

## **Appendix D**

Memo from Jim Ford,  
Federal Relations Director of  
the American Petroleum Institute to  
Vice President Cheney's Energy Task Force  
March 20, 2001

**Kelliher, Joseph**

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**From:** Jim Ford [Fordj@api.org]  
**Sent:** Tuesday, March 20, 2001 2:06 PM  
**To:** Kelliher, Joseph  
**Subject:** Statement on Energy Policy/Implementation  
**Importance:** High



NEP Statement.doc

As we discussed, please find attached a short paper on the U.S. oil and natural gas supply situation, together with a list of steps that the Administration could take at once to alleviate the situation. I will send you additional materials under separate cover.

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**Available Administrative Actions on National Energy Policy in the Oil and Natural Gas Sectors:**

Require Executive Branch agencies to avoid significant adverse energy consequences in proposing regulatory and other administrative actions.

Require Executive Branch agencies to review existing rules and policies and revise them as necessary to eliminate significant adverse energy consequences.

Make energy policy a key assignment for a senior White House aide.

Direct the Interior Department, in consultation with other federal land management agencies and the Energy Department, to complete the inventory of federal oil and natural gas resources mandated by the 2000 amendments to the Energy Policy and Conservation Act.

Direct the Energy Department, in consultation with the federal public land management agencies, to identify administrative barriers to timely exploration and development of federal oil and gas resources and take steps to remove those barriers.

Provide a "strike force" to complement existing staff of public land management agencies to immediately reduce the tremendous backlog of pending applications for permits to develop federal oil and gas leases, to revise resource management plans, and to complete required environmental analyses. Ultimately, provide adequate staffing/resources to maintain and expedited timetable for these activities.

Direct the Interior Department to expand royalty-in-kind (RIK) programs onshore and offshore, with any RIK oil to be transferred into the Strategic Petroleum Reserve.

Maintain the December 2001 schedule for OCS Lease Sale 181.

Grant California's request to the Environmental Protection Agency for a waiver from the Clean Air Act's oxygen mandate for reformulated gasoline.

Ensure that the first annual report from the advisory group to EPA on technological feasibility (equipment and construction resources) of the on-road diesel sulfur rule includes meaningful conclusions and recommendations that the agency can use quickly to decide whether modifications should be made to avoid adverse fuel supply and price consequences.

Direct the Labor Department, in consultation with the Energy Department, to develop recommendations for a job-training program designed to fill employment needs in the oil and natural gas industry.

Direct the Office of Management and Budget to determine whether fiscal 2001 funds could be reprogrammed to increase grants to states for low-income heating and weatherization assistance.

Direct OMB to determine whether funds could be reprogrammed to ensure full funding of U.S. Coast Guard nautical charting programs and Corps of Engineers harbor maintenance activities to ensure that tankers can move needed petroleum products safely and expeditiously.

## Royalty In Kind

**Description:** Under the terms of federal oil and gas lease agreements and current statutes, the federal government can take its royalty share of oil and gas production "in value" (money) or "in kind" (production). In FY2000 federal royalties brought 5.2 billion dollars to the U.S. Treasury. Industry strongly supports the federal government taking its royalties in kind because of RIK's certainty, simplicity, administrative costs savings, avoidance of disputes and costly litigation and potential for increased revenues to the U.S. Treasury. Enabling legislation to provide the federal government the authority and flexibility to fully implement RIK will increase the probability of success of RIK and result in the benefits to the public as noted.

**Background:** Some federal royalty has been taken in kind by the Secretary since the early 1920's. The principal RIK program before 1996 was the Small Refiner RIK Oil Program. Since that time, the MMS has successfully managed RIK pilot programs for both oil and gas. Numerous hearings have been held in the House and Senate during the last four years on the benefits of RIK. The State of Texas testified before the House Resources Committee in 1997 that RIK was a successful solution to the problems associated with taking the State's gas royalties in value. Alberta Canada also testified that RIK was a successful way to manage the Crown's royalties. The state of Wyoming is building on its successful RIK pilot and is proactively expanding its RIK effort. The DOI has pursued RIK during the last six years and has initiated a number of significant Pilot programs to ascertain the feasibility of RIK. The agency states that it has achieved significant cost-savings and revenue enhancement through its RIK Pilot programs.

