Committee on Resources

Subcommittee on Energy & Mineral Resources

Witness Statement

TESTIMONY OF
KATHY KARPAN
ACTING PRINCIPAL DEPUTY ASSISTANT SECRETARY,
LAND AND MINERALS MANAGEMENT
BEFORE THE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
HOUSE RESOURCES COMMITTEE
June 15, 2000

Introduction Good morning Madam Chairman and Members of the Subcommittee. I am pleased to be here today to present testimony on H.R. 4340, the Mineral Revenue Payments Clarification Act of 2000.

H.R. 4340 As the Subcommittee notes in its invitation letter, for most of the past decade the Department of the Interior has been charged with calculating the Federal Government's costs to administer the Federal onshore minerals leasing program and for deducting 25 percent of those costs from revenue owed to states from Federal minerals leasing revenues. This practice has been applied only to Federal onshore leases and has been known as "Net Receipts Sharing" (NRS). In FY 2000, the states' share will be about $20.5 million of the costs incurred by the Bureau of Land Management (BLM), the Minerals Management Service (MMS), and the U.S. Forest Service (USFS) in administering the Federal onshore minerals program. Because of the different administrative cost calculation methods a state can choose, for FY 2000, this amounts to about 17.6 percent of the total costs incurred by the Federal government to administer the program and about 4.2 percent of the amount of revenues distributed to the states under this program. Two States, Wyoming and New Mexico, bear more than half of these costs, and Colorado, Utah and Montana also bear significant shares because most of the onshore mineral leasing occurs in these states. Federal offshore and Indian onshore leases have never been subject to this arrangement.

The principal argument in favor of NRS is that states should bear some of the costs of a Federal leasing program that yields direct financial benefits to them. Although we understand arguments by the states that they should not have to pay for a Federal program as well as state concerns with the way in which NRS deductions are calculated, we believe that the relatively small share of the costs borne by the states is fair and reasonable given the large amount of revenue many states receive from mineral leasing.

We have concerns about the bill since we support continuation of Net Receipts Sharing. However, we are open to considering reforms to the system that will make it more predictable and transparent to the states. We are advised by the Office of Management and Budget that terminating NRS would have PAYGO implications of about $100 million over five years.

In addition, if the bill was enacted as written, we would recommend a change. Section 3 of the bill would provide that "payments shall not be reduced by any administrative or other costs incurred by the United

States." This language may give rise to a dispute with respect to our royalty in-kind (RIK) efforts. The Subcommittee is well aware of these efforts as the Department has testified about them several times in recent months.

With the active support of several states, the Department has been pursuing RIK as an additional means to collect royalties due from Federal leases. From an administrative perspective, we believe the program could, in certain situations, be less expensive and simpler to operate. MMS intends to aggressively pursue using and expanding RIK under those circumstances where it makes good business sense in the management of the public's royalty assets. MMS began three pilot programs to study RIK. One is taking oil royalties in kind from leases in the Powder River and Big Horn Basins of Wyoming. A second one is taking gas royalties in kind from leases in the Texas 8(g) zone of the Gulf of Mexico. The third one, initiated in 1999, for natural gas from Federal properties in the Gulf, is larger and more comprehensive than the two previous. Each of these initiatives helps to determine under what circumstances RIK can be a viable alternative to the present royalty in-value approach.

As you know, the lower 48 states receive a 50 percent share of revenues derived from most onshore leases (Alaska receives 90 percent). States may take the position that H.R. 4340, as currently written, would require MMS to pay the states 50 percent of gross RIK sales revenues, without subtracting costs for transportation and processing before the states' share is disbursed. When the government takes oil or gas as royalty in-kind, it often must incur those costs before it can sell the in-kind production. If H.R. 4340 were read to prohibit the government from deducting these costs before disbursing the states' share, states would receive more from RIK sales revenues than intended under the Mineral Leasing Act.

We do not understand this to be the intent of this provision, and do not read it in that manner. However, absent clarification, the result may be unproductive and expensive litigation.

To remove this potential ambiguity and inequity, we would suggest amending H.R. 4340 as follows:

In determining the amount of payments to the States under this section, the amount of such payments shall not be reduced by any administrative or other costs incurred by the United States, **except for costs incurred with regard to production taken as royalty in kind**.

The Net Receipt Sharing Program I would now like to summarize the history of NRS, discuss some of the issues that have arisen in implementing the program, and address how the NRS methodology has been and could be further improved.

In FY 1991, Congress decided that states should share in the costs the Federal government incurs in managing the onshore minerals leasing program since they share in those revenues. States receive half of most revenues, therefore, full cost sharing would imply that they share half of the Federal costs of administering the program. However, to reduce the full impact of NRS on states, Congress provided that states pay only 25 percent of the Federal administrative costs based on the lower of two different calculation methods. Each state's share of the prior year's administrative costs is deducted from the current year's monthly royalty distribution made by the MMS. While MMS is responsible for making these monthly deductions, its costs make up only about 30 percent of the total costs charged to the states. The Bureau of Land Management and the U.S Forest Service comprise the remaining 70 percent of the costs. MMS collects their data, merges it with its own and then allocates it according to the methodologies authorized in statute.

