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MINERALS MANAGEMENT IN THE WESTERN STATES: THE NEW FEDERALISM AND OLD COLONIALISM

Jan Stevens*

I. INTRODUCTION

Forty-eight percent of the land west of the Rockies is owned, for better or worse, by the federal government. Sixty-six percent of Utah, sixty-four percent of Idaho, and forty-eight percent of Oregon is federally owned. California is a large state in terms of overall size, but only fifty-five percent of the state can be said to be truly sovereign, because the federal government owns the rest of it. Most of the other western states face similar situations, with Nevada being the extreme, where Governor Bryan governs over an entire thirteen percent, while the remaining eighty-seven percent of land is the United States' property.¹ Inevitably, an inherent tension arises from the administration of a system of land tenures based on absentee ownership. Nowhere is this tension more apparent than in the conflict over revenues from these vast federal holdings.

II. MINERAL MANAGEMENT POLICY PROBLEMS

Conflicts between the states and the federal government over mineral royalty management can be traced back over fifty years to the Mineral Leasing Act of 1920.² Congress decreed that for lands with oil, gas and other so-called "soft" minerals, the federal policy would be one of retention rather than disposition. These lands would not be available in fee to the first claimant, as lands previously were under the General Mining Law of 1872.³ On the contrary, they would be retained by the federal government and leased for royalties. Thus, huge tracts of land would be held by another sovereign, exempt from state and local taxes and, to a large extent, land use regulation.⁴ The development of these lands would create demands for schools, roads and other types of infrastructure.⁵ The compensation, if any,

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1. UNITED STATES DEP'T OF INTERIOR, PUBLIC LANDS STATISTICS (1980).
2. 30 U.S.C. §§ 181-287 (1982).
3. 30 U.S.C. §§ 21-54 (1982).
4. See *Ventura County v. Gulf Oil Corp.*, 601 F.2d 1080 (9th Cir. 1979), *aff'd mem.* 445 U.S. 947 (1980).
5. S. Fairfax, Revenue Sharing and Evolving Policy Toward the Public Land: A Background Paper for Hearings Before the Senate Committee on Natural Resources and Wildlife 16 (Jan. 1985)

the states should receive for this obtrusive federal presence was to depend on the strength and persuasiveness of their congressional representatives. Under the Mineral Leasing Act, the states were guaranteed a substantial share of the federal pie.⁶ In its present form, the Act allocates ninety percent of the federal onshore lease revenues to the states—fifty percent outright and forty percent to the Reclamation Fund (which is devoted in large part to western projects).⁷ The other ten percent goes directly to the Federal Treasury for the expenses of administration.⁸

For many years, because revenues were small and development limited, states with federal lands were content to receive their biennial checks from federal onshore royalties without asking questions. Indeed, these checks came without explanation of any kind as to their source or nature.⁹

A. *The Clouds Gather; Reports are Released Divulging the Shortcomings of the Royalty Management System*

Since the early 1950's, however, an ominous series of reports and audits began to show deficiencies in lease administration by the Department of Interior indicating underpayment, late payment, and, in some cases, no payment at all by federal lessees. These reports reflect a fairly consistent pattern. An investigating agency (usually the General Accounting Office, but sometimes the Department's own Inspector General) would point out inadequacies in the Department's royalty management. Those responsible would admit to shortcomings and promise reforms. Then, a few years later, a new investigation would come up with another list of shortcomings.¹⁰

In 1953, the General Accounting Office (GAO) first began discussing inadequate royalty accounting procedures in reports to Congress and the Department of Interior.¹¹ Such reports appeared periodically throughout the 1950's and 1960's.¹² In the late 1970's, however, reports by the GAO of

(Unpublished paper).

6. *Id.* at 21.

7. The Reclamation Fund was established by the Reclamation Act of 1903 for irrigation works in arid and semi-arid lands. 43 U.S.C. § 391 (1982).

8. *California v. Watt*, No. 82-1217 (D. D.C. May 26, 1981), Memorandum of Amici Curiae at 5.

9. Testimony of Rowena Rogers, President, Colorado State Land Board, Hearing Before Commission on Fiscal Accountability of the Nation's Energy Resources (Sept. 23, 1981).

