitude or discretion in implementing its stated policies or regulations in such a manner as to effectuate cost-effective solutions based upon concerns raised by their constituents.

We in Industry agree with the MMS' stated goals of: "...conducting all audits on a contemporaneous basis consistent with the most effective and efficient use of audit resources, to provide Industry with earlier closure, to streamline the royalty collection process and to be more responsive to the public they serve." These goals are virtually the same as Industry's goals outlined in Mr. Nichols' testimony. However, the fundamental approaches by which Government and Industry propose to achieve these goals differ greatly.

As discussed above, it is Industry's experience that only legislation can achieve the required certainty in this area. No policy statement, and certainly not the one proposed by the MMS, can achieve the goals sought by the parties, especially the requisite certainty needed by business today. The American Petroleum Institute, in its July 7, 1995 letter to the Director of the MMS, dated June 26, 1995 (a copy of which is attached as an exhibit to this testimony), concluded:

**A policy can be unilaterally changed, suspended, or rewritten. Further, too often, goals and policies of one Director and Administration have been altered or recanted by a subsequent Director or Administration. Accordingly, API believes that real certainty and a meaningful resolution can only be achieved through legislation.**

For example, when the MMS confronted the issue of declining gas prices in the early 1980's as purchasers marketed out of gas sales contracts, it implemented a policy which collected royalty on arms-length gross proceeds believing it was consistent with the valuation regulation at 30 C.F.R. § 206.103. However, recipients who shared in the royalty revenues criticized the policy and claimed the Secretary violated his obligation under Notice to Lessees 5 (NTL-5) which requires royalty be paid on the *higher* of the sales price or the NGPA ceiling price. The NGPA ceiling price, in some cases, was more than *double* the sales price. This resulted in an effective royalty rate far in excess of the lease rate.

Consequently, legislation was introduced by Senator Nickles in 1987 (NTL-5 Gas Royalty Act of 1987) to retroactively allow royalties to be collected on the basis of gross proceeds, as opposed to the NGPA ceiling price under NTL-5. The Bill was enacted into law in 1987 and continues to provide some certainty in this area. A policy may actually be more difficult to implement than a statute. When MMS attempted, by policy, to circumvent unintended, inequitable results of NTL-5, its authority to do so was successfully challenged. Legislation was ultimately required to achieve the desired result. Without the certainty provided by legislative remedy this problem would discourage business investment and development of federal resources.

**SIMPLICITY**

Another deficiency is the current royalty regulatory framework does not recognize the complexities inherent in the oil and gas industry, particularly the gas industry. These complexities create an environment that results in inexact measurement, tracking and accounting of the product. The current framework does not allow for any tolerance to recognize the minor measuring and accounting differences that are inherent in the industry. This limits and

constrains development of an approach to the royalty collection process that is reasonable and cost-effective. The use of thresholds and tolerances, as proposed in H.R. 1975, allows everyone to approach the royalty collection process with a recognition of the cost benefits to be achieved in not pursuing small dollar amounts at unreasonable cost. Without this Bill we are left with the current inflexible and costly system.

Recognize the solution to these problems is not a regulatory or policy fix, which can take months or years to implement, if ever. Again I reiterate many of the concepts and efficiencies included in the Bill have been recognized over the years by MMS. On numerous occasions, MMS has recommended simplification and endorsed many of the same reforms contained in H.R. 1975, but has not implemented them. What is needed is a legislative remedy which can be achieved and implemented quickly and is binding and therefore certain. This would result in immediate administrative cost savings for the Federal Government and Industry without affecting the accuracy of reporting or the level of collections of federal royalties. What Industry needs is immediate relief from onerous regulatory burdens and oversight. Cost savings and simplification can be achieved by eliminating redundant or unnecessary information and forms, reducing detailed reporting requirements that require review and re-review of data elements, eliminating refund request requirements, allowing net and rolled-up reporting on retroactive adjustments, allowing for payor level estimated payments, and instituting the use of thresholds throughout the collection and reporting process. The result is be a royalty payment and collections process that is simple and cost effective.

This Bill effectuates the common goals of administrative efficiency by streamlining and reducing onerous and costly royalty reporting and accounting requirements. Since passage of the Federal Oil and Gas Royalty Management Act of 1982, there has been no legislation seeking reform of royalty accounting practices until the introduction of H.R. 1975. I want to illustrate the accounting and reporting simplification and resulting cost savings that H.R. 1975 would immediately effectuate:

1. Eliminate the Payor Information, Transportation Allowance and Processing Allowance forms. In 1994, almost 6,700 allowance forms comprising almost excess of 100,000 lines were filed. These forms and information are unnecessary for royalty reporting. Hundreds if not thousands of working hours and corresponding dollars would be saved. I have attached a copy of the forms being eliminated to this testimony as Rollins Exhibit 3.

2. Eliminate refund requests for offshore leases. In fiscal year 1994, 2,736 refund requests totalling $56,337,000 were filed. The opinions of the Solicitor of the Interior actually require refund requests to be filed for overpaid transportation and processing allowances which is unnecessary and burdensome.

   Only in rare circumstances can Industry offset underpayments with overpayments from like leases to reduce interest. The requirement of refund requests is a formality which allows the Government to retain Industry money for extended periods of time.

3. Utilize the offsetting of overpayments against outstanding obligations, including interest as an alternative to refund requests. This is a cost-effective and efficient accounting mechanism for dealing with overpayments/underpayments, that would greatly reduce the need for interest billings by the MMS and allow a company to claim previously barred, yet valid, overpayments that were denied simply based on the two-year time period for filing.

4. Provide the Secretary with reasonable discretion to perform a cost-benefit analysis for the reporting and collection of royalties. The Government should no longer spend dollars to collect dimes. Actual royalty must exceed the cost to collect.

   There is no common business sense applied in the collection of royalties. The MMS spends significant dollars and extensive human resources to collect insignificant royalty amounts partially caused by its accountability to multiple constituents including Industry, States, Indians and Congress.

5. Establish limits for compliance activities for low volume production. Compliance measures should be curtailed to deal with levels of production where it is not cost-effective to pursue such small amounts.

6. Streamline the reporting of retroactive adjustments. Lessees are required to submit multiple lines of corrections for a single adjustment in making prior period adjustments to royalty payments. For many producers over half of the total lines reported to the MMS each month are retroactive adjustments.

7. Extend royalty payments on entitled minimal production to an annual basis to maximize cost efficiency in accounting for insignificant volumes.

8. Require development of a simplified audit strategy to eliminate multiple or redundant reporting. The current audit strategy can require submission of the same data to multiple audit agencies.

9. Limit audits on minimal production leases to provide administrative relief to small producers. Currently small producers with minimum production are burdened with the same level of reporting requirements and enforcement that are associated with larger amounts of production.

10. Reduce the burden associated with minimum production that have the same level of reporting requirements and enforcement that are associated with larger amounts of production. Today producers are faced with mountains of accounting instructions that add little or no value in determining proper royalty due. Because of the details and complexities associated with royalty payments, the costs of developing an automated system for a royalty payment is often beyond a small producer's means. To ensure proper payment and collection, the Bill retains production reports, comparison to production information and the Secretary's right to obtain needed records under audit.

These efficiencies also have a trickle down effect and further reduce costs by reducing input and compilation time, input errors, error reports, and correspondence between MMS and Industry. Thousands of working hours and corresponding dollars would be saved. H.R. 1975 institutionalizes the concepts used in business every day to keep a lid on costs by implementing the use of thresholds and tolerances. This recognizes the costs associated with pursuing

small dollar claims and minimal adjustments that do not result in an acceptable level of benefit associated with the review and pursuit of these small claims. In other words we do not have dollars chasing dimes. I have attached a comparison of the existing MMS requirements to this Bill's requirements illustrating the areas of improvement to this testimony as Rollins Exhibit 4.

Finally, this Bill clarifies the Secretary's option to take royalty-in-kind by simplifying unwieldy provisions of the current law. This section of the Bill:

1. allows the producer adequate time to obtain alternative transportation arrangements to meet pipeline requirements;

2. eliminates the requirement that the Secretary compare royalty-in-kind values to fair market values; and

3. limits the producer's obligation to report and retain documents when the MMS takes its royalty-in-kind.

In summary, H.R. 1975 requires us to re-think, re-tool, re-invent and re-form the royalty collection processes to simplify and reduce costs for both the Federal Government and Industry. These bold measures can be accomplished by passage of H.R. 1975. I would like to thank Chairman Calvert and the other co-sponsors for their support of H.R. 1975.