**Status:** Currently, in addition to the Small Refiner RIK program, MMS has four, multi-year RIK programs in place- (1) a Wyoming oil RIK Pilot, (2) a State of Texas 8(g) gas RIK Pilot, (3) an OCS gas RIK Pilot, (4) and an OCS oil RIK Pilot. A full evaluation of the Wyoming pilot is expected soon. RIK oil has been used extensively to fill the Strategic Petroleum Reserve and in two pilot programs, RIK gas has been successfully used in federal facilities. Currently, MMS takes over 40% of federal royalty oil in kind, and over 95% of royalty gas in kind.

**Discussion:** Enabling legislation is required to provide the federal government the authority to fully implement RIK and to pay for RIK services such as transportation and processing? RIK should be considered part of a comprehensive national energy strategy and a permanent tool for the Minerals Management Service to use in fulfilling its mission.

Enabling legislation will allow the department to pay for costs associated with RIK such as transportation and processing, provide certainty to the lessee, the States and the federal government, provide for cooperation with the states, and avoid valuation problems that arise when royalty is taken in value.

**Legislative action:** Enact attached draft bill developed by Senate Energy Staff modifying the authorizing acts.

## Transition Policy Issue Paper

### Policy Considerations

**Description:** Since 1982, the Minerals Management Service of the Department of Interior has undergone numerous studies and initiatives on the agency's structure and organization. In 1992, the MMS instituted significant changes under the Vice-President's reinventing government initiatives. These initiatives have led to significant changes, including organizational restructuring currently under way as well as significant capital expenditures on information systems. Members of Congress in their oversight capacity, raised serious questions regarding the organizational restructuring initiatives contained in the FY 2001 budget. In particular, they questioned whether MMS had dedicated proper human resources to its team handling the government's RIK projects. Other initiatives to reinvent the department have fallen within the category of rewriting regulations into "plain English". Taken in total, the initiatives commenced in 1992 have and are effectuating significant changes within the Minerals Management Service of the Department of Interior.

**Status:** Many initiatives are currently underway and others are planned for the immediate future. The MMS is currently undergoing organizational restructuring and is implementing a new financial system. Other training and personnel reorganization initiatives are underway as well. These changes can and do impact oil and gas lessees on the burdens they impose in a myriad of ways including revising electronic reporting requirements, estimating paperwork reduction, implementation of oil valuation rules, or revising existing lease forms. All told there is significant change ongoing.

**Key Issues/Decisions:** Are the organizational structure/reinventing government initiatives of MMS fully and cost-effectively meeting the goals of timely collection of revenues, simplicity and certainty for the federal government, the states, tribes and lessees? Has MMS allocated adequate resources for management of the RIK programs?

**Options:**

- No change. This would permit the time necessary to perform a thorough review of the fundamental changes that are occurring and are planned within the core revenue collection and disbursement functions and their impact on policies of the Minerals Management Service.

**Timing/Milestones:** The reinventing government/plain English initiatives impact the core of all MMS initiatives and therefore must be reviewed within the first 100 days of the new administration.