10. A summary of these reports appears in Department of Interior, Report of the Commission on Fiscal Accountability of the Nation's Energy Resources, Appendix D (January 1982).

11. GAO, Review of Supervision of Oil and Gas Operations and Production on Government and Indian Lands (1959).

12. In 1959 the General Accounting Office first reported that there were a number of "serious deficiencies" in royalty accounting. Billing and collection were delayed at times for prolonged periods.

oil and gas royalty problems became more frequent and critical. As an example, a 1979 GAO Report was titled: "Oil and Gas Royalty Collections—Serious Financial Management Problems Need Congressional Attention." There, the GAO described what it called a "breakdown" in the financial management system in departmental collections resulting in losses of millions of dollars. Royalty lease accounts contained numerous errors and omissions, and data supplied by producers was not verified or matched against recorded sales. There was also a failure to charge interest for late payments resulting in late receipt of approximately \$359 million in one year, and understaffing was a "chronic condition."¹³

While these critical reports were being released, the financial stake in royalty collections continued to grow. Initially insignificant, by 1980 the states' share in royalty revenues had risen to \$315 million, and by 1982 to \$609 million.¹⁴ With other sources of income shrinking, it was only logical that the states should put pressure on Congress to examine the manner in which the federal stewards were administering their properties.

B. *Concurrent Congressional Investigations*

At a joint hearing of the House Subcommittees on Mines and Mining and Oversight and Investigations in 1981, Representative Edward Markey of Massachusetts pointed out that royalties owed to the government for oil, gas and other minerals are the single largest non-tax source of revenue the government receives.¹⁵ Markey also noted that according to the GAO's investigations, perhaps as much as 7-10 percent—or one million dollars a day—was never collected.¹⁶ The House Subcommittees heard extensive testimony of understaffing, mismanagement, extensive thefts and failure to enforce lease terms from ex-Department of Interior employees, states, tribes and others.¹⁷

There were "large, unexplained differences" between the Department's royalty receivable records and related control records. *Id.*

In 1964 the GAO reported continued deficiencies, but added "The Department . . . advised us that corrective action had been taken or that serious consideration was being given to our recommendations." GAO, *Certain Deficiencies in Financial Management of Oil and Gas Activities* (1964).

13. GAO, *Oil and Gas Royalty Collections—Serious Financial Management Problems Need Congressional Attention* (1979).

14. United States Dep't of Interior, *Mineral Management Service, Mineral Revenues—Report on Receipts on Federal and Indian Leases 59* (1983).

15. *Royalty Accounting System Within the United States Geological Survey: Oversight Hearings Before the Subcommittees on Mines and Mining and Oversight and Investigations of the Committee on Interior and Insular Affairs, 97th Cong. 1st Sess. (1981)* (Opening Statement of Rep. Edward Markey, Sept. 23, 1981).

16. *Id.*

17. *Id.*, testimony heard on Sept. 23 and Oct. 6, 1981.

Similar problems were identified in the Senate by the Select Committee on Indian Affairs, whose investigation revealed inadequate enforcement of the terms of leases and failure to supervise production. Until a recent reorganization creating the Minerals Management Service (MMS), the United States Geological Survey (USGS) was responsible for lease inspections. However, in the early seventies, memoranda from district offices indicated the USGS was "nowhere near achieving a lease inspection of every lease every year" and "nowhere near meeting even minimal goals on detailed lease inspections. . . ."¹⁸

In August 1980, testimony and staff studies by these subcommittees found widespread failure to enforce the sealing of locks on tanks. Bypasses around measuring meters were "fairly common." In September 1980, a memorandum from the Deputy Division Chief of Onshore Minerals Regulation acknowledged that "theft and unauthorized transfers of crude oil have become of such magnitude that they are likely to result in a national scandal of major proportions."¹⁹ And no wonder. At the time of these hearings, the Department had about 47 inspectors to check over 18,000 producing leases on federal and Indian land.²⁰

Underpayment through inefficiencies and theft were not the only causes of loss to affected states and tribes. The failure of the Bureau of Land Management (BLM) to make informative and timely biennial payments also resulted in major revenue losses. As an example, California auditors learned that one payment of \$12.9 million due October 1, 1981, had not been received until January 14, 1982. When the BLM was contacted in December of 1981 to determine why payment was late, state auditors were told that the check had been lost. As a result of that one late payment, the state lost \$200,000 to \$300,000 in interest revenues (at interest rates of 10-15 percent).²¹ New Mexico, the largest recipient of federal royalties, estimated a 1980 loss of \$1.6 million attributable to delays of only 45 days at a 12 percent interest rate.²²