Acadiana
Anchorage
Canada
Coastal Bend
Colorado
Dallas
Fort Worth
Houston
Kansas
Los Angeles
Michigan
Mississippi

New Mexico
New Orleans
Ohio
Oklahoma City
Oklahoma-Tulsa
Permian Basin
Rocky Mountains
San Antonio
San Francisco
San Joaquin
Texas Panhandle
West Central Texas
Wichita Falls

June 1, 1995

Mr. Tom Collier
Chief of Staff
Department of the Interior
Main Interior Building
1849 "C" Street, N.W.
Washington, DC 20240

Request for Comment on MMS Devolution

Dear Mr. Collier:

The Council of Petroleum Accountants Societies (COPAS) Federal Regulatory Affairs Subcommittee respectfully submits the following comments on behalf of COPAS regarding your request for comment on the referenced subject in your April 28, 1995 meeting with Rocky Mountain Oil and Gas Association (RMOGA) members. We appreciate the opportunity to provide comments and suggestions regarding the Department of Interior's (DOI) recent announcement on the devolution of the Minerals Management Service (MMS). Members of the subcommittee have extensive experience with the MMS' Royalty Management Program (RMP) rules and handle royalty valuation, reporting and payment, allowance filings,. OCS refund requests, adjustments, bills, audits and other aspects of royalty matters on a regular basis. Accordingly, our comments are limited to the MMS aspects of your proposal relative to the royalty payment and reporting processes.

COPAS supports any government effort to reduce costs, gain efficiencies and streamline processes. However, COPAS does not believe that the proposal presented by the DOI, as we understand it, achieves these goals. Rather, we view the proposal as merely a cost shifting measure, that will significantly increase costs to industry, state and tribal entities. We believe, through hands on experience with MMS' RMP systems and procedures, that the type of royalty reporting and payment activities performed by the MMS are clearly best done in a centralized system. Centralization leverages off of economies of scale and keeps costs associated with performing these activities as low as possible. Any attempt to decentralize these processes tend to erode uniformity and consistency relative to policies, reporting standards and formats, deadlines, etc.

COPAS believes a centralized reporting and payment system would retain the following advantages that would be lost if devolution were to occur:

- Consistent interpretation of rules and regulations
- Standardized reporting system
- Capitalization of established relationship with MMS
- Single point of contact for all collection processes
- Initiation by MMS to bring the state, tribe and lessee together to deal with and resolve common issues such as closing audit periods, etc.
- Quicker audit closure
- Consistency in resolving reporting disparities and audit issues that involve multiple states
- Elimination of uncertainty regarding costs and time to rewrite a new system

Instead of devolvement, COPAS believes the best and most cost effective way to achieve the DOI's goal of cost savings is to retain a centralized reporting and payment system but streamline the system to make it more efficient than today. Accordingly, COPAS offers the following specific suggestions to streamline current centralized reporting and payment processes that we believe will reap significant cost savings without the uncertainty and start-up costs associated with the devolution proposal.

Product Valuation

In today's natural gas marketing environment, gross proceeds as defined by the MMS, is increasingly difficult to ascertain. This is because of the tremendous changes in the natural gas marketing environment that have occurred as the result of open access and deregulation. Consequently, natural gas is now often sold far downstream of the wellhead after it has been aggregated with many other sources, complicating the valuation of natural gas for MMS royalty purposes and the costs associated with ascertaining this value.

- Adopt Negotiated Rulemaking Recommendations

To combat this uncertainty COPAS strongly advocates that the recommendations developed by the Federal Gas Valuation and Indian Negotiated Rulemaking Committees be promulgated as a regulation as quickly as possible.

In addition we believe certain of the Federal Committee's recommendations relative to the elimination of processing and transportation allowance forms (both oil and gas) and the definitions of compression and transportation should be instituted immediately. This would bring quick and immediate administrative cost savings to both the MMS and industry with no loss of control.

- **Clarify Gross Proceeds**

COPAS believes that clarity with respect to the definition of gross proceeds should be examined. Although simplifying and clarifying valuation with respect to natural gas has been achieved with the Federal Gas Valuation Negotiated Rulemaking Committee recommendations, additional effort should be expended to equitably, timely and clearly define gross proceeds in an ever changing gas marketing environment.

**Expected Savings: Significant**

**Reporting Procedures**

- **Reduce or streamline MMS Form 2014 reporting**

  Potentially millions of dollars each year could be eliminated if the MMS would work with industry to eliminate or streamline the level of reporting on the MMS Form 2014. The current costs associated with MMS Form 2014 reporting could be significantly reduced with little or no loss on the MMS's ability to monitor and control royalty payments.

  Specifically, COPAS suggests eliminating/simplifying selling arrangement codes, transaction codes, payment method code, calculation code, adjustment reason code, and revenue source code. Also, allowing the transportation/processing costs to be reported on the same line as the associated revenue versus a separate line as required today.

- **Report prior period adjustments on a "net" basis**

  The current instructions require adjustments for prior periods to be made with a reversal of the prior report line and the correct line. A simpler and less costly approach would be to allow industry to report the adjustment on a "net" basis. Each year millions of lines are reported by payors to the MMS whose net amount is insignificant (some are for no net monetary value at all, just a correction of a code). This would be a major step toward reducing not only the number of lines reported, which may encourage more EDI reporting, but also the system maintenance costs of historical reporting data.

- **Change estimated payment from lease level to payor level**

  The current requirement of filing and placing estimated payments at a lease level creates a burden on industry and the MMS. Changes that have occurred in the gas market make lease level estimates unreasonable. Producers move in and out of the market, change markets and routinely sell and purchase properties making it necessary for monthly monitoring and updating of estimated payments to avoid interest assessment. Likewise, lease level monitoring of estimates for today's gas market creates a significant increase of cost and administrative effort for the MMS.

  COPAS believes that estimates established at the payor level would simplify the process for both industry and the MMS. Establishing payor level estimates would eliminate the time consuming process of allocating, monitoring and adjusting lease level estimates.

- **Eliminate Payor Information Form Filings (PIFs)**

  COPAS believes the PIFs are an unnecessary reporting requirement providing no significant or tangible benefit to the MMS and should be eliminated. COPAS does not believe the PIFs are necessary to report and pay royalties accurately. The National Performance Review team (Common Reference Data Reengineering Laboratory) considered this recommendation in their analysis, but due to time constraints had to defer a decision on the issue until further information could be obtained. However, COPAS firmly believes when this issue is reviewed, no one will be able to justify the significant costs, estimated at $2-3 million dollars a year, currently being expended by the MMS and industry in filing and processing these forms.

- **Continue Conversion to Mechanical Transmission**

  MMS should continue efforts to convert payors to EDI, tape and PC disk reporting. This will greatly reduce errors associated with processing reports as well as reduce report processing costs for the MMS and industry.

- **Streamline and Integrate Databases**

  Currently, MMS employs the use of multiple databases for use in royalty collection, monitoring, control, etc. However, often the same information is required by the payor to be provided to MMS multiple times so it can be entered into different databases.

  Streamlining and integrating these databases would result in fewer processing lines and data retention in MMS systems.

- **Report Unit Revisions Prospectively**

  Where a unit revision does not materially impact overall royalties due the MMS, the new tract allocations for royalty reporting purposes should be prospective, not retroactive to first production which often is three to four years prior to the date the unit revisions occurred. Alternatively, allow reporting of royalties under the unit agreement number rather than the AID numbers associated with each tract.

  **Expected Savings: Significant**

<u>Thresholds</u>

MMS regulations and systems require an exactness that is frequently not cost justified to either MMS or industry. Measuring, tracking, and accounting for oil and gas production is not an exact science. Many of MMS' system tolerances are so low that MMS chases small differences that cost MMS more than they recover in additional royalty. COPAS suggests that MMS modify the regulations and system tolerances/thresholds so that only those exceptions that are cost beneficial for MMS to pursue are generated. Listed below are examples to better illustrate the need for tolerances/thresholds.

- Prior Period Adjustments - The requirement for adjustments is typically caused by correcting measurement inaccuracies, allocation errors or pricing differences. Under current regulations, adjustments resulting in minimal royalty differences require the same effort as larger adjustments. A more cost beneficial solution to both MMS and industry would be to allow small adjustments to be included in current month reporting. This would streamline the reporting process while not materially impacting the accuracy of current or prior periods.

- AFS/PAAS Differences - As with prior period adjustments, the same philosophy could be applied to these differences. Currently, letters are issued for what we would regard as minimal volume differences. If the threshold amount was raised in consideration of the cost to generate the exception, then the reporting could be streamlined with minimal impact upon the royalty collection.

- Penalty and Interest Invoicing - As with the above examples, the same philosophy could be applied to these differences. Currently, MMS sends bills to payors that cost far more to process than the MMS is recovering. If thresholds were instituted on penalty and interest invoices it would save significant processing costs for both MMS and industry with minimal impact upon the royalty collection.

Expected Savings: Moderate

OCSLA Refund Procedures

- Eliminate or Streamline Procedures

COPAS strongly supports recent changes that have been made relative to OCSLA Section 10, although COPAS does not believe these changes have gone far enough. Specifically, COPAS believes that OCSLA Section 10 refund requirements should be eliminated. The refund request process required by Section 10 is burdensome and costly for both the MMS and industry with no tangible benefit. For example, today, refund requests are not required for onshore properties. There does not seem to be any loss of control associated with refunds on these properties. All refunds taken by a lessee are subject to audit, thereby establishing control. This same process should be established for offshore properties.

