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BEFORE THE HOUSE OF REPRESENTATIVES
COMMITTEE ON NATURAL RESOURCES
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
“DETAILS OF OIL AND GAS PRODUCTION
ON THE OUTER CONTINENTAL SHELF”
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Mr. Chairman, members of the subcommittee, thank you for the opportunity to appear today and testify about the findings of the Office of Inspector General (OIG) for the Department of the Interior’s (DOI) regarding oil and gas royalty collection programs within the DOI. As you know, DOI’s revenue collection volume is one of the highest of any department in the federal government. Especially in these fiscally precarious times, the value to the taxpayers of these collection programs is very important, indeed.

The OIG has devoted many resources over the past 3 years to understanding, auditing, evaluating and investigating the role of DOI bureaus and offices that collect royalties from offshore oil and gas drilling. We discovered weaknesses in the oversight of royalties, in communications in the drafting of leases, the under-payment of royalties, and a culture in the Royalty-In-Kind program where employees felt exempt from the ethics rules that govern all other federal employees.

We recently completed an evaluation, at the request of Chairman Dicks for the Interior and Environment Subcommittee of the House Appropriations Committee, concerning the status of non-producing federal oil and gas leases. In addition to some very challenging data integrity and lease oversight issues, we found that the Bureau of Land Management (BLM) and Minerals Management Service (MMS) need to develop much clearer policy concerning the expectations of production of oil and gas on federal lands. We recommended that the Department consult with Congress in this regard.

With respect to non-producing leases, we found that oil and gas companies that own federal drilling leases have little obligation to actually produce. The Department has no formal policy to compel companies to bring these leases into production. While current statutes, regulations and policies do promote exploration, production activities are not required to commence within the primary lease term. The bureaus do not inquire about the production strategies of companies and have not attempted to enforce the performance clause included in lease agreements. Both industry and bureau officials cautioned, however, that mandating production activities may not necessarily have positive outcomes, and could, in fact, be counter-productive by reducing industry interest in federal leases.

With few exceptions, the Department does not track oil and gas leases until a company applies for an Application for Permit to Drill (APD). This means it may be years before the Department records any data about a lease. There being no mandate to track a lease, MMS and BLM do not begin tracking until the lease holder applies for an APD and exploratory activity begins or the primary term of the lease ends.

Our evaluation revealed three primary factors that account for – or, fail to account for – the non-producing status of so many federal oil and gas leases. These factors are: data integrity issues in the MMS and BLM systems; a litany of obstacles cited by oil and gas companies; and, limited statutory and regulatory requirements on either DOI or industry to promote production.

We believe that improved and more comprehensive data would assist in instituting a monitoring program for non-producing leases and paint a much more accurate picture of the production status of DOI leases. Similarly, a better understanding of the processes and problems leading to production would lead to a more accurate perception by the public of the production status of DOI leases. Further, more explicit statutory and/or regulatory mandates would contribute to clearer expectations on the parts of both DOI and the oil and gas industry.

Data Integrity Issues

We found numerous data integrity issues during our evaluation. In its publicly accessible data, MMS reports less than half – or 41 percent – of all federal oil and gas leases in the United States are producing. Without more information, these data suggest that existing leases are underutilized, but do nothing to explain why. We looked behind the reported data with hopes of making this determination. Unfortunately, we found that both MMS and BLM employ inconsistent procedures and definitions and that BLM's records are often incomplete and inaccurate, all of which call into question both the integrity and usefulness of their data.

Due to incompatible data in the tracking systems used by BLM and MMS, both of which are responsible for overseeing these leases, we found that DOI is at risk of losing millions of dollars in royalties. In one case, a breakdown in communications between MMS and BLM 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, not just BLM. The existing process is heavily reliant upon companies doing the right thing.

We also found inconsistencies in how MMS and BLM define and report on the status of leases. Leases that are identified as producing by BLM may be reported as non-producing by MMS. We identified over 1,400 onshore leases that were reported as producing by BLM. When we selected a random sample to determine how these leases were identified by MMS, 70 percent of the sample was reported as non-producing.