C. California v. Watt: *The Courts Become Involved*

As congressional and GAO investigations disclosed steadily growing underpayments, it became necessary to take action to protect the states'

18. Referenced in Staff Memorandum from Max Richtman and Virginia Baylor to Sen. John Melcher, Chairman, and Members, Senate Select Committee on Indian Affairs 3 (April 6, 1981) (discussing oil theft investigation).

19. *Id.* at 2.

20. Oversight Hearings, *supra* note 15, at 88.

21. See Stevens, *The Management of Mineral Royalties: An Opportunity for Cooperative Federalism*, W. NAT. RESOURCES LITIGATION DIG. 29 (Winter 1983).

22. Testimony of Alice Haerter, Legal Counsel, New Mexico Dep't of Fin. and Admin., Hearing Before Commission of Fiscal Accountability of the Nation's Energy Resources (Sept. 25, 1981).

interest in these vanishing revenues. Through its Controller, the State of California filed a lawsuit against the Secretary of the Interior alleging a breach of his fiduciary duty as a trustee to collection of mineral royalties on behalf of the beneficiary states and the federal government.²³ The court was asked to order the Secretary to render a full and complete accounting, and to institute an effective collection system.²⁴ The arguments made by California and the states that joined in the action revealed the frustrations that they all shared over the mineral royalties issue.

The states of Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, North Dakota, South Dakota, Utah and Washington joined with California as amici.²⁵ They filed a strong supporting brief demonstrating Congress' intention that the western states should receive the benefit of these mineral revenues. After extensively reviewing the legislative history of the Mineral Lands Leasing Act of 1920, they asserted that the Act was "not simply another law involving federal resources but . . . designed specifically for the benefit of the states in which the public lands were located."²⁶

The states' reasoning was easy to follow. By 1920—the date of the Mineral Leasing Act's enactment—the pattern of federal revenue sharing had been established. State land grant programs and national forest revenue sharing programs were well under way.²⁷ At the same time, the economic activity and population growth accompanying mineral leasing made obvious demands on state and local governments. The revenue-sharing formula of the Mineral Leasing Act had, therefore, been accurately characterized as a "Congressional quid pro quo" designed to foster local acceptance of federal programs.²⁸ It appeared that Congress intended that the states' inhabitants, rather than the federal government, be the primary beneficiaries of the leasing system, since the formula for distribution provides that 50 percent of the revenues are to be paid directly to the states and 40 percent to the Reclamation Fund—for projects in the arid western states—with the remaining 10 percent to be used by the federal government for the expenses of administering the program.²⁹ Thus, the states contended the leasing program was not designed as a "major source of revenue for the federal government" and "the states' interest in leasing revenues is more than a beggar's claim to a portion of federal resources."³⁰

23. *California v. Watt*, No. 82-1217 (D. D.C. May 26, 1981).

24. Complaint, *id.*

25. Memorandum of Amici Curiae, *id.*

26. *Id.* at 3.

27. Fairfax, *supra* note 5, at 16.

28. *Id.*

29. Amici Curiae, *supra* note 25, at 5.

30. *Id.* at 7.

In its answers in *California v. Watt*, the United States declined to assume any obligation to the states under the Mineral Leasing Act other than to distribute what was in fact collected from producers.³¹ In response to this, the ten-state memorandum pointed out that under the Secretary's reasoning, he could cease lease enforcement altogether, and nevertheless the beneficiary states would have no enforceable rights against him.³² This is the argument of secretarial discretion carried to extremes, to say the least.

Few propositions are as important today to equitable federal and state relations than the one at issue in *California v. Watt*: whether states have an enforceable right, as beneficiaries of federal resource revenues, to have those resources managed properly and distributed lawfully. Unfortunately, *California v. Watt* was settled without a judicial declaration to that effect. In a court-approved agreement, the Department of Interior agreed to enter into a federal-state audit of the onshore leases within that state, with half of California's expenses to be reimbursed by the Department.³³ However, the same state arguments were espoused more successfully in *Arkla Exploration Co. v. Watt*,³⁴ a more recent federal case.