Alternatively, if Section 10 refund request requirements are not eliminated COPAS offers the following suggestions: Eliminate documentation requirements for refund requests over $250M and/or increase this threshold to $500M; raise refund request limit to $5M; Exempt pure accounting adjustments for items such as production date adjustments and incorrect AID numbers; Exempt unit revisions because these revisions are often made more than two years after the date of production; establish a time limit on MMS for review of a refund request to expedite the process; and over payments on OCS properties should be allowed to be offset against any OCS underpayment.

Expected Savings: Significant

Authorize Settlement Authority at a Lower Level

Currently, the Director of the MMS is the ultimate authority for approval of settlements between lessees and the MMS. Except for the most important, controversial and significant monetary issues, COPAS believes this authority level is too high. The Director of the MMS should be the ultimate authority on a fraction of current settlement issues instead of being involved in all issues on a routine basis.

Specifically, COPAS believes the MMS could develop a settlement authority hierarchy based on dollars involved whereby ultimate authority could rest with different levels within the MMS. For example, the hierarcy could begin with the Office of Enforcement for a specific dollar range and descend thru various authority levels with the lowest level being Audit Supervisors. In the case of residencies, these audit supervisors have more knowledge regarding an individual company than any other individual or entity at MMS and are in the best position to make timely and knowledgeable decisions regarding specific issues.

The development of a settlement authority hierarchy would create efficiencies within both MMS and industry and aid in the reduction of litigation, number of appeals, etc.

**Expected Savings: Moderate**

Prepayment of Royalty

Calculating, reporting, and verifying royalty amounts applicable to "small" dollar onshore leases consumes significant administrative effort in the form of personnel and systems costs for some payors and the MMS. COPAS believes it would be worthwhile to initiate discussions aimed at determining if a mutually acceptable process could be developed giving payors the option to prepay their royalty obligation (for a to be determined time period) on these leases with no, or at least a minimum, of future true-up activity.

Cost savings would result for MMS and payors from a reduction in systems run time and staff effort devoted to the monthly royalty reporting process and associated error resolution (e.g., AFS v. PAAS, prior period adjustments, interest assessments, audit inquiries, etc.).

**Expected Savings: Small**

Efficiency Efforts Between MMS/Industry

COPAS strongly supports the MMS' open style of communication with industry that has taken place in the last few years. This open communication and dialogue have served to improve relations, increase education between the parties, achieve greater buy-in of ideas and recommendations and decrease development and implementation time of changes. This in turn has led to a increased efficiency between the parties and reduced administrative costs associated with these activities. Examples include the Negotiated Rulemaking Committees (Federal Gas Valuation and Indian), Allowance Study Team, and the MMS Common Reference Data NPR Laboratory Team.

Consequently, COPAS strongly suggests the continued use of the negotiated rulemaking process and study teams to address areas for improvement in the future and leverage off of the example set by these committees and teams.

**Expected Saving: Moderate**

In closing, I would like to thank you on behalf of COPAS for the opportunity to comment and provide specific suggestions relative to MMS reporting and payment processes we believe will result in significant cost savings being sought by the DOI if they are implemented. Additionally, members of COPAS will be glad to meet with DOI officials to discuss any of the suggested areas of improvement offered in this letter. Please call me at (713) 754-7677 if you have any questions or wish to discuss in more detail.

Sincerely,

J.B. Rollins
Chairperson, COPAS Federal Regulatory Affairs Subcommittee

cc: Mr. Bob Armstrong
Ms. Cynthia Quarterman

Acadiana
Anchorage
Canada
Coastal Bend
Colorado
Dallas
Fort Worth
Houston
Kansas
Los Angeles
Michigan
Mississippi

New Mexico
New Orleans
Ohio
Oklahoma City
Oklahoma-Tulsa
Permian Basin
Rocky Mountains
San Antonio
San Francisco
San Joaquin
Texas Panhandle
West Central Texas
Wichita Falls

May 23, 1995

Minerals Management Service
MMS Regulatory Coordinator
Policy and Management Improvement
1849 C Street NW, Mail Stop 4013
Washington, DC 20240

Attention: Ms. Bettine Montgomery

**Request for Comment on**
**Review of Existing Regulations**
**59 FR 15888 (March 28, 1995)**

Dear Ms. Montgomery:

The Council of Petroleum Accountants Societies (COPAS) Federal Regulatory Affairs Subcommittee submits the following comments on behalf of COPAS regarding your request for comment in your March 28, 1995 Federal Register notice. We appreciate the opportunity to provide suggestions for improvement that we believe will benefit the Minerals Management Service (MMS) and industry. Members of the subcommittee have extensive experience with the MMS' Royalty Management Program (RMP) rules and handle royalty valuation, reporting and payment, allowance filings, OCS refund requests, adjustments, bills, audits and other aspects of royalty matters on a regular basis.

Product Valuation

In today's natural gas marketing environment, gross proceeds as defined by the MMS, is increasingly difficult to ascertain. This is because of the tremendous changes in the natural gas marketing environment that have occurred as the result of open access and deregulation. Consequently, natural gas is now often sold far downstream of the wellhead after it has been aggregated with many other sources, complicating the valuation of natural gas for MMS royalty purposes.

To combat this uncertainty COPAS strongly advocates that the recommendations developed by the Federal Gas Valuation and Indian Negotiated Rulemaking Committees be promulgated as a regulation as quickly as possible.

In addition, we believe certain of the Federal Committee's recommendations relative to the elimination of processing and transportation allowance forms (extended also to oil) and the definitions of compression and transportation should be instituted immediately. This would bring quick and immediate administrative cost savings to both the MMS and industry with no loss of control.

Also, COPAS believes that clarity with respect to the definition of gross proceeds should be examined. Although simplifying and clarifying valuation with respect to natural gas has been achieved with the Federal Gas Valuation Negotiated Rulemaking Committee recommendations, additional effort should be expended to equitably, timely and clearly define gross proceeds in an ever changing gas marketing environment.

Reporting Procedures

- **Eliminate or streamline MMS Form 2014 reporting**

  Potentially millions of dollars each year could be eliminated if the MMS would work with industry to eliminate or streamline the level of reporting on the MMS Form 2014. The current costs associated with MMS Form 2014 reporting could be significantly reduced with little or no loss on the MMS's ability to monitor and control royalty payments.

  The potential savings would result from: 1) Simplified systems (the current system is too complex), thus reducing computer costs for both the MMS and industry; 2) Reporting requirements would be simpler, thus, easier to comply with which would result in more accurate reporting (less time spent correcting reporting errors); 3) Fewer lines would be reported due to simplified reporting (by eliminating/simplifying selling arrangement codes, transaction codes, payment method code, calculation code, adjustment reason code, and revenue source code), and allowing the transportation/processing costs to be reported on the same line as the associated revenue versus a separate line as required today.

- **Report prior period adjustments on a "net" basis**

  The current instructions require adjustments for prior periods to be made with a reversal of the prior report line and the correct line. A simpler and less costly approach would be to allow industry to report the adjustment on a "net" basis. Each year millions of lines are reported by payors to the MMS whose net amount is insignificant (some are for no net monetary value at all, just a correction of a code). This would be a major step toward reducing not only the number of lines reported, which may encourage more EDI reporting, but also the system maintenance costs of historical reporting data.

- **Change estimated payment from lease level to payor level**

  The current requirement of filing and placing estimated payments at a lease level creates a burden on industry and the MMS. Changes that have occurred in the gas market make lease level estimates unreasonable. Producers move in and out of the market, change markets and routinely sell and purchase properties making it necessary for monthly monitoring and updating of estimated payments to avoid interest assessment. Likewise, lease level monitoring of estimates for today's gas market creates a significant increase of cost and administrative effort for the MMS.

  COPAS believes that estimates established at the payor level would simplify the process for both industry and the MMS. Establishing payor level estimates would eliminate the time consuming process of allocating, monitoring and adjusting lease level estimates. Also, it seems unfair for industry to have on deposit adequate monies but be penalized interest merely because it is so difficult and often impossible to maintain the estimate correctly on an individual lease basis. Regardless of whether estimates are established at the payor level or at the lease level, we believe interest should only be administered at the payor level. In order to keep the various Indian Tribes whole, it may be that interest should be assessed at the payor level on the basis of each Indian Tribe.

- **Eliminate Payor Information Form Filings (PIFs)**

  COPAS believes the PIFs are an unnecessary reporting requirement providing no significant or tangible benefit to the MMS and should be eliminated. COPAS does not believe the PIFs are necessary to report and pay royalties accurately. The National Performance Review team (Common Reference Data Reengineering Laboratory) considered this recommendation in their analysis, but due to time constraints had to defer a decision on the issue until further information could be obtained. However, COPAS firmly believes when this issue is reviewed, no one will be able to justify the significant costs, estimated at $2-3 million dollars a year, currently being expended by the MMS and industry in filing and processing these forms.

