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Committee on Oversight and Government Reform
Darrell Issa (CA-49), Ranking Member



**Teapot Dome Revisited:
Dereliction of Fiduciary Duty at the Interior
Department**

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TEAPOT DOME REVISITED: DERELICTION OF FIDUCIARY DUTY AT THE INTERIOR DEPARTMENT

“The Interior Department has breached its fiduciary duty to the American people. It is charged with holding our natural resources in trust, but instead, it has squandered billions and cheated the American people. Over two years have passed since Congress conducted serious oversight of the Minerals Management Service. This is a government program that brings in tens of billions of dollars in non-tax revenue. We knew over two years ago that MMS was corrupted with severe ethical lapses and that it did not exercise accountability over revenues due to the federal government. We knew then that MMS did not have the ability to track how much oil was being produced or the revenues due the American taxpayer. It is time for Congress to overhaul the Minerals Management Service.”

– Darrell Issa, Ranking Member

EXECUTIVE SUMMARY

The Department of Interior is responsible for managing over 500 million acres of land and 1.8 billion acres of the Outer Continental Shelf. This territory and its resources, which are held in trust for the American people by the federal government, are worth trillions of dollars and generate over \$22 billion in annual revenue to the federal Treasury. The Interior Department, however, has shirked its duty as a steward of these resources. Over the past 25 years, there has been a rebirth of the same corruption and misconduct that caused the Teapot Dome scandal of 1922. Program mismanagement and cozy relationships with industry officials have led to the loss of billions in revenue from oil and gas leases, geothermal operations, recreational uses, grazing, and other national park related activity.

Since February of 2006, Committee Republicans have investigated numerous allegations of waste, fraud, and abuse at the hands of the Interior Department’s Minerals Management Service. The Committee has concentrated its oversight efforts on offshore royalty revenue collection, which amounts to nearly \$12 billion in annual income to the federal government. Working in conjunction with GAO and the Interior Inspector General, staff has found that flawed data and collection practices, inadequate accountability procedures, ethical lapses, and outright corruption has led to billions of lost revenue to the federal treasury over the past ten years. The fact that MMS cannot account for oil and gas production and cannot, therefore, accurately collect royalty revenue, represents a massive breach of a fiduciary duty owed to the American people. This Congress and the Obama Administration are duty-bound to take immediate corrective action.

The Interior’s Inspector General’s Office, the Interior’s Royalty Policy Committee, and GAO have submitted numerous reports concerning MMS’ revenue collection programs. The reports describe management difficulties and programmatic shortcomings, and detail nearly 200 recommendations to the Department. In nearly every instance, the Department has been slow to implement these recommendations. As a

result, systematic data collection and verification errors have accounted for \$160 million in potential revenue loss in 2006 and 2007 alone. Unfortunately, GAO's recommendations over the years have done little to spur measurable reform at the Interior Department.

Though MMS suffers from innumerable day-to-day process failures, perhaps the most egregious occurred in the late 1990s. In 1998 and 1999, the Interior Department entered into offshore drilling leases which did not contain critical price threshold provisions as required by law. To date, this failure has allowed lease holders to produce and sell resources without paying nearly \$1 billion in royalties to the federal government.

After nearly a year of investigative hearings in the 109th Congress, the Committee discovered that on the surface, bureaucratic mishaps, cover-ups, and questionable ethics had led to this unprecedented loss. As the investigation unfolded, it became clear that a culture of unaccountability was tightly woven into the fabric of Interior's bureaucracy.

Congress and the Obama Administration must reorganize MMS and its fee collection practices. Through immediate legislation, Congress should establish an independent agency with the sole purpose of collecting revenue from federal oil and natural gas resources. Removed from Interior's bureaucracy, such an organization could implement its own policies and programs without the strictures of operating under an umbrella bureaucracy. A stand-alone agency with independent funding and reporting requirements would also allow for more effective congressional oversight. Offshore oil and gas royalties alone account for nearly \$12 billion of non-tax revenue per year. Dedicated funding and attention will guarantee that the federal government fulfills its fiduciary duty to collect every cent owed to the American people.