In *Arkla*, the Eighth Circuit held that the Secretary of Interior does indeed have a duty to the states to perform a diligent and efficient job of collecting mineral revenues. The district court ruled that the State of Arkansas had standing to intervene in a lawsuit in which a prospective lessee challenged the Secretary's allegedly arbitrary classification of a potential lease area if the Secretary's action would result in substantial loss to the state's share of federal revenues.³⁵ In affirming the district court decision, the Eighth Circuit held that Arkansas had standing to seek enforcement of lease payments due because of its interest in the revenues.³⁶ The *Arkla* decision stands for a proposition which the federal courts have been willing to support in other fields during the past few years: that the Secretary of Interior has a mandatory duty to husband the resources entrusted to his control, and to protect the interests of the ultimate beneficiaries of his management—whether they be states concerned with their share of mineral revenues or, as in the Redwood National Park

31. Defendants' Memorandum in Support of Motion to Dismiss, *supra* note 23.

32. Amici Curiae, *supra* note 25.

33. Stipulation of Voluntary Dismissal, *supra* note 23.

34. 562 F. Supp. 1214 (N.D. Ark. 1983), *aff'd sub nom.* *Arkla Exploration Co. v. Texas Oil & Gas Corp.*, 734 F.2d 347 (8th Cir. 1984), *cert. denied*, 53 U.S.L.W. 3499 (Jan. 15, 1985), *see* Novins, *Growing Role of States in Federal Resource Administration*, WESTERN NAT. RESOURCES LITIGATION DIG. 32 (Summer 1984).

35. *Arkla*, 562 F. Supp. at 1217.

36. *Arkla*, 734 F.2d at 354-355.

cases,³⁷ members of the Sierra Club fighting to preserve the redwoods from the Interior Department's failure to protect them.

III. POLICY REFORM BEGINS

A. *Action by the Department of Interior*

As the gravity of the situation became increasingly apparent, the Department of Interior proceeded to pursue several different remedies, the most visible being the appointment of a distinguished commission led by David F. Linowes of the University of Illinois to study and make recommendations on the problems of federal collections.³⁸

The Linowes Commission made its final report in January 1982. It found "management of royalties for the nation's energy resources has been a failure for more than 20 years" and that because of mismanagement the oil and gas industry was not paying all the royalties it rightly owed.³⁹ It also found the government's royalty recordkeeping for federal and Indian oil and gas leases to be in "disarray."⁴⁰ The exact amount of underpayment was unknown, and the Commission suggested that hundreds of millions of dollars due the U.S. Treasury, the states and Indian tribes were going uncollected each year.⁴¹ Accordingly, it recommended that the royalty management system be strengthened and that the federal government work more closely with states and Indian tribes, "sharing both information and specific tasks, such as auditing and site inspection."⁴²

It was noted that although it was not possible to determine the exact amount of losses due to under-reporting and oil theft, in light of the fact that the federal royalty management system lacked the most elementary controls, the GAO's 1979 estimate of seven to ten percent was reasonable.⁴³

The Commission found the collection of oil and gas royalties was "on an honor system," with the government having no way of verifying independently how much oil and gas was taken from leases on federal and Indian lands:

37. *Sierra Club v. Dep't of Interior*, 376 F. Supp. 90 (N.D. Cal. 1974); *Sierra Club v. Dep't of Interior*, 398 F. Supp. 284 (N.D. Cal. 1975). In these cases, the Court held the Department had a duty to protect Redwood National Park from erosion and related damage by logging outside the Park.

38. Report on the Commission on Fiscal Accountability of the Nation's Energy Resources, Appendix A (January 1982) (Linowes Commission Report).

39. *Id.* at XV-XVII.

40. *Id.* at 13, see Statement of David F. Linowes at Press Conference Releasing the Commission's Final Report (Jan. 21, 1982).