Thresholds

MMS regulations and systems require an exactness that is frequently not cost justified to either MMS or industry. Measuring, tracking, and accounting for oil and gas production is not an exact science. Many of MMS' system tolerances are so low that MMS chases small differences that cost MMS more than they recover in additional royalty. COPAS suggests that MMS modify the regulations and system tolerances/thresholds so that only those exceptions that are cost beneficial for MMS to pursue are generated. Listed below are examples to better illustrate the need for tolerances/thresholds.

- Prior Period Adjustments - The requirement for adjustments is typically caused by correcting measurement inaccuracies, allocation errors or pricing differences. Under current regulations, adjustments resulting in minimal royalty differences require the same effort as larger adjustments. A more cost beneficial solution to both MMS and industry would be to allow small adjustments to be included in current month reporting. This would streamline the reporting process while not materially impacting the accuracy of current or prior periods.

- AFS/PAAS Differences - As with prior period adjustments, the same philosophy could be applied to these differences. Currently, letters are issued for what we would regard as minimal volume differences. If the threshold amount was raised in consideration of the cost to generate the exception, then the reporting could be streamlined with minimal impact upon the royalty collection.

- Penalty and Interest Invoicing - As with the above examples, the same philosophy could be applied to these differences. Currently, MMS sends bills to payors that cost far more to process than the MMS is recovering. If thresholds were instituted on penalty and interest invoices it would save significant processing costs for both MMS and industry with minimal impact upon the royalty collection.

COPAS encourages MMS to seriously consider the concept of thresholds/tolerances in the rulemaking process. We believe this would streamline the reporting process while reducing administrative costs.

OCSLA Refund Procedures

COPAS strongly supports recent changes that have been made relative to OCSLA Section 10, although COPAS does not believe these changes have gone far enough. Specifically, COPAS believes that OCSLA Section 10 refund requirements should be eliminated. The refund request process required by Section 10 is burdensome and costly for both the MMS and industry with no tangible benefit. For example, today, refund requests are not required for onshore properties. There does not seem to be any loss of control associated with refunds on these properties. All refunds taken by a lessee are ultimately subject to audit, thereby establishing control. This same process should be established for offshore properties.

Alternatively, if Section 10 refund request requirements are not eliminated COPAS offers the following suggestions: Eliminate documentation requirements for refund requests over $250M and/or increase this threshold to $500M; raise the refund request limit to $5M; Exempt pure accounting adjustments for items such as production date adjustments and incorrect AID numbers; Exempt unit revisions because these revisions are often made more than two years after the date of production; establish a time limit on MMS for review of a refund request to expedite the process; and over payments on OCS properties should be allowed to be offset against any OCS underpayment.

Efficiency Efforts Between MMS/Industry

COPAS strongly supports the MMS' open style of communication with industry that has taken place in the last few years. This open communication and dialogue have served to improve relations, increase education between the parties, achieve greater buy-in of ideas and recommendations and decrease development and implementation time of changes. This in turn has led to an increased efficiency between the parties and reduced administrative costs associated with these activities. Examples include the Negotiated Rulemaking Committees (Federal Gas Valuation and Indian), Allowance Study Team, and the MMS Common Reference Data NPR Laboratory Team.

Consequently, COPAS strongly suggests the continued use of the negotiated rulemaking process and study teams to address areas for improvement in the future and leverage off of the example set by these committees and teams.

Reciprocity

COPAS believes that regulations and statutes regarding royalty payment and reporting functions should be reciprocal. Specifically, that industry be afforded the same rights as the MMS with respect to a certain and clear statute of limitations, matching time frame on OCSLA Section 10, corresponding right to refund and credits on overpayments and a right to interest.

In closing, I would like to thank you on behalf of COPAS for the opportunity to provide suggestions and comments we believe will result in significant cost savings to both the MMS and industry once they are implemented. Additionally, members of COPAS will be glad to meet with MMS officials to discuss any of the suggested areas of improvement offered in this letter. Please call me at (713) 754-7677 if you have any questions or wish to discuss in more detail.

Sincerely,

J. B. Rollins
Chairperson, COPAS Federal Regulatory Affairs Subcommittee

cc: Mr. Darrell Gingerich
Ms. Mary Stonecipher
Mr. Saloman Tristan

# TESTIMONY

*of*

# THOMAS A. DUGAN

My name is Tom Dugan and I am President of Dugan Production Corporation, located in Farmington, New Mexico. We operate on 450 developed federal leases and have approximately 40 undeveloped federal leases. We have been in business in the San Juan Basin for 36 years.

I want to discuss some of the problems associated with current regulations and practices of the Minerals Management Service. MMS regulations for royalty reporting are cumbersome and difficult to comply with, especially in this rapidly changing industry. Many small producers such as myself spend a tremendous amount of time and effort devising ways to reduce costs, maximize profits, and extend the life of the lease to benefit all interested parties. We should be commended by the MMS for these efforts, instead of constantly being overburdened with unnecessary reporting requirements, excessive auditing procedures, and unfair penalties. The bottom line is that the MMS lacks reasonableness and basic common sense. Specific examples of my company's experience with the MMS will justify my statements.

EXAMPLE 1: "THE SNOWSTORM"

In an MMS invoice dated January 13, 1992, Dugan was assessed $7,650 which represented an assessment of $10 per report line for the September 1991 MMS 2014 report. The MMS Royalty Remittance report was due by 4:00 p.m. on October 31, 1991. Due to a crippling snow storm in Denver, Federal Express could not deliver our report as scheduled. The MMS 2014 report was delivered to MMS at 10:05 a.m.a on November 1, 1991. Dugan appealed the invoice on January 31, 1992 and had to post a Letter of Credit in March 1992. The MMS field report, dated June 3, 1992 recommended the appeal be denied, allowing the assessment to stand. I wrote to Senator Pete Domenici requesting assistance on June 25, 1992. In that letter I explained that due to the snow storm more than 100 other companies experienced the same problem and were also penalized. The MMS was not willing to compromise. Senator Domenici wrote the Secretary of the Interior on our behalf asking for a special dispensation for the uncontrollable event. Although this Bill was eventually credited, a tremendous amount of valuable time and money was spent appealing the assessment. This Bill addresses the problem by allowing the Secretary to waive interest when circumstances such as this warrant it.

**EXAMPLE 2: "THE 2900% PENALTY"**

**On July 23, 1992, my company was assessed a penalty for royalty reporting due to an adjustment. The penalty amounted to $9,200 for the reporting of 920 lines of adjustments. These adjustments resulted in additional royalty of $319.63 to the Federal Government. We appealed the assessment on August 10, 1992.**

**A letter of Credit was issued September 1, 1992 and renewed September 1, 1993. Our appeal was resolved on October 1, 1993.**

**From time to time adjustments are necessary to report royalties correctly. These amendments cannot be predicted. The best an Operator can do is process the adjustments as soon as they are received in order to lessen the penalty imposed by MMS. The flat rate of $10 per line is totally unreasonable in certain situations as demonstrated by this example. A less-diligent Operator may not have bothered to report an additional 920 lines in order to only pay $319.675 in additional royalties. The royalty per line averaged less than $1.50. Imposing a $10 per line penalty equated in an astronomical 299% penalty of the total royalty due.**

**In the appeal we tried to emphasize that the penalties were intended to compensate MMS for actual administrative costs incurred by the late reporting and should not be used to turn the MMS into a money-making agency. We were willing to pay for any actual costs incurred by the MMS as a result of the amendments. The $10 flat rate per line penalty is unreasonable and forces many marginal wells to become uneconomical to produce. In this case, the MMS finally credited the bill, but it took over a year and the loss of many man-hours spent to resolve the problem. Again, this Bill addresses the problem discussed here.**

**EXAMPLE 3: "THE NIGHTMARE"**

**A tremendous burden is being placed on Operators due to the number of audits being performed and the amount of data required to comply with audit requests from the various agencies. The MMS Dallas office started an audit of our royalty payment procedures in 1990. They audited the previous five-year period. It took two years, countless man hours, and thousands of copies to complete the audit. Our appeals for their audit findings have been dormant since 1992. We are now currently being audited again by the MMS Oklahoma City office. This audit also spans a five-year period. The MMS requires copies of every document associated with determining the amount of royalty paid. We estimate that it takes at least ten hours and 750 copies to supply the requested**

data for one lease. Audits typically included about ten leases. This puts an undue burden on our staff. Once the copies are provided, many hours are spent answering questions and explaining various documents.