BACKGROUND

Interior Owes a Fiduciary Duty to the American People

The Interior Department is charged with managing roughly 2.3 billion acres of land and waters. This territory and its resources are held in trust by the federal government for the American people. The Department and its bureaus owe a duty to the American people to properly manage these resources and collect fees resulting from private use. In FY-08, the Department collected the following revenue:¹

Onshore and Offshore Oil and Natural Gas Fees and Royalties:	\$22,277,000,000
Coal Royalties:	\$666,878,000
Geothermal Royalties:	\$14,342,000
Grazing Fees:	\$16,033,000
Timber Fees:	\$14,144,000
Recreation Entrance/Use Fees:	\$193,214,000

¹ The Department of the Interior Fiscal Year 2010 Interior Budget in Brief, Appendix P. p. P-1.

Park Concession: \$130,165,000
Rent of Land and Structures: \$39,784,000
Sale of Land, Water, Power, Buildings: \$246,000,000

When offshore oil and natural gas are produced, private entities are contractually bound to surrender royalty payments to the Minerals Management Service based upon the volume and value of the production sold, minus certain allowable costs. In turn, MMS is responsible for accurately collecting these royalties, which represent approximately \$12 billion of revenue for the federal government per year. Any failure by a private entity to accurately surrender royalties to MMS is a breach of contract. Likewise, any failure by MMS to properly manage these resources and accurately collect fees is a breach of a fiduciary duty owed to the American people.

Corruption and Mismanagement of Resources at the Interior Department

The Interior Department has suffered from a culture of corruption and mismanagement, beginning with the Teapot Dome scandal in the 1920s. This scandal, which hovered over Washington for nearly 10 years, caused great embarrassment for the Department and the federal government. In 1922, Interior Secretary Albert B. Fall leased two tracts of oil reserves located in Wyoming and California to oil magnates Harry F. Sinclair and Edward L. Doheny, respectively. These reserves, known as Teapot Dome and Elk Hills, were granted without soliciting bids from the general public.² While the non-competitive nature of the bidding process was not illegal at the time, a Senate investigation led by the Committee on Public Lands revealed that Secretary Fall had received and covered up \$404,000 in gifts and zero-interest loans from Sinclair and Doheny.³ The value of those bribes today is approximately \$5,000,000. Though Doheny was ultimately acquitted of any wrongdoing, Fall and Sinclair were fined and imprisoned.⁴ This elaborate scheme of kickbacks and cover-ups would haunt the Department for years to come.

In the late 1990s and early 2000s, a combination of willful negligence and corruption led to one of the biggest revenue losses in U.S. history. When drafting offshore Gulf of Mexico leases in 1998 and 1999, government officials omitted critical price threshold terms required by the Deep Water Royalty Relief Act of 1995. The omission of these lease terms, which are required by law, has allowed leaseholders to drill royalty-free until volume suspensions are met. MMS estimates the total loss of royalty revenue at nearly \$10 billion over the lives of these leases.⁵

Evidence obtained by Committee staff shows that Department officials knew that these terms were absent from drilling leases shortly after they were signed. Committee

² David Rapp, "Before Watergate, There was the Teapot Dome Scandal," *AmericanHeritage.com*.

³ *Id.*

⁴ *Id.*

⁵ *Oil and Gas Royalties: Royalty Relief Will Likely Cost the Government Billions, but the Final Costs Have Yet to be Determined.* Testimony Before the Committee on Energy and Natural Resources, United States Senate. Testimony No. GAO-07-369T. U.S. Government Accountability Office, January 18, 2007. p. 3.

testimony revealed that oil company executives, who stood to profit most from this blunder, were the first to alert Department officials to the omissions. Instead of immediately rectifying the leases, Department officials covered it up. E-mail and other communications obtained by staff verify that officials knew the leases did not conform to the law, but failed to resolve the issue within the Department or seek Congressional assistance. The Department has yet to hold key individuals accountable for this catastrophe.