41. Linowes Commission Report, *supra* note 38 at XV.

42. *Id.*

43. Statement of David F. Linowes, *supra* note 40.

The producing companies that lease our lands tell us how much they pump out of our wells and what the value is. There are no internal controls. Only a handful of audits has ever been conducted. And incidentally, they reveal rather significant underpayments. Site security is deficient. Theft of oil is quite common throughout the country.⁴⁴

The Commission recommended more severe sanctions for willful underpayments and the institution of cooperative arrangements for states and Indian tribes to help monitor oil and gas sites and share in lease audits.⁴⁵ It urged that the Department share information and royalty management functions with affected states and tribes to the maximum extent possible.⁴⁶ The Commission also proposed immediate steps to enter into cooperative agreements with interested states and tribes, especially for inspections, audits and training, and recommended that the Department participate in funding where appropriate.⁴⁷ Finally, the Commission recommended legislation to enhance the abilities of states or tribes to carry out royalty functions.⁴⁸

At a White House press conference publicizing the Commission's findings, Secretary Watt acknowledged "the existing program was resulting in losses of hundreds of millions of dollars every year," and stated: "I have accepted every one of the (Commission's) 60 recommendations. We think when you're seeing a hemorrhage of several hundreds of millions of dollars every year, you'd better address it and address it completely and thoroughly."⁴⁹

The cooperative agreements to which the Commission referred were already beginning, inspired by a combination of pragmatism and desperation. Some of the producing states suggested that their own royalty management systems might be better suited to police and audit the federal leases.⁵⁰ These states administer extensive mineral lands themselves, including lands often checkerboarded by federal sections. Western states suggested that perhaps state participation in lease audits and inspections could result in immediate results.⁵¹ Indeed, there is nothing new to the concept of delegation to states. Alexander Hamilton suggested in the

44. Linowes Commission Report, *supra* note 38.

45. Statement of David F. Linowes, *supra* note 40.

46. *Id.*

47. Linowes Commission Report, *supra* note 38 at 255-256.

48. Statement of Secretary of Interior James G. Watt at Press Conference Releasing the Commission's Final Report (Jan. 21, 1982).

49. *Id.*

50. *See, e.g.*, Western Legislative Conference Resolution No. 84-23 (Sept. 19, 1984); Western Governors Conference, Resolution No. 82-9 (1982); Western States Land Commission Ass'n (Dec. 3, 1982).

51. *Id.*

Federalist Papers that Congress might rely on state officers to collect *all* of the national revenue.⁵²

At this time, the Department is accelerating the planning of an extensive and costly computerization for more efficient accounting of mineral leases.⁵³

B. Action by Congress

California v. Watt was settled by a cooperative agreement.⁵⁴ In the meantime, Congress acted. It passed the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA),⁵⁵ which increased penalties for late payments and other violations, provided an array of enforcement mechanisms, imposed minimum inspection and audit standards, and institutionalized state-federal relationships by providing for formal cooperative agreements or delegations of federal management functions to the states.⁵⁶ Today, eight states—Wyoming, California, Colorado, Utah, North Dakota, Montana, Nevada and New Mexico—have formal or informal cooperative audit agreements with the Department.⁵⁷

The legislative history of the FOGRMA and its terms indicate Congress' intent that states be compensated for their efforts to shore up the federal collection system. It is axiomatic that the intent of Congress, however, often becomes obscured and lost in the halls of administrative agencies. The same Secretary of Interior who, a year earlier, enthusiastically endorsed all 60 recommendations of the Linowes Commission, enacted regulations governing state participation providing for (1) a reimbursement limit to states with cooperative agreements to 50 percent; and (2) 100 percent reimbursement to states with whom functions were delegated.⁵⁸ The Department enthusiastically adopted a proposal that its royalty management budget be financed from undistributed federal royalties—thus compelling the states to pay half.⁵⁹

There is a kind of rough logic, to the uninitiated, in the theory that the states, which theoretically share 50 percent of the royalty revenues, should assume half the expense of their audit activities. However, the proposal to draw on gross lease revenues, coupled with imposition of the windfall

52. THE FEDERALIST No. 36 (A. Hamilton) (Mentor ed. 1961).

53. GAO Oil and Gas Royalty Accounting—Improvements Have Been Initiated But Continued Emphasis is Needed to Ensure Success (April 27, 1982).

54. *California v. Watt*, *supra* note 33.

55. 30 U.S.C. §§ 1701-1757 (1982).

56. *Id.* at §§ 1731-1736.