A similar situation exists with the Bureau of Land Management. They are actively conducting Production Accountability Audits to verify that the volumes of production are being properly reported. These audits typically go back at least six years, but can go back to the date of first production. Copies of everything associated with oil and gas measurement are required to be provided. A copy of a typical BLM request is being provided for your information. Again, countless hours are spent compiling, copying, and retaining the data. The Operator is given 20 working days to provide all the requested data. This strict deadline is most difficult to meet considering the daily workload of our staff, not to mention that numerous requests are usually sent out and due at the same time. We have received more than twelve such requests in the last year.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 173702
Denver, Colorado 80217-3702

IN REPLY REFER TO:
CVD-FCB-PCS
Mail Stop 3672
Re: F/O&G

OCT 20 1994

CERTIFIED MAIL --
RETURN RECEIPT REQUESTED

# DEMAND FOR PAYMENT

Dear Payor:

The Minerals Management Service (MMS) directs you to pay the enclosed bill for the late payment of royalties, assessments, or insufficient estimates. Under 30 CFR 218.54 (1993) interest charges are assessed when a payment is received after its due date or when an estimate balance is less than the actual royalties reported on a specific lease for a given sales month.

PAYMENT INSTRUCTIONS

Your payment must be received by the due date shown on the Remittance Advice. Payments received after the due date are subject to further interest charges and penalties.

If you pay by check, payment must be sent to the address indicated on the Remittance Advice. To ensure proper credit, return the Remittance Advice page with your payment and record your payor code and the invoice number on your check. If you pay by electronic funds transfer (EFT), include your payor code and the invoice number in the "Payment Information" field of the EFT message.

APPEAL RIGHTS

You have the right to appeal this Demand for Payment if you disagree with its contents [30 CFR 290 (1993)]. Your notice of appeal must be filed with:

Chief, Compliance Verification Division
Minerals Management Service
P.O. Box 173702, MS 3672, ATTN: Appeals - FCB
Denver, Colorado 80217-3702

You have 30 days from receipt of this bill to file an appeal. The appeal must include a written justification why MMS should reverse or modify the bill. You may file additional information within 60 days of receipt of this bill if you notify us of your intention in your initial appeal. The time for filing documents related to your appeal may be extended if you file a written request for an extension within 60 days of receipt of this bill at the address noted above.

**********

Due to the voluminous size of the bill for collection, the entire contents may be found in the subcommittee files

# STATE and TRIBAL ROYALTY AUDIT COMMITTEE

State of Alaska • Blackfeet Nation • State of California • State of Colorado • Fort Peck Tribes
Jicarilla Apache Tribe • State of Louisiana • State of Montana • Navajo Nation • State of New Mexico
State of North Dakota • State of Oklahoma • Shoshone & Arapaho Tribes • Southern Ute Indian Tribe • State of Texas
State of Utah • Ute Indian Tribe • Ute Mountain Ute Tribe • State of Wyoming

*Perry Shirley, Chair* (602) 871-6340
*Wanda Fleming, 1st Vice Chair* (406) 444-2441
*George Staigle, 2nd Vice Chair* (701) 250-4682

*Former Chair, Ex Officio:*
Reed L. Simpson, (801) 297-4708

July _, 1995

By Fax, Original _/ Mail

The Honorable Ken Calvert, Chairman
Subcommittee on Energy and Mineral Resources
House Natural Resources Committee
1626 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I am writing to you on behalf of the State and Tribal Royalty Audit Committee (STRAC) to request that the July 18, 1995 hearing on the Federal Oil and Gas Royalty Simplification and Fairness Act of 1995, H.R. 1975, be rescheduled for a later time.

STRAC is an organization composed of auditors from 19 mineral producing States and Tribes, all of whom participate with the U.S. Department of the Interior's Minerals Management Service (MMS) in its royalty audit program. STRAC representatives have also taken an active role in the development of MMS regulations and policies, and have served on MMS advisory committees and performance review panels. STRAC has a unique familiarity with the federal royalty collection program.

STRAC understands that the impetus for this legislation is industry's concern that MMS reviews decades-old accounts during its audits and industry's business need for repose. STRAC sympathizes with these concerns. As royalty recipients, STRAC's jurisdictions would like to receive the full revenues owed in the most timely manner.

H.R. 1974 is a complex piece of legislation that clearly goes far beyond proposing a reasonable statute of limitations. STRAC's initial review of this legislation indicates, that whether intended or not, the Act would have the effect of:

- Repealing DOI's authority to enter into delegation or cooperative agreements with States, and repeal each State's statutory right to sue.

- Establishing a new offsetting system for royalty payments that will require 100% lease coverage during audit. This will increase costs

to the federal government and to the States through net receipts sharing.

- Placing severe limits on the type of data that DOI can require be reported up front and thus cripple the ability to implement cost effective, less intrusive automated compliance programs.

- Exempting the bulk of onshore federal leases from any compliance review, ... it auditing or accounting.

- Tying up the audit process with disputes over documents since the statute of limitations would not be tolled under such circumstances.

These are just five examples of the practical effects of H.R. 1975. STRAC's review and analysis, however, continues. At this point, STRAC has serious concerns that the effect of H.R. 1975, if enacted, will be to return to the days of the "honor system" of royalty payments that the Independent Linowes Commission confirmed resulted in public loss and that led former Secretary James Watt to establish MMS and seek legislative reform.

STRAC would like to apply the benefits of its experience to assist the efforts of its member jurisdictions and your Subcommittee to craft beneficial reforms to the federal royalty management program. But in the two short weeks since the bill was introduced, STRAC members have not had the time to conduct a full analysis or fully brief the relevant officials in their member jurisdictions.

Indeed, on the day of the scheduled hearing, July 18, the great majority of the interested officials, including many STRAC members, will be in Denver, Colorado, to attend the first meeting on Secretary Babbitt's so-called "devolution" proposal. As you noted during the Subcommittee's June 8 hearing on "devolution," its "value . . . is that this Administration has invited a dialogue" on the issue of the proper role of the federal government in federal land management programs. H.R. 1975, however, would appear to preempt many of the issues that arise under the "devolution" proposal.

For the foregoing reasons, STRAC respectfully requests that the July 18 hearing be postponed. In the event that this proves impossible, I have attached for your consideration in connection with H.R. 1975 a brief "Q&A" that outlines some of the impacts of the proposed legislation.

Your consideration of STRAC's request and its views is greatly appreciated.

Very sincerely,

Wanda Fleming

Wanda Fleming
First Vice Chair

Enclosure with Original

Talking Points
The Proposed Federal Oil and Gas Royalty "Fairness" Act of 1995

Summary

The industry-drafted Federal Oil and Gas "Simplification" and "Fairness" Act of 1995 would severely limit the Department of the Interior's ability to collect the royalties industry owes under leases whereby they profiting from the extraction of public resources. Under the "Fairness" Act:

- DOI will n l to audit every one of over 21,500 leases, complete administrative review in three years, and start actions to collect in six years, or forever lose the public's right to what is lawfully owed from industry's exploitation of public lands. No realistic tolling of these time limits will be allowed, even where industry denies DOI access to necessary audit documents. And, DOI's ability to receive meaningful information in a timely manner would be so restricted that the only means left to it for overseeing industry's royalty payments will be time consuming and expensive audits. DOI would lose the authority, shared by every other federal agency in the government, to collect debts owed the United States through administrative offsetting procedures. DOI's authority to charge interest on unpaid royalties would effectively end. DOI would lose the right to enter into contracts with States to audit leases.

- Industry would gain the incentive to "beat the clock" on DOI by litigating every issue and order. Industry will have the incentive to stall audits since disputes over document access will not toll any time limits. Industry will retain all its review rights without realistic concern that six years may have passed. Unlike DOI, industry will be able to collect nearly all overpaid royalties, even after six years, simply by filing a notice. Industry lessees will gain interest on any overpayments and will be given discretion over when and how overpayments will be repaid by the government and thus over the amount of interest. Industry will be effectively relieved of any duty to bring all of its lease accounts into compliance with audited results and their duty to accurately report.

The net effect of the "Fairness" Act will be to make meaningful royalty management so difficult, time consuming and expensive that it will cease to exist. What will be left is a federal bureaucracy that simply functions to sanction an industry "honor" system -- a system under which the public is the proven loser. The following, while not an all-inclusive evaluation of the proposed "Fairness" Act, sets out some of the adverse effects that would follow enactment of the "Fairness" Act.

Question: "Isn't the Royalty "Fairness" Act necessary to correct the inequity to industry of the lengthy federal royalty collection process?"

Answer: No. The proposed Act is not needed. DOI's Minerals Management Service (MMS) has spent most of its short 13 year life trying to accommodate industry's desire to conduct royalty audits and collection procedures within a six (6) year time frame. Audits of the small payor companies are currently on a five (5) year schedule, with large companies on a three (3) year schedule. Global settlements have been reached or are in process to resolve the older, outstanding issues. MMS has expended considerable resources on efforts to streamline the administrative appeals process and study alternative approaches to dispute resolution. Progress has been made.

Most delays in the royalty collection process are caused by industry. In its early years, MMS spent the much of its resources processing industry refund requests. Delays in audits normally result from industry's refusals to cooperate and provide access to needed documentation. Delays in final agency action are caused by industry initiated appeals. The great number of these appeals raise routine, well-settled issues; thus they seem almost designed to achieve delay. While appeal is a lengthy process, industry has not actively assisted in ways to shorten the process: for example, not one federal lessee volunteered for MMS's alternative dispute resolution pilot program. Nothing in the "Fairness" Act will serve to hinder industry's delays and indeed more incentives to delay the process will exist.

