

Testimony of Poe Leggette
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Subcommittee on Energy and Mineral Resources
House Committee on Resources
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Introduction

Good afternoon, Madame Chairman and members of the subcommittee. My name is Poe Leggette. I am a partner at the law firm of Fulbright & Jaworski, LLP. I am grateful for the opportunity to appear here before you today on behalf of the American Petroleum Institute (API), the Independent Petroleum Association of America (IPAA), the Independent Petroleum Association of Mountain States (IPAMS), the Domestic Petroleum Council (DPC) and the U.S. Oil and Gas Association (USOGA).

My testimony will discuss the advantages of royalty-In-kind (RIK), for both the industry and the government. We applaud the committee for holding a hearing to explore the potential efficiencies available to the federal government and to industry if the use of in-kind royalty collections is broaden beyond current practice, and to compare and contrast this with the more typical practice of in-value collections. The entire oil and gas industry believe RIK provides the government numerous opportunities to creatively provide energy to in-need end-users while at the same time efficiently ensuring that the Country is receiving each royalty molecule of gas or oil due to the government. In fact Madame Chairwoman, it is this very committee that has led the way for encouraging RIK since the 104th Congress. We appreciate your efforts, including the RIK appropriations language contained in FY 2001 Interior Appropriations, which gave MMS limited flexibility to do more with RIK.

For several years, there has been and remains today widespread support for RIK in the oil and gas industry. So much so, in fact, that in 1997 the trade associations mentioned above, which represent substantially all of the U.S. oil and natural gas industry, united to organize a multi-association committee to work in conjunction with the Minerals Management Service (MMS) and other stakeholders to formulate and promote a workable system through which federal royalties might be taken in-kind.

I am pleased to be able to report to you today that MMS has made great strides in this arena through the establishment and continuing operation of its RIK pilot projects. The industry applauds the MMS RIK management team for the creativity and flexibility it has demonstrated in putting together these RIK pilots. While problems have inevitably arisen, industry views none of these as being intractable so long as the agency maintains its demonstrated commitment to cooperatively searching for the best and most efficient solutions.

Despite the successes of these RIK pilots, industry believes much work remains to be done. The pilots can only go so far, given certain legislative barriers. We encourage Congress to provide MMS the legislative RIK tools needed to fully expand the volumes of oil and gas royalties it

takes in kind, it Congress and the Administration deem appropriate, to provide energy to in need consumers.

Complexity of the Royalty In-Value Process

RIK offers the most logical and efficient means of avoiding the kinds of disputes over oil and gas valuation that have arisen in recent years. The markets for oil and gas are extremely volatile, and their rapidly changing nature renders the determination of product value at various points of sale a very complex, labor-intensive exercise which all too often results in protracted, costly disputes. Any set of regulations designed to capture value in such an uncertain atmosphere must of necessity be vague and open to interpretation by the various players in the process. Interpretations lead to disagreements, disagreements to disputes, disputes to litigation.

Capturing volume is a very simple process by comparison. A barrel of oil is a barrel of oil. A cubic foot of gas is a cubic foot of gas. So long as the measuring devices used are accurately calibrated, there is no room for interpretation, and no need to estimate the value of the production. For example, if a lessee in the Gulf of Mexico produces six barrels of oil, he satisfies his royalty obligation by delivering one barrel to the government. Simple as that.

With RIK, the accounting is simplified. There is no need to estimate the value of production. The auditing is simplified; all that needs to be verified is the volume of production and the volume delivered as royalty. Disputes are fewer.

This simplicity of process is the main reason for the industry's support of the RIK process. Lessees have a business need for certainty in the royalty payment process, but simplicity should be appealing to every stakeholder; the lessee, who produces the oil and gas and pays the royalties; the federal government, who collects the royalties; and the beneficiaries who share in the royalty revenues, states like Wyoming, New Mexico, Colorado and California.

We urge the federal government to take full advantage of RIK and make it the standard method for collecting royalties, with royalty in-value becoming the exception rather than the rule. A permanent RIK program would greatly enhance government flexibility by offering several options for disposing of its royalty share: selling the royalty production on the open market or to small refiners; making available the royalty production for use in government/public facilities; filling the strategic petroleum reserve; or providing cheaper energy to pre-approved low-income families. For example, satisfying low-income heating needs via RIK versus sending royalty payments, ensures that every molecule is delivered in a timely fashion and provides the government and utilities an opportunity to provide further advantage to low income families by participating in the market place.

We were pleased that RIK was referenced in the Administration's National Energy Policy as a way to accommodate the strategic petroleum reserves. Additionally, the National Energy Policy proposes the use of royalty payments for LIHEAP. As you will hear today, by taking this payments in-kind, many benefits will occur to both the government and the recipients under the LIHEAP program.

Need for Legislative Action

The governing mineral leasing statutes already allow the Secretary to take royalties in-kind. The pilot projects thus far conducted by MMS demonstrate that RIK works. However, some enhancements to the current statutory language would make RIK work even better.

It is important to note that the RIK concept had its germination and grew rapidly during the last years of the Clinton Administration. Clinton Administration officials were resistant to the idea at first, but commendably were willing to explore the idea through the conduct of a series of pilot projects. Over time, these pilots evolved and became better tests of RIK as experience was gained. The pilot projects now demonstrate that RIK can increase revenues to the Treasury and reduce administrative costs. The pilot projects also show that the Secretary is handcuffed in some instances by existing statutory language and by budgetary constraints that prevent the department from fully exploiting the concept. MMS and industry joined together last year to endorse language that would have corrected some of these roadblocks, but much of that language was unfortunately struck on the floor of the House.

We urge Congress to work together with the Administration to craft solutions to eliminate or avoid unnecessary obstacles to optimization of an already proven RIK program. . Industry does believe the current statutes provide MMS much flexibility to enter into creative RIK programs, but to eliminate any uncertainty legislative language should:

- Clearly delineate producer and government obligations
- Provide the government use of in-value proceeds to cover any expenses downstream of the lease
- Provide for reports to congress
- Allow disposition to federal agencies or entities designated by the federal government

In closing, let me again thank you for this opportunity to appear before you today on behalf of the industry trade associations

The industry also wishes to commend you, Madame Chairman, and this Committee for all the hard work you and your staff members have put in over the years, encouraging the creation and growth of the federal RIK program. Working together, this Committee, the Congress, MMS and industry have demonstrated that RIK is a very useful tool to optimize MMS's royalty collection efforts. Working together, we can ensure that RIK ultimately achieves its maximum effectiveness.

I would be happy to answer any questions the committee may have.