The total loss from offshore drilling may extend beyond the troubled 1998 and 1999 leases. Ongoing litigation may also cripple the government's ability to collect the royalties owed. In addition to the 1998 and 1999 leases, Kerr-McGee Oil and Gas Corporation (now Anadarko Petroleum Corporation) has challenged the Interior Department's authority to impose price thresholds on *any* deepwater lease signed between 1996 and 2000. On January 12, 2009, the Fifth Circuit Court of Appeals upheld a lower court ruling that the Interior Department did not have the authority to impose price thresholds.⁶ On October 5, 2009, the U.S. Supreme Court refused to hear an appeal of the 5th Circuit's decision. Unless the Court decides to grant *certiorari* at a later date, which is unlikely, any company that entered a similar lease between 1996 and 2000 could escape paying royalties until certain volume suspensions expire. Additionally, the 5th Circuit's decision may force the federal government to reimburse companies who have already tendered royalty payments. Depending upon the market price of oil and natural gas, the total cost of foregone royalties could total nearly \$80 billion.⁷

As the Department's internal watchdog, Interior's Inspector General recently reported serious ethical problems within MMS. In addition to its work on the problematic offshore leases, the IG has taken aim at blatant abuses of power within MMS' chain of command. In three successive reports issued in the fall of 2008, the IG revealed that senior MMS officials gave preferential treatment in awarding contracts, received improper gifts and kickbacks from industry personnel in exchange for lucrative contracts, abused drugs with coworkers, and had sex with subordinates.⁸ Some of these transgressions occurred at Department headquarters in Washington, DC, and others took place in field offices. In one report, the IG noted that its investigation "revealed an organizational culture lacking in acceptance of government ethical standards, inappropriate personal behaviors, and a program without the necessary internal controls in place to prevent future unethical or unlawful behavior."⁹

Unfortunately, allegations of corruption have again targeted the Department's senior leadership. On September 18, 2009, the *Associated Press* reported that the Justice

⁶ *Kerr-McGee Oil and Gas Corp v. United States Department of Interior; C Stephen Allred*, 554 F.3d 1082 (5th Cir. January 12, 2009).

⁷ *Oil and Gas Royalties: Royalty Relief Will Likely Cost the Government Billions, but the Final Costs Have Yet to be Determined.* Testimony Before the Committee on Energy and Natural Resources, United States Senate. Testimony No. GAO-07-369T. U.S. Government Accountability Office, January 18, 2007. p. 5.

⁸ *Investigative Report of MMS Oil Marketing Group – Lakewood*, Case No. PI-CO-06-0271-I, August 19, 2008; *Investigative Report of Gregory W. Smith*. Case No. PI-PI-07-0120-I, August 7, 2008.; *Investigative Report of MMS – Federal Business Solutions Contracts*. Case No. PI-PI-07-0218-I, September 4, 2008.

⁹ *Investigative Report of MMS Oil Marketing Group – Lakewood*, Case No. PI-CO-06-0271-I, August 19, 2008. p.1.

Department has launched a criminal investigation of former Secretary Gale A. Norton.¹⁰ The Justice Department is investigating whether Norton used her cabinet-level position to steer lucrative oil leases to Royal Dutch Shell PLC, her current employer. The investigation focuses upon a 2006 decision by the Interior Department to award three oil shale leases on federal land in Colorado to a Shell subsidiary. These leases could represent hundreds of billions of dollars in revenue for Shell.¹¹ The investigation will likely attempt to determine whether Norton personally profited from this arrangement, including whether her position with Shell was awarded as compensation.

Corruption and mismanagement of federal resources by senior officials is only one facet of the Department's dereliction of duty. The Department suffers from day-to-day process inefficiencies that have caused the loss of millions of dollars to the American people. These management difficulties surround the most basic function of royalty collection: data verification.