From the beginning of our planning efforts for the evaluation, we were confronted with lease data availability and reliability issues that hindered our progress. For example, BLM reported 6,198 non-producing leases (19 percent) with no expiration dates (only producing leases should have no expiration dates). In addition, there were 528 producing leases that had expiration dates. Other data errors we found include leases that had terms of 8,000 years (expiration date was January 1, 9999), leases with no effective dates, and leases with negative lease terms (leases expired before the effective date).

Industry Cites Obstacles

As we were conducting our field work, the Government Accountability Office (GAO) issued a report in October 2008 in which it identified business, geologic and regulatory factors influencing companies' decisions to develop oil and gas leases. During our review, we obtained additional information from 11 oil and gas companies that held oil and gas leases, 3 oil and gas industry organizations, Interior bureaus, subject-matter experts, and our review of leases on each of these three factors. Finally, industry cited resource availability as having an effect on the production status of leases, including technology, equipment, infrastructure and workforce.

The exploration and production of oil and gas requires significant capital investment. And, it requires careful planning while considering many variables, such as variations in commodity prices, escalating material and labor costs, drilling and transportation infrastructure, lease and capital acquisition, and regulatory concerns.

Despite the best expectations, millions of dollars are spent on exploration and drilling of wells that result in no actual production. Fluctuating prices can have a direct influence on project planning. For instance, the recent downward spiral in oil and gas prices during the second half of 2008 directly resulted in decreased domestic exploration and production.

Some leases may be considered non-producing because of geological factors. Seismic data for oil and gas inform industry as to the size of a potential reservoir and, therefore, assist in the determination of how many lease blocks to acquire. Once exploration starts and the reservoir is better defined, the leases on the outer edges of the reservoir may not be developed and therefore remain non-producing.

Regulatory issues also are a factor. Federal leases usually have a lower royalty rate than state or private leases. But developing onshore federal oil and gas leases is much more difficult, expensive and time-consuming. In large part, this is due to regulatory restrictions and requirements. These requirements are designed to protect many of the natural, environmental, historical, and cultural resources contained on federal lands. But they can also severely limit the amount of time in which companies are allowed to access the land to conduct operations. Rig availability and cost can become significant hurdles.

The increasing challenges for discovering and accessing new oil and gas reserves have caused a sharp demand for technological advancements, which can also delay exploration and production. As a result, there is a shortage of drilling rigs worldwide, causing further delays. If oil and gas is discovered and a rig is available, industry cites other challenges such as transportation availability and a shortage of oil and gas field workers.

Finally, we found that litigation and public opposition to oil and gas production have significant impact on the ability of lease holders to conduct development activities. Industry advocacy groups emphasized this point, citing a dramatic increase in opposition that begins even prior to lease issuance and continues throughout the development process.

Limited Statutory and Regulatory Support for Promoting Production

A number of laws and regulations direct and guide the Department on all aspects of oil and gas leasing. They also contain more general “due diligence” provisions concerning production, requiring lessees to take affirmative action toward diligently developing their leases.

The Department has done little to provide specific guidance to lessees on the “due diligence” production requirements. While leases typically include a performance clause to promote or compel production, the Department has not definitively established the authority in lease terms, regulations, or past enforcement actions. For the vast majority of leases – 99 percent – the Department does not monitor to ensure that due diligence is exercised. Accordingly, none of these leases is terminated for failure to produce. Rather, the Department allows these leases to expire naturally.

Other OIG Efforts

We are presently conducting an audit of MMS’s process for verifying oil volumes delivered as RIK, including oil destined for the Strategic Petroleum Reserve. In addition, we are reviewing the status of the recommendations advanced to MMS by the Royalty Policy Committee in 2007. At the request of MMS, we have expanded this review to include recommendations by OIG and GAO. MMS estimates that there are approximately 200 recommendations by these three entities, some of which overlap and some that may conflict with one another. We also have several law enforcement efforts ongoing concerning the underpayment of royalties. And we have queued up evaluations of the onshore lease auction process that BLM employs, the Inspection and Enforcement Program for onshore leases, and the wind and solar energy programs for the near future.

Mr. Chairman, that concludes my testimony. I would respectfully request that my written testimony be accepted by the Subcommittee and made part of the record. I would like to thank you for the opportunity to testify today and would welcome any questions you might have.