



U.S. Department of the Interior
Office of Inspector General

AUDIT REPORT

NEGOTIATED ROYALTY SETTLEMENTS,
MINERALS MANAGEMENT SERVICE

REPORT NO. 96-I-1264
SEPTEMBER 1996



United States Department of the Interior

OFFICE OF THE INSPECTOR GENERAL
Washington, D.C. 20240

SEP 30 1996

MEMORANDUM

TO: The Secretary

FROM: Wilma A. Lewis *Wilma A. Lewis*
Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "Negotiated Royalty Settlements, Minerals Management Service"

Attached for your information is a copy of the subject final audit report. The objective of the audit was to determine whether the settlements were conducted in accordance with the "Minerals Management Service Settlement Negotiation Procedures."

We found that the results of royalty settlement negotiations were not always documented in accordance with the "Negotiation Procedures." Specifically, based on our review of 10 settlements, we found that Service files: (1) did not contain adequate documentation on the estimated values of the issues to be settled and the arguments for reducing the values of issues for 6 settlements and (2) did not explain why the estimated values of 9 issues totaling about \$312 million were reduced by about \$94 million at settlement. Service personnel said that documentation was inadequate because they did not have sufficient personnel to perform this task and because they were concerned that release of this information under the Freedom of Information Act could affect future settlement negotiations with other royalty payers. We also found that the Service did not offer two Indian tribes the options to negotiate their issues separate from Federal and state issues in one of the settlements or to participate in the negotiations of their issues for this settlement, although offering these options was required by the "Negotiation Procedures."

We considered our recommendation relating to Indian tribal participation in the settlement negotiations resolved and requested that the Service reconsider its responses to the recommendations regarding documentation and release of information issues, which were unresolved.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment



United States Department of the Interior

OFFICE OF THE INSPECTOR GENERAL
Washington, D.C. 20240

SEP 30 1996

AUDIT REPORT

Memorandum

To: Director, Minerals Management Service

From: Robert J. Williams *Robert J. Williams*
Acting Assistant Inspector General for Audits

Subject: Audit Report on Negotiated Royalty Settlements, Minerals Management Service (No. 96-I-1264)

INTRODUCTION

This report presents the results of our review of royalty settlements negotiated by the Minerals Management Service's Royalty Management Program. The objective of the review was to determine whether the settlements were conducted in accordance with the "Minerals Management Service Settlement Negotiation Procedures." Based on our review of completed settlements, we concluded that the Service had not complied consistently with the "Negotiation Procedures." As a result, the Service did not maintain sufficient information to substantiate that the settlements were negotiated in the best interests of the Government, states, Indian tribes, and Indian allottees.

BACKGROUND

The Minerals Management Service is responsible for managing mineral resources on the Nation's Outer Continental Shelf and for collecting and distributing lease and royalty revenues from Outer Continental Shelf, Federal onshore, and Indian lands. The Service's Royalty Management Program has frequently been involved in disagreements with states, tribes, individual Indians, and mineral lessees concerning the amount of royalties owed Federal/state governments, Indian tribes, and individual Indians.

The Administrative Dispute Resolution Act of 1990 allows the Service to negotiate settlements of royalty payments without going through extensive and costly adjudication and litigation processes. The negotiations for royalty settlements are requested by royalty payers that have appealed bills or orders. The Office of Enforcement of the Service's Royalty Management Program has primary responsibility for overseeing each royalty settlement. This responsibility is carried

out through use of a negotiation team composed of representatives from the Program divisions, the Office of Enforcement, and other Service and/or Office of the Solicitor personnel. If onshore or tribal monies are involved in a settlement, representatives of affected states or tribes are to be included on the negotiation team.

From April 1993 through March 1995, the Service negotiated 97 settlements, which will result in additional royalty payments and interest on late payments of about \$322 million.

SCOPE OF AUDIT

Our review was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, our review included such tests of records and other auditing procedures that were considered necessary under the circumstances to accomplish the audit objective.

This audit was performed during April through September 1995 at the Service's Royalty Management Program office in Lakewood, Colorado. We reviewed 10 settlements completed during April 1993 through March 1995 that totaled about \$218 million, or about 68 percent of the total value of settlements completed during this period. We selected settlements that included multiple (global), single, Federal onshore and offshore, state, and Indian oil and gas issues, as well as minerals and geothermal issues.

As part of our review, we evaluated the system of internal controls to the extent we considered necessary. The internal control weaknesses identified are discussed in the Results of Audit section of this report. If implemented, the recommendations should improve the internal controls.

We reviewed the Department of the Interior Annual Statement and Report, required by the Federal Managers' Financial Integrity Act, for fiscal year 1994 to determine whether any reported weaknesses were within the objective and scope of our review. The Department's Annual Statement and Report did not report any weaknesses related to negotiated royalty settlements.