MMS Does Not Know How Much Oil and Gas Is Produced Offshore

For years, MMS' databases have contained erroneous data on the production and sale of offshore oil and natural gas. Under current regulations, oil and gas companies are required to "self-report" the volume and value of production sold. This data provides the basis for calculating royalty payments. However, some of the data are either missing or incorrectly reported by companies. For 2006 and 2007 alone, bad data could account for \$160 million in lost royalty revenue.¹²

GAO has closely examined MMS' production data for a number of years. In 2003, it reported significant shortcomings within the Royalty in Kind ("RIK") program. Specifically, it noted that 1.9 percent to 3.3 percent of the data it examined for oil leases in Wyoming and the Gulf of Mexico were erroneous, and that 6 percent of the data it examined for gas leases in the Gulf of Mexico contained inaccuracies.¹³

GAO's September, 2009 report continues to cite difficulties with production data for 2006 and 2007. GAO examined gas leases in the Gulf of Mexico and found that, in about 5.5 percent of the time, lease operators reported production, but royalty payors did not submit the corresponding royalty reports. This has the potential to cost taxpayers \$117 million in uncollected royalties.¹⁴ It also found that a small percentage of royalty payors reported negative royalty values resulting from transportation fee deductions that exceeded production values. If left uncorrected, these errors could potentially cost \$41

¹⁰ John Heilprin and Dina Cappiello, "Bush Cabinet Official Target of Corruption Probe," *Associated Press* (September 18, 2009).

¹¹ *Id.*

¹² *MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties*. Report No. GAO-09-549. U.S. Government Accountability Office, August, 2009. p. 13, 15.

¹³ *Mineral Revenues: Cost and Revenue Information Needed to Compare Different Approaches for Collecting Federal Oil and Gas Royalties*. Report No. GAO-04-448. U.S. Government Accountability Office, April, 2004. pp. 24, 28, and 30.

¹⁴ *MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties*. Report No. GAO-09-549. U.S. Government Accountability Office, August, 2009. p. 13.

million in uncollected royalties. In addition, payors claimed processing allowances 2.3 percent of the time for unprocessed gas, potentially resulting in \$2 million in uncollected royalties.¹⁵ Taken together, these three examples account for \$160 million in potentially foregone royalties due to data inaccuracies alone.

MMS Does Not Know Whether It Is Receiving Accurate Royalty Payments

MMS is required to verify that the production and sales data, as well as payment submissions, are accurate. However, numerous reports have stated that MMS lacks critical auditing procedures to ensure their accuracy. In 2008, GAO reported that MMS' royalty management system lacked several capabilities that would provide greater assurance that royalties are collected accurately.¹⁶ These include readily identifying changes that companies make to previously entered data, detecting the absence of royalty reports, and implementing a process for collecting the proper amount of royalties when MMS identifies that oil and gas volumes have been incorrectly reported.¹⁷ Though GAO has made countless recommendations along these lines, MMS has been slow to implement them.

Instead, MMS relies on either full-blown audits or less intrusive measures such as compliance reviews, which are much less thorough than an audit. An expedited review process, such as a compliance review, is not accurate enough to uncover critical discrepancies. At times, critical data errors are not caught by reviewers. One official told Committee staff that he was forced to develop his own Excel spreadsheet to track royalty payments because databases are riddled with inaccurate data. Even with good data, the lack of sufficient auditing procedures means that MMS cannot verify that valid payments are indeed accurate.

Inadequate data verification procedures also hinder RIK collections. The RIK program allows MMS to collect royalties in the form of oil and gas instead of cash payments (royalty-in-value). It then has the option of selling the oil and gas for profit or placing it in the strategic reserve. Among other things, the purpose of this program is to increase profit and decrease administrative costs. In other words, it is designed to reduce inefficiencies associated with cash collection. However, GAO reports that MMS does not have an information system that can provide accurate and timely data for reconciling and resolving uncollected gas royalties.¹⁸ This has resulted in nearly \$21 million in foregone royalty revenue.¹⁹ Though MMS' verification procedures are slightly more robust for its oil collections, the inefficiencies associated with its gas collections jeopardize the integrity of the entire RIK program. Despite Secretary Ken Salazar's

¹⁵ *Id.* at p. 15.

¹⁶ *Id.* at p. 6.

¹⁷ *Id.* at p. 6.