57. Linowes Commission Report, *supra* note 38 at XV.

58. 30 C.F.R. §§228.105, 229.109 (1984).

59. Statement of Donald T. Sant, Staff Economist, Minerals Management Service, Before the California State Senate Committee on Natural Resources and Wildlife (Jan. 31, 1985).

profits tax on these funds, represents a serious attempt to alter the statutory formula of the Mineral Leasing Act for two reasons.

First, when the windfall profits tax was established, the Treasury Department decided to deduct it from lease payments before distribution to the states of their share. This results in state receipts substantially less than the 50 percent promised by the Mineral Leasing Act. Although a federal district court found this practice to be unlawful, the decision was reversed on jurisdictional grounds, and a petition for certiorari is now pending.⁶⁰

Second, the simultaneous effort, proposed during the last three fiscal years—to finance the Department's royalty management budget from undistributed royalties will, if successful for fiscal year 1986, result in additional reductions of nearly \$5.3 million from the states' shares.⁶¹ The 50 percent share is rapidly dwindling.

C. State Responses

Meanwhile, state auditors became restive. At meetings in November, 1983, and March, 1984, they reported a number of continuing problems in conducting joint audits.⁶²

These meetings provided a picture of frustration with the activities of the federal Minerals Management Service. Audit heads from the states attending—Wyoming, Colorado, Utah, North Dakota and California—described several major problem areas in connection with the two-year cooperative audit program.

Colorado reported \$6 million collected from 300 leases. The work was performed by three state auditors and an MMS auditor (he was replaced twice within an 18-month period). In addition, Colorado's auditors identified an apparent failure by the MMS to collect from producing wells. They found producing wells in three areas which operated three years before any collection of royalties were made. Furthermore, they estimated

60. *New Mexico v. Regan*, 745 F.2d 1318 (10th Cir. 1984) U.S. App. Pndg.

61. Dep't of Interior, Land and Minerals Management Budget for Fiscal Year 1986, Appendix, I-M10-12 (1985).

62. These instances were summarized in a letter from eight western governors to Secretary William Clark (Feb. 26, 1984) reflecting reports made at meetings of western state auditors November 17, 1983, and March 21, 1984. They were summarized in more detail in Western Attorneys General, Oil and Gas Royalties Subcommittee Report (Nov. 1983) (referred to as WAG report) and in *Western Energy Update*, Newsletters of Nov. 18 and Dec. 30, 1983.

The reports in *Western Energy Update* were criticized on a number of grounds by the Associate Director for Royalty Management, Mineral Management Service. Essentially, the criticisms were to the effect that proposed product valuation guidelines did not reflect true market value, that the Department's collection computerized system was not breaking down, and that there was no institutional resistance to the state-federal cooperative effort. Letter from Robert E. Boldt to Alison Wilson, Staff, *Western Energy Update*, Jan. 25, 1984.

that there are 2,000 producing wells within the state, although federal figures show only 1,200.⁶³

Wyoming found that a new gas plant with 10 federal wells had been established with full federal knowledge but no production had been reported for two of those wells for an eight-month period, although over one million cubic feet of gas a month had been produced. The auditors also reported that serious problems existed with respect to coal-leasing. Of course, the GAO Report contending a total loss of \$100 million for bargain basement leases in the Powder River Basin was subject to continuing concern.⁶⁴

The states were not alone in their criticism. Professor Linowes, in his capacity as chairman of the Secretary's Commission on Fair Market Value Policy for Federal Coal Leasing, was quoted as describing the Department's coal leasing program as "deficient in all of its functions."⁶⁵

IV. DESPITE REFORMS, PROBLEMS PERSIST

The Department of Interior has placed undue and disproportionate reliance upon implementation of a costly and elaborate computerized system.⁶⁶ Reportedly, the system is being established without regard to the veracity of the data which will go into it and without regard to the necessity to audit unpaid accounts in the meantime.⁶⁷

Surprisingly, in a report dated December 7, 1984, Richard H. Shriver, a consultant to Secretary Clark, conceded "MMS's current direction is neither cost-effective, compliant with the intent of the laws, nor sufficiently responsive to the legitimate complaints of states and Indians."⁶⁸

The MMS's data processing system was described by Shriver as a "technical marvel and an operational nightmare"—a system "operating at capacity with no assurance that the basic accounting functions are being performed," and incapable of performing essential tasks such as exception processing and making the clear explanation of payments to state and tribes required by the FOGRMA.⁶⁹

Shriver found what he characterized as "the backbone of MMS's

63. WAG Report, *supra* note 62, at 5.

64. *Id.* at 5-6.

