Congress of the United States
House of Representatives
Washington, D.C. 20515

January 16, 2003

The Honorable Gale Norton
U.S. Department of the Interior
1849 C St. NW
Washington, D.C. 20240

Dear Secretary Norton:

Today, the General Accounting Office (GAO) issued a new report, entitled, "Mineral Revenues: A More Systematic Evaluation of the Royalty-In-Kind Pilots is Needed" (GAO-03-296) prepared at our request, on the Department's Royalty-in-Kind (RIK) program. The report may be accessed at the GAO website: http://www.gao.gov.

As Members who have been closely involved in oil royalty issues through work on the Government Reform and Resources Committees, we are extremely concerned that the RIK program, if made permanent and/or fully operational in 2004 as proposed by the MMS, could seriously jeopardize the federal government's ability to collect the appropriate amount of royalties from oil and gas taken from federal lands and waters.

Specifically, we have grave doubts that the RIK program will provide *any* benefits to the American taxpayer over the current cash payment system. Consequently, concerned over the relatively rapid expansion of the RIK program, we asked the GAO in 2001 to review the extent to which MMS has taken royalties in kind since 1995, the reasons for taking royalties in kind, and MMS's progress in implementing management control over its RIK program.

Our request followed the Department's final oil valuation rule in 2000 that should ensure that the Federal government is properly reimbursed for oil taken from Federal lands. The new rule provides for greater "transparency" and accountability by requiring oil companies to value oil based on market-based spot pricing instead of so-called "posted prices" which companies determine on their own. As a result of these changes, the Federal government is expected to save more than $66 million each year in otherwise lost or under-reported royalties.

Indeed, according to the GAO report, the oil industry strongly opposed these regulations primarily because they would increase the industry's royalty payments. In commenting on the proposed rule change, industry officials suggested that instead of cash payments, MMS should adopt the royalty-in-kind approach to royalty payments. Given the oil and gas industry's stated preference for this system, especially in light of the multi-million dollar settlements paid by the industry to the government for royalty underpayments, we remain skeptical that RIK is a viable alternative to the current cash payment system.

Seeking an objective evaluation, we asked GAO to conduct a comprehensive analysis of the RIK pilot program to determine whether it has been more profitable than traditional royalty payment arrangements. The GAO's work builds upon a previous 1998 report that questioned if it would be "feasible for the federal government to take its oil and gas royalties in kind...".

While not surprised, we are, nonetheless, gravely concerned with the GAO's most recent findings. For example, GAO has concluded that after five years of conducting pilot programs and completing 24 oil and gas pilot sales, the MMS cannot:

- Monitor or evaluate its RIK Program,
- Determine the program's overall cost and effectiveness, and
- Ascertain whether RIK generates *at least as much* revenue as traditional cash royalty payments as required by law.

This is extremely problematic in light of the Department's intention to make the RIK program "fully operational" in 2004. To quote GAO, "MMS will be unable to determine whether RIK sales generate more or less revenue than traditional cash royalty payments; whether MMS obtains fair market value; and hence, whether it should convert the RIK pilots to an operational status." There is simply no good reason to replace the current system with one that cannot save money, provide transparency and increase accountability.

Therefore, we again urge you to prevent MMS's full implementation of the RIK program until solid data is available to show that the American taxpayers – who own the oil and gas on the public lands – would be getting a fair deal under this system. In an era of increasing budget deficits, we cannot afford to give-away publicly owned resources to the oil and gas industry.

This should be of particular concern to State governments, as onshore royalty payments to the states are often used to pay for public schools and many other important state priorities.

It is imperative that the Department proceed with expansion of the Royalty-in-Kind pilot program only when, and if, there is clear proof that production levels are being quantified through strict accounting and oversight procedures that protect the public interest.

Sincerely,

NICK J. RAHALL, II
Ranking Democratic Member
Committee on Resources

CAROLYN B. MALONEY
Member of Congress