¹⁸ *Royalty-in-Kind Program: MMS Does not Provide Reasonable Assurance It Receives Its Share of Gas, Resulting in Millions in Foregone Revenue.* Report No. GAO-09-744. U.S. Government Accountability Office, September 14, 2009. p. 6.

¹⁹ *Id.* at p. 6.

recent commitment to eliminate the entire RIK program, his timeframe for doing so is unclear.²⁰

MMS Has Breached Its Fiduciary Duty to the American People

MMS and its leadership have breached their obligations as trustees of America's natural resources. MMS is required by law to ensure that the federal government receives every penny of revenue owed from the production and sale of offshore oil and natural gas drilled on federal property. As it stands, MMS has no way of knowing exactly how much oil and gas are produced because its databases contain inaccurate data. Moreover, the lack of verification procedures prevent MMS from ensuring both the accuracy of data and royalty payments submitted by private entities. This has caused \$160 million in foregone revenue for 2006 and 2007 alone.²¹ MMS is also plagued by the Interior Department's culture of corruption and mismanagement, which has led to multiple instances of embarrassment and loss of revenue. The combination of these factors has reached into the billions. MMS has indeed breached the fiduciary duty it owes to the American people.

Congress and the Administration Must Reorganize MMS

Simply stated, the Minerals Management Service is a fractured bureaucracy in dire need of reform. As the highest revenue collector behind the U.S. Treasury, MMS should be an example of principled and programmatic success. Instead, it is marred by ethical lapses and bureaucratic waste. At nearly every turn, senior Department leadership has failed to implement the necessary measures to ensure that MMS functions properly. It is time for a new approach to royalties collection from our federal resources. MMS must split from the Interior Department and become an independent agency.

Divorced from Interior's bureaucracy, MMS will benefit from dedicated funding and focused leadership. A new management structure, coupled with strict congressional reporting requirements, will allow the agency to focus primarily upon revenue collection without the responsibilities of being a subordinate entity. With a fresh start, MMS will have ample opportunity to implement streamlined and responsible revenue collection procedures. Not only will this save time and administrative costs, but the endeavor will pay for itself from the beginning. All funding associated with MMS could be stripped from the Interior Department's annual budget and applied directly to the new entity. With overhauled management practices, it would begin effectively collecting the royalties owed and quickly recoup any start-up costs. Over time, it would generate far more revenue and save taxpayer money – all without creating additional bureaucracy.

²⁰ Noelle Straub and Ben Geman, "OIL AND GAS: Interior To Eliminate Royalty-In-Kind Program," *E&E Daily*, September 16, 2009.

²¹ *MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties*. Report No. GAO-09-549. U.S. Government Accountability Office, August, 2009. p. 13, 15.

Congress Must Continue Strict Oversight of Royalties Collection

In the meantime, Committee Democrats must continue Republican-led oversight hearings on these issues. In the 110th Congress, under then-Chairman Waxman's leadership, the Committee remained inactive and unwilling to demand accountability from the Interior Department and MMS for their role in losing out on, according to GAO, tens of billions of dollars over the life of offshore leases. As a result, Minority staff lacked the necessary support to determine whether oil companies are correctly reporting the amount of oil and gas being produced and whether the correct royalties are being paid on that production. Oil and gas royalty payments represent one of the country's largest non-tax sources of revenue. Taxpayers must get every cent that is owed to them.

RECENT KEY GAO AND IG REPORTS

Current Efforts

Interior's Inspector General is continuing its oversight of the Minerals Management Service. The list of its current efforts includes:

- An audit of MMS' process for verifying oil volumes delivered as RIK, including oil destined for the Strategic Petroleum Reserve; and
- Ongoing law enforcement efforts concerning the underpayment of royalties.