65. *More Trouble Looms on Coal Leasing*, N.Y. Times, Feb. 12, 1984, at 4E, col. 2.

66. HOUSE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS, FEDERAL MINERALS ROYALTY MANAGEMENT: AN ANALYSIS OF PROBLEM AREAS RELATED TO THE MANAGEMENT OF THE FEDERAL MINERALS ROYALTY MANAGEMENT PROGRAM BY THE MINERALS MANAGEMENT SERVICE OF THE DEP'T OF INTERIOR WITH RECOMMENDED SOLUTIONS 11-12 (1984).

67. *Id.* at 2-4.

68. Memorandum from Dick Shriver, Mineral Management Service, to William Clark, Secretary of the Interior (Dec. 10, 1984).

69. *Id.*

systems”—the Auditing and Financial System (AFS), which handles collections and disbursements as well as errors, changes and auditing thereof, “has never been able to function properly.”⁷⁰ FOGRMA also calls for a production auditing and accounting system (PAAS), to provide a check on sales for which royalties are reported. Shriver found PAAS, as planned, to be “overly complex” and still incapable of providing a “fool-proof link” needed between inspected, metered production and reported sales, despite expenditures on it of \$10 million to date.⁷¹

The report called for deferral of further development plans until reevaluation of the MMS Program, and presentation of a “clear and acceptable plan” for a new system.⁷²

As of January 31, 1984, the MMS identified over \$3.6 million in undisbursed royalties from the sixteen months ending January 31, 1983. Of this, \$4 million was in payments of which the payor and the reported royalty could not be identified.⁷³ The MMS was apparently still permitting the companies to report their royalties on the honor system. A further survey of the December 1983 - March 1984 period found no evidence in mandatory monthly MMS reports that 47 percent of producing leases were submitting royalties on an estimated production of \$9.6 million.⁷⁴

In addition, the MMS is threatening to write off old balances. Without consulting with or even notifying the affected states, and despite the royalty collection controversy already in place, the MMS wrote to all federal payors stating that steps would be taken to write off all accounts of less than \$100,000 within one year unless they were collected by states or otherwise paid.⁷⁵

Furthermore, the Department threatens to adopt unrealistic standards for the valuation of natural gas. The Department of Interior proposed to implement a valuation standard for natural gas which assumes that for each payor the fair market value is the contract price.⁷⁶ This reflected the assumption that all contracts are arms-length contracts. Apparently, this is contrary both to industry practice and a survey done by the MMS of its accounts.⁷⁷ Data supplied by the Wyoming State Auditor showed substantial differences in revenue in these two standards.⁷⁸

70. *Id.*

71. *Id.*

72. *Id.*

73. California State Comptrollers Office, Office of Inspector General, Report of Examination (October 1977 - June 1984).

74. *Id.*

75. Letter from Milton M. Dial, Chief, Royalty Compliance Division, to Payors (Nov. 4, 1983).

76. Schriener, *States Alert: Gas Production Valuation on Federal Lands*, WESTERN NAT. RESOURCES LITIGATION DIG. 19 (Winter 1984).

77. *Id.*

78. *Id.*

Additionally, the Department of Interior is once again attempting to finance its royalty management program by reducing the states' shares of royalties. For the 1986 fiscal year, the Department of Interior has proposed that the Payment in Lieu of Taxes Program (PILT) and the budget of the MMS be financed from the undistributed onshore royalties, thus requiring producing states to pay half of those costs.⁷⁹ The proposal has been characterized as an improper attempt to amend the Mineral Leasing Act through the appropriations process. It is contrary to the rules of Congress. When it arose in 1983 and was rejected, the Senate Committee on Appropriations stated:

The Committee is particularly displeased with the Department's attempt to substantially alter the Mineral Leasing Act of 1920 through the appropriations process rather than through the proper authorizing committees of Congress. The Committee will consider no further alteration proposals in this regard until the authorizing committees have thoroughly reviewed the matter and the Congress has affected changes in the law.⁸⁰