## Transition Policy Issue Paper

### Royalty in Value

**Description:** Under the terms of federal oil and gas lease agreements and current statutes, the federal government can take its royalty share of oil and gas production "in value" (money) or "in kind" (production). When royalty is taken in value, the point of valuation is the value at the well on the lease where the oil or gas was produced. On March 15, 2000, the MMS finalized new oil valuation regulations which became effective on September 1, 2000. The goals of the new rules as articulated by MMS were, certainty, simplicity and fairness. The final regulations were immediately challenged by the oil and gas industry in two cases filed in the D.C. District Court. Industry strongly opposes the new rules on a number of grounds, the most important being that they impose expanded obligations on oil and gas lessees which were not part of and are greater than their existing lease obligations with the government. Among other things, the new obligations impose valuation away from the lease, a "duty to market", increased costs of transportation, and contain affiliate resale valuation issues. In a recent D.C. District Court case, Judge Royce Lamberth rejected MMS' implied duty to market argument. In his opinion, Judge Lamberth stated, "as explained above, the court finds that an implied duty to market downstream is not consistent with the terms of the existing leases." This decision has been appealed by the MMS to the Federal Circuit. If the District Court rules similarly in the challenges to the oil valuation rules, the MMS would then potentially be required to re-write the rules to conform to Judge Lamberth's opinion. Further, the oil valuation rules are relevant to royalty taken in kind (RIK) as the benchmark for measuring the cost/benefit of RIK initiatives will be measured against royalty taken in value and thus, the bar for RIK will be raised by the new RIV regulations.

**Status:** The Senate and House held numerous hearings on MMS' proposed oil valuation rules last year and imposed a multi-year moratorium prior to the rules going final in March. The MMS is in the process of implementing the new rules and training internal personnel. As discussed above, the industry has challenged the rules in D.C. District Court.

**Key Issues/Decisions:** Should the MMS obtain a legal opinion from the new DOI Solicitor regarding valuation away from the lease and specifically on the duty to market issue? Should the Department engage in a review of transportation issues? Should the MMS have further policy discussions regarding decisions using an indexing methodology to approximate lease value and the issuance of valuation determinations? Should DOI revisit the issue of comparable sales and tendering?

**Options:**

- Obtain a legal opinion from the new DOI solicitor regarding the Department's position on the duty to market and the best methodologies to obtain value at the lease.
- After a review of Judge Lamberth's decision obtain a legal opinion from the new DOI solicitor regarding oil and gas transportation issues and consider whether to prosecute the appeal.
- Consider rewriting the gas transportation rules on appeal to the Federal Circuit and the oil valuation rules being challenged in light of the D.C. District Court decision.

**Timing/Milestones:** First 100 days.

Fill was suspended in FY 1995 to devote budget resources to refurbishing the SPR equipment and extending the life of the complex through at least the first quarter of the next century. In 1999, fill was resumed in a joint initiative between the Departments of Energy and the Interior to supply royalty oil from Federal offshore tracts to the Strategic Petroleum Reserve.

#### **Proposal**

Presidents have made findings that increasing oil imports can threaten the Nation's national security. The history of the last 30 years demonstrates that energy price and supply volatility can result in significant, deleterious economic conditions.

Under the Outer Continental Shelf Lands Act and the Mineral Leasing Act, the Secretary of the Interior is authorized to take the federal government share of oil and gas production extracted from federal lands as a percentage share of the commodity produced. Further, those statutes permit the Interior Secretary to transfer the federal government's production share to the Secretary of Energy or Defense, as well as to other agencies.

In 1998, during a period of lethargic crude oil markets, the Secretaries of Energy and Interior entered into an agreement for the federal share of crude oil production to be deposited, directly or indirectly, into the Strategic Petroleum Reserve rather than being sold into the market, with the proceeds being deposited into the U.S. Treasury.

This program agreement successfully added to the volumes stored in the SPR. The program was suspended when the Secretary of Energy found that the federal share of oil production would be better utilized to be sold into domestic markets to augment supplies flowing to domestic refineries as world supplies tightened and upward price volatility pervaded energy markets.

#### **Language**

At the appropriate place insert the following:

The Secretary of the Interior shall enter into an agreement with the Secretary of Energy to transfer title to the federal share of crude oil production from federal lands for use at the discretion of the Secretary of Energy in filling the Strategic Petroleum Reserve during periods of crude oil market stability. The Secretary of Energy may also use the federal share of crude oil produced from federal lands for other disposal within the Federal Government, as he may determine, to carry out the energy policy of the United States.