GAO's most recent examinations of MMS' royalties collection practices include the following two reports:

- "Mineral Revenues: MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties." Report No. GAO-09-549. Washington, D.C.: September 16, 2009. MMS has ongoing efforts to improve the reasonableness and accuracy of its royalty data. However, the agency still has more to do to ensure that key data used to report, pay, and audit federal royalties are accurate. MMS still lacks some effective controls to (1) prevent erroneous data on allowances from being accepted into the system, (2) detect errors in data once they are accepted into the system, and (3) ensure that key data needed for complex oil and gas units are consistently provided. This can make the auditing and other compliance work done by MMS staff more difficult and could result in the federal government not receiving all the royalties it is due. In particular, detailed examination of a portion of key fiscal year 2006 and 2007 data has identified missing data, significant errors, and questionable data, raising doubts about the 97 percent accuracy level that MMS reports. In light of these findings, it seems unlikely that MMS could sustain its goal of 98 percent data accuracy without taking additional steps.
- *Royalty-In-Kind Program: MMS Does Not Provide Reasonable Assurance It Receives Its Share of Gas, Resulting in Millions in Forgone Revenue.* Report No. GAO-09-744. Washington, D.C.: September 14, 2009. MMS risks losing millions of dollars in revenue because it does not accurately and promptly identify and collect on RIK gas imbalances. Specifically, MMS (1) estimates it is owed a net of \$21 million for gas imbalances, but it lacks the necessary information to determine the exact amounts; (2) does not audit RIK gas operators' production and allocation data, and thus cannot verify that it receives the correct volumes of RIK gas; (3) lacks adequate policies and procedures to reconcile and resolve imbalances; (4) does not have an information system that can provide accurate and timely data for reconciling and resolving imbalances; and (5) has insufficient staff and training to administer the program efficiently and effectively.

Previous GAO Reports

- *Oil and Gas Royalties: MMS' Oversight of Its Royalty-in-Kind Program Can Be Improved through Additional Use of Production Verification Data and Enhanced Reporting of Financial Benefits and Costs.* GAO-08-942R. Washington, D.C.: September 26, 2008. Under the royalty-in-kind program, MMS's oversight of its natural gas production volumes is less robust than its oversight of oil production volumes. As a result, MMS does not have the same level of assurance that it is collecting the gas royalties it is owed. Moreover, MMS's annual reports to the Congress do not fully describe the performance of the royalty-in-kind program and, in some instances, may overstate the benefits of the program. In addition, these annual reports lack important information on the financial results of individual oil sales that the Congress could use to more broadly assess the performance of the royalty-in-kind program. GAO recommended that MMS improve its verification of gas volumes owed to the government and, therefore, gas royalties owed, by using third-party production information, such as data from OEMM's gas verification system. It also recommended that MMS take several actions to improve its calculations of the benefits and costs of the royalty-in-kind program and the information it presents annually to the Congress on the program.
- *Mineral Revenues Data Management Problems and Reliance on Self-Reported Data for Compliance Efforts Put MMS Royalty Collections at Risk.* GAO-08-893R. Washington, D.C.: September 12, 2008. Collections of accurate royalties will remain at risk as long as companies may make unverified adjustments to royalty and production data after MMS completes its compliance activities. Increasing this risk is uncertainty regarding the statutory time frames for MMS to collect unpaid royalties, which under one interpretation may leave just 1 year for MMS to identify an improper adjustment. Ultimately, Interior's royalty IT system and policies should provide adequate assurance that the federal government receives appropriate value for oil and gas produced from federal lands and waters. This royalty collection process should also rely less on companies providing accurate information on production and royalties owed, and more on a system with the ability to conduct thorough and independent verification of what is owed to the government, using third-party data where available at reasonable cost, and more systematically examining company source documentation.
- *Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment.* GAO-08-691. Washington, D.C.: September 3, 2008. Data GAO evaluated from a June 2007 industry consulting firm indicated that the government take in the deep water U.S. Gulf of Mexico ranked 93rd lowest of 104 oil and gas fiscal systems evaluated. Interior does not routinely evaluate the federal oil and gas fiscal system, monitor what other governments or resource owners are receiving for their energy resources, or evaluate and compare the attractiveness of federal lands and waters for oil and gas investment with that of other oil and gas regions. As a result, Interior cannot

assess whether or not there is a proper balance between the attractiveness of federal leases for investment and appropriate returns to the federal government for oil and gas resources.