Question: "Doesn't the Royalty "Fairness" Act serve the public interest by forcing the federal government to operate more efficiently and effectively?"

Answer: No. The Act will require more not less government. To maintain the current level of DOI audit compliance activities (which some believe are inadequate), the Act will easily require a large increase in federal resources. Under the Act, DOI is limited to six years for commencing administrative or judicial proceedings. The definition of "order" under the Act will also effectively require DOI to actually audit each and every federal lease, i.e., 100% lease audit coverage, rather than following standard audit sampling procedures. Taken together, these limitations mean audit activity will need to substantially increase or else the royalty audit program will be hopelessly crippled. For some sense of comparison, today only about 2% of the 21,768 federal onshore and offshore leases are sampled during audits by DOI; DOI uses sampling to detect compliance errors over all a lessee's holdings. But under the "Fairness" Act, DOI could enforce compliance and make collections only on leases actually audited; concomitantly, lessees will be relieved from bringing all of their leases into compliance with the law and from paying what is fully owed the public.

The need for further audit resources would be exacerbated by the Act's one year limitation on DOI's ability to review offsets unilaterally taken by a lessee.

In order to maintain its current level of compliance activities within these limitations of the "Fairness" Act, DOI would need to require more detailed up front reporting by lessees. But under the "Fairness" Act, the information DOI may require industry to report is restricted to such an extent that only minimal, if any, cross checking of a payment's accuracy will be possible. Some lessees would be statutorily relieved of any compliance so long as some level of payment is received from them.

Clearly, under the "Fairness" Act, the only means that will be left for meaningful royalty compliance review will be time consuming and expensive audits. But, the need for increased resources would not stop with audit. The Act proposes a three year limitation on DOI to complete any administrative proceeding. No matter what the merits or complexity of an individual appeal, a lessee will win if DOI does not meet this time limit so long as the particular order under review involves less than $2,500. Under the language of the Act, this is not simply a win by default, but a win on the merits; meaning that precedent and policy may be set by engaging in dilatory litigation tactics. On appeals of orders involving larger amounts, lessees will be entitled to de novo judicial review -- a full evidentiary review. DOI decisions would not be entitled to the deference afforded decisions of other federal agencies. Accordingly, an increase in DOI's appellate review and legal staffs will be required. And an increase in the level of appeals and court actions by industry should be expected. The "Fairness" Act invites more not less litigation.

Question: "Won't a limit on the events that could toll a limitations period act as an incentive to DOI to speed up its audit and collection process?"

Answer: No. The "Fairness" Act gives industry the incentive to delay and play "beat the clock" with a handicapped DOI. The Act gives lessees the incentive to deny auditors access to documents and to litigate all issues.

Auditing federal lessees is not a cooperative exercise. Lessees often delay turning over documents to auditors, denying access unless specifically identified documents are named. Even where auditors are successful at playing "name that document," lessees may refuse access, forcing the issuance of government orders, which the lessees then appeal through the administrative then judicial processes. The issue of document access can easily be extended for six years or more. The "Fairness" Act does not provide for tolling under such circumstances.

The case law under most statutes of limitation recognizes that time limits on claims should not begin to run until the injured party knew or should have known of its claim. When control over the means of discovery of a claim rests with an opposing person, fundamental fairness dictates tolling of applicable time limits.

The "Fairness" Act also gives lessees an incentive to litigate and appeal all royalty payment orders. The three year time limit put on DOI to complete its administrative review process will provide an impetus for clogging an agency appeal process that is already overflowing with lessee appeals on routine, previously settled and indeed frivolous issues (to date, nearly all agency appeals involving royalty issues have been initiated by lessees). The rationale for this is simple: under the "Fairness" Act if DOI fails to complete review within three years, the lessee is deemed the winner or will be entitled to de novo review by the courts.

Question: "Won't the "Fairness" Act result in a simplified federal royalty management program?"

Answer: No. The "Fairness" Act will not simplify the royalty management program, it will cripple it.

The "Fairness" Act will increase the complexity of the royalty management program to the loss of the public. Part of the complexity of the "Fairness" Act will result from the proposal to determine the royalties owed on a "net" basis. Currently, royalty overpayments and underpayments are determined on a lease basis – each lease being under the law a separate contract. The "Fairness" Act will permit a lessee to offset its overpayments and any accrued interest against obligations owed on all of its leases in a geographic area. This would be allowed without any prior approval or notification to MMS. Thus in order to account for what is owed, MMS will no longer be able to look at the activity on a particular lease but will need to review all of a lessee's payments on leases in a State.

But in a classic catch-22, under the "Fairness" Act DOI will be barred from reviewing all of a lessee's payments on leases in a State. Indeed, by way of example, DOI would be statutorily precluded from assuring that royalties were properly paid on over 75% of federal onshore leases producing crude oil. Under the Act, leases with wells producing at a certain rate would be exempt from all compliance activities. Since under the "Fairness" Act a lessee determines its royalty obligations by offsetting across all of its leases, this limit on DOI effectively means that there will be no way for the government to check industry royalty payments.

The "netting" provisions of the "Fairness" Act will place particular and unique burdens on states. Revenues received by many states must be allocated to the counties in which the leases are located for impact assistance, e.g., schools, roads. Proper allocation will be made an impossibility under this Act.

Question: "Isn't it fair to equalize the interest burden?"

Answer: No. Under principles of sovereign immunity, the United States is not liable for interest on its debts. Congress should not waive this immunity unless special

circumstances justify an interest award. This is especially true in budget cutting times when every dollar spent must be scrutinized. There is nothing that justifies a waiver of sovereign immunity in favor of federal lessees.

Interest at the rate currently specified under FOGRMA was intended by Congress to act as an incentive to federal lessees to pay royalties accurately, in full and on time. An overpayment is an error in payment that DOI has little ability to detect upon receipt. Without notice from the lessee or audit, DOI has no means of knowing that a correction is needed and thus no means to reduce the government's liability for interest. Lessees, however, have the information necessary to correct those errors, and their incentive to make corrections is reduced if interest is accruing on the overpayments.

Moreover, interest is not equalized under the "Fairness" Act; rather the only recipient of interest will be industry. Due to the offsetting provisions of the "Fairness" Act, lessees are permitted to credit themselves interest, without prior approval of DOI. In other words, lessees will have complete discretion over the timing and amount of interest they will receive from the government. DOI, on the other hand, may not charge interest on a single lease debt. Rather, before interest can be charged, DOI must offset all overpayments and underpayments across all a company's leases in a Statewide area. Since DOI will not have the resources to review 100% of a company's leases and indeed since DOI will be barred from auditing most onshore leases, industry's obligation to pay interest on underpaid royalties will be an effective nullity, as will be DOI's ability to verify the accuracy of the interest industry credits itself at the public's expense.

Question: "Aren't the impacts of the "Fairness" Act identical to the States and DOI?"

Answer: No. While many of the burdens imposed under the "Fairness" Act discussed above are shared by States and DOI, special and unique burdens will be experienced by States. The financial impact on many mineral producing States is greater than that for the federal government. For onshore lands, States share 50% of the royalty revenues collected by MMS. For many States, these receipts form a greater percentage of their overall revenues than is true for the federal government. These revenues are used to the greatest extent to fund education. Losses, experienced because of a reduction in audits or because DOI's inability to complete appellate review results in a default, will be keenly felt in these States.

Indian tribes and allottees, in many states, benefit from the educational opportunities funded by state governments. These groups, too, will feel the loss.

The "Fairness" Act contains State-specific provisions that are not only burdensome but also demonstrate that the Act is based on some fundamental

misunderstandings concerning the royalty management program and the State and federal relationship.

Generally, under current law, States have little control over the royalty management program and have no power to control the events that would trigger the time limits imposed under the "Fairness" Act. However, under current law, States can assist the federal government by accepting delegations of authority to conduct audits and States can sue lessees directly to recover underpaid royalties. These powers have served as a means to enhance State ability to protect their financial interests. State power would be repealed under the "Fairness" Act, and State beneficiaries would be deprived of any role in the royalty management program.

The "Fairness" Act purports to change the obligation of DOI to pay States interest when royalty payments are not timely disbursed. The "Fairness" Act oddly provides that interest will not be paid to the States if (1) it is waived, or (2) it is not collected. To the extent that this suggests that the Secretary may waive his obligation to pay interest to the States, it is on its face objectionable. Congress intended DOI to be liable for interest because of delays attributable to its own failure to disburse revenues after collection from lessees. By analogy, this provision is like one that would allow lessees to waive their obligation to pay interest on underpayments of royalties. The statement that interest would not be owed if not collected is simply nonsensical. The interest owed the States does not represent interest paid by lessees for underpayments. Indeed, for years, DOI has requested a separate appropriation to cover its obligation under §111(b) of FOGRMA to pay interest to States, but Congress, in order to strengthen the incentive to DOI, required that interest be paid from MMS's own budget.