PRIOR AUDIT COVERAGE

Neither the Office of Inspector General nor the General Accounting Office has issued any reports that addressed the Service's negotiated royalty settlements.

RESULTS OF AUDIT

We found that royalty settlement negotiations were not always conducted in accordance with the “Minerals Management Service Settlement Negotiation Procedures.” Specifically, for 9 of the 10 settlements reviewed, there was no documentation for the estimated values of the issues concerning the underpayment of royalties to be negotiated, the arguments for reducing values of issues, and/or the reasons why the values of issues were reduced as a result of negotiations. In addition, for one of the nine settlements, Indian tribes were not given the opportunity to exclude Indian issues from a global settlement and were not included in negotiations applicable to their leases.

The “Negotiation Procedures” requires that the Service take the following actions prior to negotiation: (1) prepare a list of issues to be settled, including leases and all estimated values and arguments for reducing the values of issues, and (2) determine whether Indian tribes want to be included in global settlements. After negotiations have been completed, the “Negotiation Procedures” requires the Service to prepare a memorandum for each settlement that describes the issues settled, how the issues were valued, and the reasons why the values of issues were reduced, if appropriate. In addition, an Indian tribe may have its royalty issues negotiated separate from Federal and state issues if it desires, and each tribe is authorized to have a representative participate in the negotiations.

Based on our review of 10 settlements, we found that the Service’s files: (1) did not contain adequate documentation on the estimated values of the issues to be settled and the arguments for reducing the values of issues for 6 settlements and (2) did not explain why the estimated values of 9 issues totaling about \$312 million were reduced by about \$94 million at settlement. Further, the Service did not offer two tribes an option to exclude their issues from one of the settlements or include the tribes in negotiations of their issues for this settlement. For example:

- Prior to negotiations, one of the Service’s Royalty Management Program divisions estimated the value of a particular issue to be negotiated in a global settlement to be about \$439 million. However, the list of issues and values prepared by the negotiation team prior to negotiations estimated that the same issue was valued at \$78.6 million. Documentation in the settlement file was insufficient to explain the \$360.4 million difference in the estimated values of this issue.

- A single issue settlement was negotiated for \$4.3 million. Documentation in the settlement file was insufficient for us to determine the prenegotiation estimated value for this issue.

- A global settlement with an estimated prenegotiation value of \$208.1 million was negotiated for \$150 million. Documentation in the settlement file was insufficient to explain why issue values were reduced by \$58.1 million.

- A global settlement with an estimated prenegotiation value of \$58 million was negotiated for \$44 million. Documentation in the settlement file was insufficient to explain why issue values were reduced by \$14 million.

- In a global settlement, two Indian tribes were not contacted to determine whether they desired to have their issues excluded and negotiated separately. Also, these tribes were not offered the opportunity to participate in the negotiation process. Subsequent to this settlement, the State and Tribal Royalty Audit Committee stated, in a March 30, 1995, letter to the Service, that the negotiation process could be improved by notifying states and tribes immediately when a company had informed the Service that it wanted to initiate settlement discussions that involved state and tribal revenues. Also, the Committee stated that the Service should contact the states and tribes to determine whether their issues should be excluded from a global settlement. The "Negotiation Procedures" requires that if a state or tribe decides that its issues are to be included in a settlement, then each affected state or tribe should participate in settlement negotiations.

Service personnel stated that lists of issues, estimated values of issues to be negotiated, and arguments for reducing the royalty amounts in negotiations were not documented before negotiations commenced because the Office of Enforcement did not have sufficient personnel to document this information. Although the Office of Enforcement has a staff of only eight people, we believe that this documentation could be prepared by members of the settlement negotiation team.

Service personnel also stated that documentation was not prepared that explained why values of issues were reduced because the release of this information under the Freedom of Information Act could affect future settlement negotiations with other royalty payers. Service personnel stated that royalty payers may obtain information that reveals the Service's negotiation strategies or its willingness to reduce the values of issues. Although the Service cited release of negotiation information as a concern, the Service had not requested an opinion from the Office of the Solicitor to determine whether such information is required to be released to royalty payers under the Freedom of Information Act. The Service also had not received any requests under the Freedom of Information Act to obtain information on why the values of issues were reduced.

Further, Service personnel stated that Indian tribes were not always given the opportunity to exclude Indian issues from global settlements and were not always included in settlement negotiations of their issues in instances in which the Service obtained 100 percent of the value of Indian issues in global settlements. However,

Service personnel stated that Indian tribes would be queried prior to future settlement negotiations to determine whether Indian issues should be negotiated separately and to determine whether tribes desired to participate in settlement negotiations of tribal issues.