- *Oil and Gas Royalties: Litigation over Royalty Relief Could Cost the Federal Government Billions of Dollars.* GAO-08-792R. Washington, D.C.: June 5, 2008. The value of foregone royalties is highly dependent upon oil and gas prices, production levels, and the ultimate outcome of litigation over price thresholds. Assuming that the District Court's ruling in the Kerr-McGee case is upheld, future foregone royalties from leases issued between 1996 and 2000 could range from a low of about \$21 billion to a high of \$53 billion. The \$21 billion figure assumes low production levels and oil and gas prices that average \$70 per barrel and \$6.50 per thousand cubic feet over the lives of the leases. The \$53 billion figure assumes high production levels and oil and gas prices that average \$100 per barrel and \$8 per thousand cubic feet over the lives of the leases.
- *Oil and Gas Royalties: Royalty Relief Will Cost the Government Billions of Dollars but Uncertainty Over Future Energy Prices and Production Levels Make Precise Estimates Impossible at this Time.* GAO-07-590R. Washington, D.C.: April 12, 2007. The absence of price thresholds in leases issued in 1998 and 1999 has already cost the government about \$1 billion and MMS' most recent estimate in February 2007 indicates a range of future foregone royalties of between \$6.4 billion and \$9.8 billion over the lives of the leases. However, because there is considerable uncertainty about future oil and natural gas prices and production levels, actual foregone royalties could end up being higher or lower than MMS' estimates. Additionally, Kerr-McGee's legal challenge to leases issued between 1996 and 2000 could add tens of billions to the total amount of foregone royalties.
- *Mineral Revenues: A More Systematic Evaluation of the Royalty-in-Kind Pilots is Needed.* GAO-03-296. Washington, D.C.: January, 2003. To date, MMS has not developed clear strategic objectives linked to statutory requirements nor collected the necessary information to effectively monitor and evaluate the Royalty-in-Kind Program. Without clear objectives linked to statutory requirements and the collection of necessary information, MMS cannot systematically assess whether Royalty-in-Kind sales are administratively less costly, whether they generate fair market value or at least as much revenue as traditional cash royalty payments, and thus whether MMS should expand or contract the Royalty-in-Kind Program.

Previous IG Reports

- *Evaluation of Royalty Recommendations Made to the Department of the Interior Fiscal Year 2006 – February 2009.* Report No. CR-EV-MOA-0003-2009, April 2009. Royalty Initiatives Group. Interior's Subcommittee on Royalty Management, GAO, and Interior IG all made recommendations to Interior for program improvements in the last 3 years. The Subcommittee issued one report,

GAO issued 12 reports and testimonies, and OIG issued 6 audit and evaluation reports from October 1, 2005 through February 9, 2009, concerning royalty collections. A total of 137 recommendations were generated from the reports. The RIG found that 41 or the 110 recommendations of the Subcommittee had sufficient actions taken to consider them implemented or closed. For the remaining 69 recommendations, it confirmed 43 as having actions initiated towards completion, and 26 as having no action taken but a completion date has been established in the corrective action plan. In addition, it confirmed that 9 of the 14 recommendations made by GAO and 9 of the 13 recommendations made by the IG had been implemented. The remaining five GAO recommendations and four IG recommendations were resolved but not implemented.