Question: "Doesn't DOI's authority to punish industry's noncompliance through assessments need to be curbed?"

Answer: No. Effective and efficient royalty collection is dependent on receiving timely and accurate information. This is in everyone's interest – receiving good information up front and on time will reduce the time and burden of royalty compliance activities. In order to assure the receipt of reliable information, MMS has imposed assessments on industry. Assessments are not penalties. Rather they are simply reimbursements to the government of the costs it incurs in detecting and correcting lessee reporting errors. Such costs are rightfully borne by the lessee. Indeed, in these days of reinvention, Congress should encourage all agencies to reevaluate their activities to see what costs may be passed through equitably. Also worthy of note is the fact that the total assessments collected in 1994 from the over 1800 payors on 21,768 federal and onshore leases was less than $1 million.

MMS's assessment program would effectively end under the "Fairness" Act. The Act would require MMS to show that a lessee had engaged in knowing or wilful

misconduct before an assessment could be made, and requires only good faith compliance by lessees. It will not be cost effective for MMS to pursue assessments under such a difficult standard of proof. By way of comparison, MMS's existing penalty authority is circumscribed by similar burdens of proof and in nearly 13 years only a handful of penalties have been pursued.

Question: "Doesn't the "Fairness" Act simply establish reciprocality between DOI and federal lessees with regard to their claims against each other?"

Answer: No. The "Fairness" Act tips the balance in favor of the federal lessee. The answers to the preceding questions clearly demonstrate this. Other examples of the overt lack of reciprocal treatment under the Act include:

- Lessees would be permitted to recoup overpayments beyond a six year limit upon notice; whereas DOI would be barred from collecting any underpayment upon expiration of six years.

- Lessees would be permitted to offset overpayments against any outstanding debt owed to the government, whereas DOI would have no control over offsetting. These two limitations are also inconsistent with the debt collection procedures applicable to federal agencies generally.

- Lessees would be entitled to interest on overpayments without exception, whereas interest on underpaid royalties could be waived. This is particularly unfair to States who share in the interest collected.

- Lessees would be entitled to interest on overpayments immediately, whereas DOI would have to wait until an underpayment had been outstanding for one year before collecting interest.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

AUG 24 1995

Honorable Ken Calvert
Chairman, Subcommittee on Energy and
Mineral Resources
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find additional information requested at the hearing before the Subcommittee on Energy and Mineral Resources, held on July 18, 1995, regarding H.R. 1975 -- the Federal Oil and Gas Royalty Simplification and Fairness Act of 1995.

The enclosed information has been prepared for insertion as requested on page 36 of the transcript, lines 800 - 806.

I am also pleased to be able to report significant progress implementing actions recommended in these documents. For example, the Minerals Management Service (MMS) has implemented procedures for establishing Royalty Policy Teams when dealing with contentious royalty issues, pursuant to both the September 1993, "MMS Royalty Management Service Reinvention Laboratory Report" and the MMS section of the March 1994, "Reinvent Government Report." Two examples are the Negotiated Rulemaking Committees established under the Federal Advisory Committee Act. The diverse affected membership of these committees includes representatives from industry, States and Tribes. These parties have worked with us to reach consensus on streamlining of Federal and Indian gas valuation procedures. Publication in the Federal Register of a proposed revised Federal gas valuation rule is imminent; a similar rule to revise Indian gas valuation procedures is being drafted by the committee.

You may be interested to know that the MMS already accepts data from industry in certain electronic media. However, the March 1995, "NPR Summary Report," describes a number of electronic commerce initiatives that are being pursued to streamline and simplify reporting processes. These include, but are not limited to, Electronic Data Interchange (EDI). Two large companies have entered into agreements to use the more efficient EDI reporting medium. Additional companies are also studying the feasibility of submitting data through EDI. Piloting of acceptance of payments via Automated Clearing House (ACH) has also been implemented.

Pursuant to the "Report on Administration of Transportation and Processing Allowances" the MMS, on August 7, 1995, published a proposed rulemaking in the Federal Register to streamline forms-filing requirements and reduce associated penalties. The report and

proposed rule incorporates the recommendations of an MMS Study Group which obtained input from States, Tribes, and industry, and was approved by the Royalty Management Advisory Committee.

As a result of recommendations in the May 1995, "Common Reference Data Reengineering Laboratory Report," the processing of Payor Information Forms (PIF's) was selected as the pilot process for RMP's new technology called "Workflow." Under "Workflow" software, PIF's will be processed in a paperless environment, while practically eliminating administrative requirements such as tracking, duplicating, and filing.

The MMS plans also to undertake improvements in solid minerals data processing; RMP's internal structure for managing other reference data; update of offshore lease data by electronic means; electronic transmission of lease accounting data from the BLM; reporter training; and streamlining of nonproducing and producing lease workloads. These were also addressed by the Common Reference Data Reengineering Laboratory.

Thank you for the opportunity to provide this material to the Committee.

Sincerely,

Cynthia Quarterman
Director

Enclosures (NOT CONTAINED IN TRANSCRIPT BUT ARE ON FILE WITH THE COMMITTEE)

cc: Honorable Don Young
Chairman, Committee on Resources
House of Representatives

A BILL

To provide authority for the Department of the Interior to pay interest on certain payments under onshore and offshore Federal and Indian mineral leases, and to revise Sections 10 and 27 of the Outer Continental Shelf Lands Act to extend the time period and procedures for requesting refunds and taking credits of royalty overpayments under Federal offshore leases, and to revise the requirements applicable to selling royalty oil or gas taken in kind from Federal offshore leases.

*Be it enacted by the Senate and House of Representatives of the United States in Congress assembled,*

SECTION 1. The Federal Oil and Gas Royalty Management Act of 1982 (Public Law No. 97-451) (30 U.S.C. 1701 *et seq.*), is amended to add a new section 111A (30 U.S.C. 1721A) as follows:

"SEC. 111A. **Authority to pay interest on certain payments under Federal and Indian mineral leases held by the Secretary pending adjudication or for potential offset.**

"(a) Notwithstanding any provision of section 104 of this Act, or any amendment to any other law made by any provision of section 104 of this Act, or any provision of section 10(a) of the Outer Continental Shelf Lands Act of 1953 (43 U.S.C. 1339(a)), the Secretary shall establish with the Secretary of the Treasury an account in which the Secretary shall hold any royalty or any other payment made to the Secretary under or in connection with any lease or leasing law administered by the Secretary for exploration or development of oil, gas, coal, any other mineral, or geothermal steam on Federal lands, Indian tribal or allotted lands, or the Outer Continental Shelf, which was paid to the Secretary under protest pending any administrative appeal or action for judicial review of any order or decision requiring such payment. Upon disbursement to any recipient prescribed by law other than any account in the Treasury, or upon refund or credit of any amount to the royalty payor, the Secretary shall pay interest to the recipient or to the royalty payor, at the rate equal to the rate determined by the Secretary of the

Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611), from the date of receipt of the payment until the date of disbursement to the recipient or the date of refund or credit to the royalty payor, as applicable (except that interest on monies paid to the Secretary pending administrative appeal or judicial review before the date of enactment of this section shall be paid only from the date of enactment of this section until the date of disbursement or refund or credit).

"(b) If the Secretary, pursuant to rule, requires a royalty payor to report amounts which would have been reported and taken as credits for excess payments previously made and holds such amounts as a credit balance for possible offset against other amounts due from that payor, the Secretary shall pay interest upon disbursement to any recipient prescribed by law other than any account in the Treasury, or to the royalty payor if any amount held is refunded or credited to the payor, from the date the amount was reported as a credit balance to the date of disbursement to the recipient or the date of refund or credit to the royalty payor, as applicable, at the rate equal to the rate determined by the Secretary of the Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611).

"(c) Interest under paragraphs (a) and (b) shall be paid from amounts received as current receipts from sales, bonuses, royalties (including interest charges collected under section 111 of this Act) and rentals of the public lands and the Outer Continental Shelf under the provisions of the Mineral Leasing Act of 1920, as amended, the Geothermal Steam Act of 1970, as amended, and the Outer Continental Shelf Lands Act of 1953, as amended, which are not payable to a State or to the Reclamation Fund.

SEC. 2. Revision of time period and procedures for requesting refunds and taking unilateral credits of royalty and other overpayments under Federal offshore leases.

Section 10 of the Outer Continental Shelf Lands Act (43 U.S.C. 1339) is amended –

(1) by amending subsection (a) to read as follows:

"(a) When it appears to the satisfaction of the Secretary that any person has made a payment to the United States in connection with any lease under this subchapter in excess of the amount he was lawfully required to pay, such excess shall be repaid to such person or his legal representative. The Secretary shall certify the amounts of all such repayments to the Secretary of the Treasury, who is authorized and directed to make such repayments out of any moneys in the special account established under section 1338 of this title and to issue his warrant in settlement thereof. The Secretary shall not make any such repayment unless a request for refund is filed with the Secretary within five years after the making of the payment, or within such longer time as the Secretary may by rule prescribe. No lessee or other royalty payor shall take any unilateral credit for any excess payment against current or future royalties due unless the credit is taken within five years after the making of the payment, or within such longer time as the Secretary may by rule prescribe. This section shall apply to any credits taken or repayments made after the date of enactment of this section regardless of the date the excess payment was made."