As a result of the documentation deficiencies cited, there was insufficient information for us to determine whether the settlements were negotiated in the best interests of the Government, states, Indian tribes, and Indian allottees. Specifically, we could not determine whether issues were improperly omitted from negotiations or whether royalty values were reduced unnecessarily. Without complete prenegotiation and postnegotiation settlement documentation, the actions taken by settlement negotiation teams cannot be accounted for.

Recommendations

We recommend that the Director, Minerals Management Service, ensure that Royalty Management Program personnel:

1. Document the estimated values of issues to be settled, arguments for reducing values of royalties before negotiations commence, and reasons why the values were reduced.

2. Obtain a written opinion from the Office of the Solicitor as to whether the Service is required to release information on the Service's negotiation strategies to royalty payers under the Freedom of Information Act that could compromise future settlement negotiations. If the Office of the Solicitor opines that such information must be released, the Service should develop alternative procedures to ensure accountability and that settlements are negotiated in the best interests of the Government, states, Indian tribes, and Indian allottees.

3. Offer Indian tribes the opportunity to exclude their issues from global settlements. In addition, tribal representatives should be included in negotiations of issues applicable to Indian tribes.

Minerals Management Service Response and Office of Inspector General Reply

The January 30, 1996, response (Appendix 1) to the draft report from the Director, Minerals Management Service, expressed concurrence with Recommendation 3, partial concurrence with Recommendation 1, and nonconcurrence with Recommendation 2. Based on the response, we consider Recommendation 3 resolved and implemented and Recommendations 1 and 2 unresolved. Accordingly, the Service is requested to reconsider its responses to the unresolved recommendations (see Appendix 2).

Recommendation 1. Partial concurrence.

Service Response. The Service stated that it “does document estimated values of issues, the arguments for compromising and reasons why compromises should be accepted” when accurate information is available. However, the Service said it did not believe that “any purpose is served” by attempting “to estimate the values of issues when orders to perform¹ are at issue prior to conducting settlement discussions.” “Without the assistance and data of the payor,” according to the Service, “such estimates [for orders to perform] are highly inaccurate and very costly to attempt.” The Service said that it explains, in a memorandum to the Director, the reasons for settlement and that before a settlement is approved, the Director may request additional information. The Service further stated that its settlement process has “adequate accountability” because it parallels the “accountability in the appeals process.” The Service said that it believes the settlement process is “adequate to meet all the legitimate goals of this recommendation and does not believe that the increased complexity recommended is beneficial.”

Office of Inspector General Reply. Our review of 10 settlements totaling about \$218 million, or 68 percent of the total value of settlements negotiated by the Service during April 1993 to March 1995, disclosed that the Service did not always: (1) adequately document the estimated values of issues to be settled (of which most were not based on orders to perform) and the arguments for reducing the values of issues for 6 settlements and (2) explain why the estimated values of 9 issues totaling about \$312 million were reduced by about \$94 million at settlement. Accordingly, the Service’s settlement negotiation practices do not meet the standards set forth in its own “Negotiation Procedures,” which requires the preparation of a list of issues to be settled, including leases and all estimated values and arguments for reducing the values of issues. We believe that additional documentation for the settlements is still needed to account for actions taken by the settlement negotiation teams.

While we agree that it is difficult to estimate values for orders to perform, we believe that the Service should attempt to estimate and document such values prior to settlement negotiations to ensure that the settlement amounts are reasonable and in the best interests of the lessor. Regarding the estimates, the State and Tribal Audit Committee, in its March 30, 1995, letter to the Service, stated that states and tribes may have information that could be useful in estimating the value of issues included in orders to perform.

Regarding the memorandum to the Director, we found that it contained only general information about each settlement and did not specify each issue that was settled,

¹An order to perform requires a payer to recalculate and pay any additional royalties that may result when royalty accounting practices of the payer cause apparent underpayments.

the estimated value of the issues to be settled and the corresponding settlement amount, or the reasons for the compromises.

Recommendation 2. Nonconcurrency.

Service Response. The Service stated that it believes that regardless of the opinion of the Office of the Solicitor, “it is no protection if we are later required by a court to produce such information. The benefit of knowing that the Solicitor believes that MMS [Minerals Management Service] could protect information that reveals the government’s negotiation strategies is less detrimental than if the Solicitor opines that such information is protectable and they are wrong.”

Office of Inspector General Reply. A July 5, 1996, legal review of this matter by our General Counsel stated:

The Service should not avoid the Procedures ["Negotiation Procedures"] because the documents produced pursuant to the Procedures may be releasable under FOIA [Freedom of Information Act]. They should know whether, in the opinion of the Solicitor’s Office, the documents are subject to FOIA.