Below is the break out of the actual FY 1999 costs for the three bureaus for the FY 2000 allocation, of which about $20.5 million is charged to the states. The amount charged to the states is about 17.6 percent (for reasons I will explain later in my testimony) of the total Federal costs for the onshore minerals management program.

Agency	FY2000
Bureau of Land Management	$74,686,600
Minerals Management Service	$34,615,256
U.S Forest Service	$ 7,202,785
Total	$116,504,641

The total revenues distributed to the states from the onshore Federal minerals program in FY 1999 were as shown below. The $20.5 million charged to the states amounts to about 4.2 percent of the total revenues distributed. For selected states, the amount charged is as follows: Wyoming, $7.4 million charged, 3.1 percent of the revenues distributed; New Mexico, $5.6 million charged, 4.2 percent of the revenues distributed; Colorado, $2.3 million charged, 6.1 percent of the revenues distributed; Utah, $1.9 million charged, 6.1 percent of the revenues distributed; Montana, $1.0 million charged, 6.1 percent of the revenues distributed; and California, $0.8 million charged, 6.3 percent of the revenues distributed.

State	FY1999
Wyoming	$231,453,518
New Mexico	$135,007,854
Colorado	$37,426,612
Utah	$29,982,252
Montana	$17,012,364
California	$12,036,847
All others	$20,104,614
Total	$483,024,061

Congress originally mandated NRS in the Department of Interior's FY 1991, 1992 and 1993 Appropriations Acts. To estimate and allocate its costs for the onshore minerals program, MMS initially developed a method that was based on the ratio of Federal onshore producing leases to total leases. This amount, along with BLM and USFS estimates, was then allocated to each state in the same proportion as that state's revenues to total revenues. This is referred to as the "Revenue Method." Several states objected to this method arguing that costs allocated to them were too high and not representative of the actual costs MMS expended in managing leases within their state. As a result, the Department's FY 1992 Appropriations Act required MMS to study its costs to collect onshore revenues. This study confirmed that the actual costs to perform onshore mineral activities in some states were less than the costs allocated to them under the

Revenue Method.

Permanent NRS language was enacted in the Omnibus Budget Reconciliation Act of 1993 (OBRA). This act statutorily established two methodologies for calculating NRS amounts. One method was, of course, the "Revenue Method." The other was the "Cost Method" which was designed to cap some of the higher cost allocations derived from the Revenue Method. The Cost Method reflects the best estimate of the three agencies' actual costs to conduct onshore mineral activities in each state. The language in OBRA calls for MMS to calculate state shares using both methods and then charge each state the lower of the two, which results in less than the full 25 percent being deducted from state mineral payments. Report language accompanying this legislation further specifies the process. Only two states are regularly charged using the Cost Method -- Wyoming and New Mexico.

Since 1993, when permanent language was established, the Department has looked for ways to improve and refine the formula established in OBRA, including an MMS-initiated peer review of NRS in 1995. That review recommended a number of improvements to the NRS process, including several that resulted in savings to the states. After consulting with Congress, the MMS made the changes to implement the savings. This resulted in a decrease of MMS costs of almost $5 million between 1995-1997. Over the past several years, BLM has focused on improving the accuracy of its administrative costs. By implementing its management information system (MIS), BLM is capable of ensuring greater accuracy of the data reflected in the NRS costs. In October 1997, the Office of Inspector General (IG) issued a report which questioned both the inclusion of BLM's pre-leasing costs and the methodologies used by MMS to calculate its costs. The report concluded that the Department of the Interior overcharged the states by $8.8 million during the period reviewed in the report (1994-1996).

The Department requested and received two legal opinions addressing issues raised in the report. First, in an April 14, 1998 opinion, the Solicitor concluded that BLM pre-leasing costs were properly included in NRS deductions. Then, in a January 26, 1999 opinion, the Solicitor advised that any erroneous calculations in NRS deductions should be corrected and appropriate amounts plus interest refunded to states. However, the opinion stated that improvements in the methodology itself should not be applied retroactively. The opinion recognized that this has been a dynamic process from the beginning and that the process of continual improvement in allocations will have to be ongoing. As a result of the Solicitor's opinion, approximately $3.1 million dollars have been refunded to states to compensate for erroneous deductions.

Since the inception of NRS, the Administration has worked to improve its accounting systems and its method for calculating NRS deductions so that it would be as fair as possible to the states. We are committed to continuing these efforts. For example, both BLM and MMS are instituting new accounting systems that will better track the amount of time its employees spend on activities that directly support the onshore Federal minerals program in specific states. We also continually seek to improve the methods we use to allocate centralized costs (such as policy development, training, communication systems costs, and personnel and contract administration) that are necessary to conduct the Federal onshore minerals management program. We want these allocations to be as fair and transparent as possible.

We recognize, however, that no matter how much we improve our accounting methods, some level of controversy is likely to continue. Therefore, we are willing to consider legislative efforts to reform NRS. One possibility would be to establish a flat percentage based on one or more clearly defined criteria such as revenues and number of leases.

Thank you for the opportunity to testify. The Department looks forward to working with the Subcommittee as we continue our efforts to improve net receipts sharing. I will be happy to answer any questions that you or the Members may have.

# # #