- *Evaluation Report: Oil and Gas Production on Federal Leases: No Simple Answer.* Report No. C-EV-MOA-0009-2008, February 2009. Oil and gas companies that own federal drilling leases have little obligation to actually produce resources. During the IG's evaluation of non-producing federal oil and gas leases, it found that Interior has no formal policy to compel companies to bring these leases into production. It also found that due to incompatible data tracking systems used by the Bureau of Land Management (BLM) and MMS, both of which are responsible for overseeing these leases, Interior is at risk of losing millions of dollars in royalties. In one case, a breakdown of communications between BLM and MMS could have resulted in a loss of nearly \$6 million in royalties over a 5-year period, had the company holding the leases not sent its first production report to both bureaus and not just BLM. The existing process is heavily reliant upon companies doing the right thing.
- *Investigative Report of MMS Oil Marketing Group – Lakewood.* Case No. PI-CO-06-0271-I, August 19, 2008; *Investigative Report of Gregory W. Smith.* Case No. PI-PI-07-0120-I, August 7, 2008.; *Investigative Report of MMS – Federal Business Solutions Contracts.* Case No. PI-PI-07-0218-I, September 4, 2008. Collectively, these three investigations revealed a relatively small group of individuals wholly lacking in acceptance of or adherence to government ethical standards; management that through passive neglect, at best, or purposeful ignorance, at worst, was blind to easily discernible misconduct; and a program that had aggressive goals and admirable ideals, but was launched without the necessary internal controls in place to ensure conformity with one of its most important principles: 'Maintain the highest ethical and professional standards'.
- *Evaluation Report: Minerals Management Service Royalty-in-Kind Oil Sales Process.* Report No. C-EV-MMS-0001-2008, May 2008. This evaluation found that MMS has taken some important and necessary steps to enhance the overall performance and effectiveness of its RIK program. Although RIK is taking steps toward improvement, weaknesses in the program still exist. The integrity of the RIK oil sales process is undermined by poor business practices. Without detailed guidance to govern its operations, the RIK business environment falls short in two critical areas – fairness and effectiveness. The IG discovered that modifications

to oil sale contracts were made without clear criteria, and that the modifications appeared to inappropriately benefit the oil companies.

- *Investigative Report: Minerals Management Service False Claims Allegations.* September 7, 2007. This report assessed the legitimacy of claims made in a series of *qui tam* lawsuits filed by MMS auditors against oil companies for alleged underpayments of royalties and interest owed. Ultimately, it determined that the claims made were either based on a lack of knowledge of other MMS efforts to collect royalties and interest or the auditors disagreed with both MMS management decisions and MMS guidance that the companies were following. During the course of investigating these issues, it found a number of other significant concerns, worthy of separate investigation, including program mismanagement and process failures.
- *Investigative Report: On the Lack of Price Thresholds in Gulf of Mexico Oil and Gas Leases.* Spring, 2007. This investigation found that shortly after the inception of the Outer Continental Shelf Deep Water Royalty Relief Act in 1995, MMS made the policy decision to include price thresholds in the leases issued between 1995 and 2000. MMS field personnel initially attached addenda to the leases containing price threshold language but stopped for 2 years and instead cited a regulation that they thought contained threshold language, when, in fact, it did not. MMS' review process, which included the Office of the Solicitor, simply failed to identify this discrepancy. The investigation also revealed that when the omission was first brought to the attention of the former Associate Director for Offshore Minerals Management in 2000, she chose not to inform the former MMS Director, preferring to "work out a solution with OMM." The former MMS Director and Deputy Director both said they had only become aware of the issue contemporaneously with a January 2006 *New York Times* article. The Director testified before the Government Reform Committee in 2006 that she became aware of the issue either contemporaneously with, or just prior to, the article being run. A series of uncovered emails, however, suggest that the Director may have been told of the omissions as early as 2004, and upon reviewing these e-mails, she conceded that she must have been advised in 2004.
- *Audit Report: Minerals Management Service's Compliance Review Process.* Report No. C-IN-MMS-0006-2006, December 2006. MMS has increasingly substituted compliance reviews for audits in its Compliance and Asset Management program, resulting in underpayment of royalties. Compliance reviews are only a test of the reasonableness of royalties paid and do not provide the same level of royalty verification as an audit. This audit disclosed weaknesses in MMS' management of compliance reviews and its overall CAM program. Specifically: MMS lacks reliable management information to adequately develop a compliance strategy, monitor progress, and assess results of its CAM program; MMS needs to improve its compliance review process to maximize outcomes; MMS' performance measures are inadequate and need to be revised.

About the Committee

The Committee on Oversight and Government Reform is the main investigative committee in the U.S. House of Representatives. It has authority to investigate the subjects within the Committee's legislative jurisdiction as well as "any matter" within the jurisdiction of the other standing House Committees. The Committee's mandate is to investigate and expose waste, fraud and abuse.

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