(2) by deleting subsection (b).

SEC. 3. **Revision of Requirements for Selling Royalty Oil or Gas Taken in Kind from Outer Continental Shelf Leases.**

Section 27 of the Outer Continental Shelf Lands Act (43 U.S.C. 1353) is amended by deleting the words "for not more than its regulated price, or, if no regulated price applies, not less than its fair market value," from paragraphs (b)(1) and (c)(1).

**INTERSTATE OIL AND GAS COMPACT COMMISSION**
900 Northeast 23rd Street ■ P.O. Box 53127 ■ Oklahoma City, Oklahoma 73152-3127 ■ Phone: 405/525-3556 ■ Fax: 405/525-3592

**RESOLUTION 95.601**

**In Support of the Domestic Oil and Gas Production Act**



Whereas, the IOGCC has in recent years adopted a number of resolutions calling for incentive measures to be taken by the Congress of the United States in order to promote domestic oil production; and

Whereas, the IOGCC report *Marginal Oil: Fuel for Economic Growth* documents the benefits to the states and the nation for such incentive; and

Whereas, many of the positions of the IOGCC have been recently introduced in the Congress as the Domestic Oil and Gas Production and Preservation Act (S-451), with broad support by the Congressional Oil and Gas Forum;

Now Therefore Be It Resolved, that the IOGCC meeting this 13th day of June 1995 in Charleston, West Virginia hereby urges Congress to conduct immediate hearings on this vital legislation and move the principles embodied in this legislation to the floor of each house for consideration before the end of the year.

June, 1995

OXY USA INC
PAYOR CODE – 16922
GBIL 07940182
DATED 10/20/94

| DOLLAR RANGE | LINES | | DOLLARS | |
|---|---|---|---|---|
| | TOTAL LINES | PERCENTAGE OF LINES | TOTAL DOLLARS | PERCENTAGE OF DOLLARS |
| .01 – .99 | 795 | 71.17% | $132.95 | 0.63% |
| 1.00 – 4.99 | 94 | 8.42% | $229.64 | 1.09% |
| 5.00 – 9.99 | 41 | 3.67% | $307.58 | 1.46% |
| 10.00 – 24.99 | 61 | 5.46% | $1,049.59 | 4.97% |
| 25.00 – > | 126 | 11.28% | $19,378.39 | 91.85% |
| TOTAL INVOICE | 1,117 | 100% | $21,098.15 | 100% |

## SECTION 10
## and
## INTEREST EXAMPLE

## OUTER CONTINENTAL SHELF LEASES

| CURRENT | H.R. 1975 and S. 1014 |
|---|---|
| • Notice from MMS that the two formations under Lease A and B have consolidated into one formation underlying Lease A | |
| • Accountant paid royalties of $972,000 on Lease A only | |
| • MMS notified Company that Lease A and B should not have been consolidated which meant that royalties in the sum of $486,000 were underpaid on Lease B; Company offsets $486,000 in royalties from Lease A to Lease B. | • Section 4: Over-payments, Offsets and Refunds |
| • MMS assessed $110,000 interest on Lease B which Company paid | • Section 6: Royalty Interest |
| • The $486,000 offset from Lease A to Lease B was ordered to be repaid six years after the fact due to failure to file a refund request | • Section 3: Limitation period<br>• Section 4: Over-payments, Offsets and Refunds |
| • Government had 100% of the royalty the entire time | • Section 4: Over-payments, Offsets and Refunds |
| • Company's liability, in addition to the 100% royalty was the $486,000 disallowed offset and the $110,000 interest assessment | • Section 6: Royalty Interest |

# BILL - UNAUTHORIZED RECOUPMENT
## ALL BILLS AND INQUIRIES
## RECEIVED AND REFUTED

| ITEM NUMBER | BILL NUMBER | DATE | AMOUNT |
|---|---|---|---|
| 1. * | BILL 76920090 | 04/15/92 | 45,477.33 |
| 2. | BILL 76920095 | 04/15/92 | 180,214.83 |
| 3. | INQUIRY | 08/18/92 | 1,774.83 |
| 4. | INQUIRY | 12/30/92 | 178,606.42 |
| 5. | INQUIRY | | 8,867.49 |
| 6. | INQUIRY | 03/31/94 | 46,812.04 |
| | | | 461,752.94 |

## FEDERAL OIL AND GAS ROYALTY SIMPLIFICATION AND FAIRNESS ACT OF 1995
(H.R. 1975 & S. 1014)

*Comparison*
*of*
*Existing MMS Requirements to Bill Requirements*

| MMS REPORTING FORMS | EXISTING REQUIREMENT | BILL REQUIREMENT | IMPROVEMENTS EFFECTED BY BILL |
|---|---|---|---|
| Report of Sales and Royalty Remittance (MMS-2014) | Yes | Improved | • Simplified form -- elimination of unnecessary and costly information. Bill limits the data required to only the information necessary to verify the royalty payment.<br>• Streamlines retroactive reporting.<br>• Annual reporting for entitled minimal production -- primarily benefits small producers. |
| Production Reporting (OGOR & MMS-3160) | Yes | Yes | • No change. |
| Royalty Report Compared to Production Reporting (AFS/PAAS) | Yes | Improved | • Lessens enforcement on minimal production leases by eliminating comparison. This provides monthly accounting relief primarily to small producers.<br>• Significant cost savings will be realized by the federal government because monthly adjustments for insignificant quantities are not required. |
| Transportation and Processing Allowance | Yes | Improved | • Elimination of forms and related exception processing. |
| OCS Credits/Overpayments | Written Request | Improved | • Written request eliminated. |
| Interest Collection | Yes | Improved | • Interest is charged on the net underpayment per month which simplifies the process.<br>• Minimizes administration costs. |
| Refund Requests | Yes | Improved | • Specifies time and data requirements for requesting and refunding overpayments.<br>• Provides certainty. |
| Payor Information (PIF) | Yes | Improved | • Elimination of form. Information is supplied to the Department on other documents or forms. |

## FEDERAL OIL AND GAS ROYALTY SIMPLIFICATION AND FAIRNESS ACT OF 1995

(H.R. 1975 & S. 1014)

*Comparison of Existing MMS Requirements to Bill Requirements*

| ROYALTY INFORMATION & COLLECTION | EXISTING REQUIREMENT | BILL REQUIREMENT | IMPROVEMENTS EFFECTED BY BILL |
|---|---|---|---|
| Amount of Royalty Due/System Integrity | Same | Same | • No change. Companies will still be required to pay every dollar due.<br>• MMS will retain all necessary mechanisms to ensure proper payment and collection. |
| Collection Requirements | Numerous | Improved | • Additional royalty must exceed cost to collect. Sound business sense. Dollars no longer spent to collect dimes.<br>• Limits collection activities on minimal production leases. Will reduce the burden on small producers for minimal dollars.<br>• Offsets of overpayments and underpayments will be allowed against the current royalty obligations. |
| | | Major Improvement | • Establishes de minimis production threshold resulting in no enforcement or compliance on interest billings, AFS/PAAS comparisons and penalties. |
| Date Royalty Payment Required | Yes | Improved | • Royalty payment due on entitled minimal production is extended to an annual basis to maximize cost efficiencies in accounting for insignificant volumes.<br>• This payment relief will primarily benefit small producers. |
| | | Major Improvement | • Royalty payment on agreement redetermination is due when the redetermination is approved by the Department. Eliminates years of unnecessary adjustments. |
| MMS Penalties | Same | Same | • No change. |
| Records Subject to MMS Review | Yes | Improved | • Only documents related to production must be retained if the Department takes royalty in kind. |

**FEDERAL OIL AND GAS ROYALTY SIMPLIFICATION AND FAIRNESS ACT OF 1995**
(H.R. 1975 & S. 1014)

*Comparison of Existing MMS Requirements to Bill Requirements*

| ROYALTY INFORMATION & COLLECTION | EXISTING REQUIREMENT | BILL REQUIREMENT | IMPROVEMENTS EFFECTED BY BILL |
|---|---|---|---|
| Right to Audit | Same | Improved | • No change for amount above de minimis amounts. |
| Audit | Yes | Improved | • Directs Secretary to develop a simplified audit strategy.<br>• Limits audits on minimal production leases -- provides administrative relief to small producers. |
| MMS Assessments | Yes | Improved | • Small producers are particularly hard hit with these assessments because they do not have costly royalty reporting systems to meet all of the regulatory nuances.<br>• This will limit the monthly assessment to a maximum of $250 per month. |
| Record Keeping | Yes | Improved | • Record retention limited to six years or for the duration of a judicial or administrative appeal, whichever is longer. |



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