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BEFORE THE HOUSE COMMITTEE ON NATURAL RESOURCES
ON THE
"CONSOLIDATED LAND, ENERGY AND AQUATIC RESOURCES ACT OF 2009"
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Mr. Chairman, and members of the Committee, thank you for the opportunity to testify today about the on-going work of the Office of Inspector General (OIG) regarding federal energy and mineral leasing programs within the Department of the Interior (DOI), and our perspectives on the proposals in the Consolidated Land, Energy and Aquatic Resources Act of 2009, H.R. 3534. My testimony this morning will speak to myriad issues and challenges we have uncovered and continue to uncover in the Department's energy programs.

As you know, my office in recent years has conducted numerous investigations, audits and evaluations of oil and gas royalties programs. The OIG has amassed a vast independent body of knowledge in these programs. We discovered weaknesses in the oversight of royalties, in communications in the drafting of leases, in the onshore oral lease auction process, in the under-payment of royalties, and in the culture of the Royalty-In-Kind program where employees considered themselves exempt from the ethics rules that govern all federal employees.

Currently, we are reviewing the Department's onshore oil and gas lease inspection and enforcement program of the Bureau of Land Management (BLM), how BLM coordinates with the Minerals Management Service (MMS) on production data and royalty collection, royalty-free use of oil and gas during production, and oil volume verification in the MMS Royalty-In-Kind program.

We are also examining alternative energy generation authorities, regulations, and practices within the Department, to include MMS and BLM offshore and onshore programs in the areas of wind, wave and ocean current, and solar and geothermal. In the course of our work over the years, we have observed that MMS has been challenged when standing up new programs. For instance, we found no governing principles or written detailed policies for the RIK program or the Cape Wind Project. Recently, both MMS and BLM officials have told OIG personnel that they do not have written detailed policies for emerging energy programs since they do not know what they will need until they begin operating these programs. To us, this is a bright red flag cautioning the need for special attention and oversight.

One particular area warranting increased oversight is geothermal. Our overall concern is whether companies with geothermal leases are paying appropriate royalties. MMS has conducted nine audits of geothermal leases in the last eight years, collecting approximately $8.7 million additional royalties in the last five years alone. MMS compliance auditors raised concerns to the OIG that two companies were improperly or perhaps fraudulently claiming deductions to their royalty payments.

In one of those cases, we are also reviewing the propriety of regulations governing deductions up to 99 percent of gross sales. We were curious to learn if other companies are routinely reporting the 99 percent deductions. MMS, however, was unable to provide that information. It does not collect the necessary data from companies to determine the amount of deductions the companies take. In fact,

MMS has little ability to determine the reasonableness of geothermal royalty payments it receives from a company unless it selects the company for an audit or compliance review, and seeks additional documentation that is not routinely submitted.

Poor communications between BLM and MMS also threaten the loss of royalty revenues to the Treasury. In the area of beneficial gas, BLM regulations and supplemental guidance inform operators that all deductions must meet regulatory requirements or receive prior approval by BLM. We found, however, that operators claim the deduction without meeting the established requirements or getting BLM's approval. Thus, operators underpaid federal royalties. But because the jurisdiction regarding beneficial use is strictly a BLM function, MMS cannot determine whether the deductions claimed in the operators' reports are valid.

Mr. Chairman, your draft legislation addresses many of the problems we have uncovered in our body of work. In Title I, for instance, the ethics penalties and restrictions on gifts, employment and post-employment would be constructive changes and would adequately address the behavioral anomalies we uncovered in the Royalty-In-Kind program, and would affirmatively set expectations for any other employees involved with oversight of energy production.

Also in Title I, the consolidation into one bureau of the leasing and royalty tracking and collection functions currently managed by MMS and BLM would address the weaknesses we found in terms of communications, royalty collection, data collection and sharing, differences in terminology, and separate data systems. This would help standardize procedures within the Department. Prior reports of both the OIG and the Government Accountability Office (GAO) have disclosed inconsistent procedures between MMS and BLM that have complicated and hampered lease monitoring and royalty collection.

Finally in Title I, the bill would transfer the MMS audit and compliance section to OIG. This proposal is best addressed by a discussion of the pros and cons, as the OIG is neutral on it.

On the pro side, there would be greater independence for auditors, taking audit responsibility out of the entity responsible for collecting royalties and put it into an independent entity responsible for conducting audits of the Department. It would separate auditors from the negotiation, policy and rulemaking processes. It would separate the audit responsibility away from MMS management, which would eliminate allegations of management putting pressure on auditors to adjust findings.