The following year, the Department nevertheless renewed its proposal to amend the state's formula for royalties distribution to states by paying for the royalty management program from undistributed royalties. This time, the Senate Appropriation Committee rejected it without comment, and its action was confirmed in conference.⁸¹

Undeterred by this, the Department of Interior is strongly urging that in the 1986 fiscal year *all* federal costs of auditing, collections and site inspection be taken from undistributed royalties—at an estimated cost to states of more than \$125 million.⁸²

Unfortunately, progress at reform has not been as rapid as might be hoped. A staff report from the House Committee on Interior and Insular Affairs issued in December, 1984 found that:

Although a great deal of time, effort and money has gone into system design and development efforts over the last several years, many of the problems which were discussed during the Committee staffs' oversight work 2 ½ years ago, which were discussed in previous GAO reports and which helped guide the development by the Congress of the Federal Oil and Gas Royalties Management Act of 1982 (FOGRMA), not only persist, but have become worse in some areas. Many of these problems could have been avoided if the MMS's approach to and

79. Statement of Donald Sant, *supra* note 60.

80. H.R. Rep. No. 184, 98th Cong., 1st Sess. (1983). According to one recent report, even Department of Interior sources question the legality of this proposal. *Inside Energy with Federal Lands* 18 (Feb. 18, 1985).

81. H.R. REP. No. 578, 98th Cong., 2nd Sess. (1984).

82. Statement of Donald Sant, *supra* note 59.

management of the royalty management system development had been carried out in an orderly, systematic manner.⁸³

The report emphasized the "extraordinary efforts" of technical and support staff of MMS to keep the accounting system running, but found that poor project management of the design, development, and implementation effort has resulted in an overly complex system that is not working well.⁸⁴

The Committee's criticisms of the MMS were a litany of earlier ones. Among them were the following:

1. Failure to collect interest owed;
2. Inadequate reports to the states and Indian tribes;
3. Failure to publish product valuation guidance;
4. No on-site production verification;
5. No exception processing;
6. Lack of direct MMS involvement in cooperative audits;
7. Inordinate delay in implementing Sections 202 and 205;
8. Poor communication and coordination with states and Indian tribes;
9. Failure to reconcile the royalty accounting system's account balances;
10. Unaccounted royalty payments;
11. Overly-ambitious systems development effort;
12. Lack of a complete, accurate lease universe.⁸⁵

In short, as the report concluded, management of minerals royalties is still in disarray, despite a number of attempts at reform.

V. CONCLUSION

The management of federal minerals royalties provides a unique opportunity for creative federalism. Implementation of the administration's announced "good neighbor" policy in a realistic and mutually advantageous way appears to be desired by all concerned, but to date has not been achieved. The states and the federal landlord were on the verge of formal separation, if not divorce, as the sagebrush rebellion raged in the late seventies. Now, like other couples who survived that era, they have instead begun to discuss their relationship. If indeed they are to stay together (and the last serious efforts at another kind of solution ended at Appomattox in 1865), then it behooves them both to work at the amicable sharing of responsibility. Congress has provided the framework for such a relationship, and Secretary Clark showed signs of wanting to clear up this

83. House Committee, *supra* note 66 at 2.

84. *Id.*

85. *Id.* at 3-5.

problem, along with others, before the end of his term as Secretary. In addition, subsequent action by the Assistant Secretary and the MMS staff has shown encouraging momentum and progress.⁸⁶

Nonetheless, the story is far from over. The December 1984 staff report of the House Committee on Interior and Insular Affairs and the Shriver report to Secretary Clark have found that in some respects, despite sometimes heroic staff efforts within the MMS, by the states and Congress, the federal royalty system may be getting worse rather than better. The Congress' fateful decision to retain the public lands has inevitably placed the Department of Interior in the position of a quasi-colonial landlord, administering nearly half the lands of the western states. It is torn between conflicting policies—the increasing pressure to produce federal revenues and the need to accommodate the rights and aspirations of state and local governments and their people. An efficient and productive royalty management program meets both objectives. Unfortunately, that goal still remains distant.

86. Phone conversation with Jean Abadi, Program Manager, Cooperative Auditing, California State Comptroller's Office (April 29, 1985).