Greater coordination between production and royalty auditors and the OIG investigative component could also result in greater collections and better oversight. We are seeing this with the interaction of two new units in our Central Region office in Lakewood, Colorado. There, the Energy Investigations Unit (EIU) and the Royalty Initiatives Group (RIG) work closely together to share information and leverage available resources to improve oversight. This cross-discipline collaboration is relatively unique within the IG community, but it is extraordinarily effective.

Finally on the pro side, would be the opportunity to improve the federal government's relationship with STRAC -- the State and Tribal Royalty Audit Committee. STRAC has had a rather contentious relationship with MMS over the years, often questioning the accuracy of royalty payments. As the OIG is independent of MMS management, the OIG would begin with a clean slate in dealing with STRAC. And the oversight of STRAC audits would be consistent with OIG oversight of other external audits.

On the con side, OIG would inherit the current problems associated with the royalty compliance program. These problems include: the Compliance Information Management system; a lack of reliable

performance data; a lack of reliable data on payors and audit results; a dependence on MMS's current payor system, or the need to build a new one; and the backlog of audits for previous years.

In addition to these issues, the OIG would have a substantial learning curve to overcome. Whether or not MMS personnel would be transferred, OIG does not currently have sufficient expertise. The mechanics of doubling the size of our office with additional auditors and support personnel would be challenging. Questions to be answered include: were to place new personnel; how to organize the function; would it cause a slowdown in other OIG work; how significant an effort would the hiring process be; could royalty audits end up dwarfing the other OIG functions?

The transfer would also move the OIG more towards the compliance audit mode, as opposed to performance audits. That would present difficult organizational structure issues, and would require finding a balance between the primary mission of OIG to the Department, which is to provide independent oversight to ensure and improve the integrity of its programs and operations, versus the mission of validating royalty payments. The transition would take at least 18 months and would be costly. It would require developing new procedures, hiring and training employees, getting equipment up and running, dealing with possible staff morale issues, and relocation issues.

Finally on the con side are the challenges with OIG taking over the management of contracts and cooperative agreements related to the STRAC, and the dynamics of conducting oversight of 18 separate audit entities.

Mr. Chairman, we have identified other provisions in the bill that would be useful for effective oversight. I will mention just a few. OIG supports the doubling of fines and penalties contained in Title II. Prior OIG and GAO reports have discussed the need to increase fines and penalties. The bill also would allow for sharing civil penalty proceeds with states and Indian tribes. This would help create an incentive for the states and tribes to be extra diligent in their royalty audits.

In Title III, OIG supports the development of more specific expectations concerning diligent development of oil and gas leases. Recent OIG and GAO reports on non-producing leases mentioned that existing law is vague. Increasing non-producing lease annual rental rates might help encourage lease holders to develop the leases.

In Title V, OIG supports getting fair market value for revenues from solar and wind projects. We also support authorizing audits of wind and solar leases, although this would require additional audit capacity. Finally, in Title VII, OIG supports the repeal of certain incentives and royalty relief for drilling because new technology has reduced drilling costs in those areas. It would also establish and index an annual fee of $4.00 per acre for non-producing leases. We do not take a position on this proposal. Rather, we point to the report we issued earlier this year on non-producing leases, we discuss the time periods involved in producing on oil and gas leases. For example, time periods increase for the deeper Outer Continental Shelf (OCS) leases due to the time required to establish transportation systems. Imposing fees on non-producing leases may have the unintended negative impact of reducing industry interest in federal leases.

Finally, Mr. Chairman, I would like to discuss the issue of deterrence against fraud in the payments of royalties, and the recovery of hundreds of millions of dollars for the taxpayer. Between 1998 and 2007, the OIG jointly conducted royalty management investigations with the U.S. Department of Justice (DOJ). They resulted in the recovery of nearly $700 million from 25 U.S companies operating oil, natural gas, coal, and other activities on federal and Indian lands. These were difficult and often complex civil cases, many of which were *qui tam* cases. With a growing demand for all sources of

energy in this country, there is an even greater need to continue such investigations and secure recoveries.

Unfortunately, Mr. Chairman, the OIG must carefully balance working those cases against other compelling investigative demands. When the Justice Department works those cases, three percent of recoveries go into a general fund that helps finance future cases prosecuted by DOJ. Investigative agencies however have no such fund, although we are absolutely critical to advancing such cases to prosecution.

I would ask the Committee to consider a one percent fund, fashioned after the fund created for DOJ, to help finance future civil recovery cases. I understand that this may not be in this Committee's jurisdiction, but we would be happy to work with this Committee and the relevant committee of jurisdiction toward that end.

This concludes my testimony. I respectfully request that my full written testimony be incorporated into the record.

Once again, Mr. Chairman, I appreciate the invitation to share my views with you. I would be happy to answer any questions.