If the Solicitor’s Office determines the documents would be released under FOIA then the Service can use the opinion to amend their procedures regarding documentation if they choose. If the Solicitor’s Office determines the documents should be withheld pursuant to FOIA, the Service should not evade the Procedures just because a court may order them to release the documents, despite the opinion of the Solicitor’s Office. Before a court orders the release of these documents, the court will have to make a determination that the release will not harm the Service in future negotiations. Further, prior to the court’s determination to release documents, MMS [Minerals Management Service] would have the opportunity to present its position as to how release of these documents would harm future negotiations.

General Comments on Audit Report

Service Response. The Service disagreed that the failure to follow its “Negotiation Procedures,” which it characterized as “a preliminary set of procedures,” should form the basis of the conclusions and recommendations that were presented in the audit report. The Service also said that “we disagree with the OIG’s [Office of Inspector General’s] assertion . . . that the Service did not maintain sufficient information to substantiate that settlements were negotiated in the best interests of the Government, States, Indian tribes and Indian allottees.” In that regard, the Service stated:

Our current procedures are consistent with our belief that ADR [alternative dispute resolution] should have internal controls similar to the appeals process; i.e., 1) a team is used to assure that all viewpoints are represented and that no settlement is made if anyone believes that the agreement is not in the best interests of the lessor(s), and 2) all settlements must be accompanied by a memorandum to the Director (or her delegate) explaining why the settlement should be accepted.

The Service stated that the alternative dispute resolution process “is more attractive” than the appeals process to resolve royalty issues. Specifically, the Service stated that the appeals process results in “further delays, costs, and risk of decisions inconsistent with MMS [Minerals Management Service] policy.”

In addition, the Service stated that its Office of Policy and Management Improvement conducted a survey of Service employees, state and tribal representatives, and royalty payers to examine the effectiveness of the settlement process. The Service further stated that the results of the survey concluded that “most individuals are reasonably satisfied with the settlement process and believe the process to be quite useful in resolving outstanding issues.”

Office of Inspector General Reply. The Service’s response did not support its position that use of the alternative dispute resolution process results in the resolution of disputes consistent with the best interests of the lessors. Furthermore, the July 5, 1996, legal review by our General Counsel stated:

The Administrative Dispute Resolution Act. . . gives general guidance as to what types of disputes that would normally be litigated, maybe resolved by alternative means. . . . While the Act requires each agency to adopt a policy that addresses the use of alternative means of dispute resolution, there are no formal requirements as to documentation of settlements. . . .

The Service does state that they feel their current procedures regarding documentation adequately show settlements are achieved in the best interests of the Government because their procedures parallel the internal controls of the “appeals process.” . . . These appeals process regulations regarding documentation are tailored specifically for the appeals process. They do not discuss nor do they necessarily cover the different circumstances involved in the settlement negotiation process. . . .

So while the Service’s current procedures regarding documentation may parallel the appeals process in certain instances, that does not mean they are providing adequate documentation to show they achieved a settlement in the best interests of the Government. The Service is not currently

following the Procedures ["Negotiation Procedures"] created by their own bureau, which are specifically tailored for the settlement negotiation process. The Procedures also provide for different types of documentation than the appeals process. They are relying on regulations that do not directly cover the settlement negotiation process.

Based on the foregoing, we believe that our conclusion and recommendations are valid.

Regarding the alternative dispute resolution process, we believe that this process can be a beneficial method for resolving complex royalty matters. However, as previously stated, we believe that it is important for the Service's "Negotiation Procedures," or comparable alternate procedures, to be complied with to ensure that the settlement amounts are reasonable and equitable to all parties and that settlement decisions are supported by adequate documentation. If, as the Service states, the "Negotiation Procedures" is simply a "preliminary set of procedures," the Service should develop more current procedures that provide a basis for ensuring accountability and ensuring that settlements are negotiated in the best interests of all parties concerned.

Although the Service's report on the survey results concluded that most individuals were "satisfied" with the settlement process, the report also concluded that there was "little consistency" in the Service's implementation of the "Negotiation Procedures" and that the respondents cited "a gap between policy and practice." In addition, tribes said that they were "not always invited to participate in dollar for dollar settlements." Further, the report on the survey results recommended that the Office of Enforcement distribute a modified procedure package as an educational tool to the organizations affected by the settlement process. In a March 30, 1995, letter to the Service responding to the survey, the State and Tribal Royalty Committee stated that the settlement negotiation process should involve states and tribes when state and tribal revenues are involved.

Service Response. The Service stated that we should "correct the statement that 'From April 1993 through March 1995, the Service negotiated 97 settlements, which will result in additional royalty payments of about \$322 million.' Actually, the payments were for royalty and late payment interest (and compensatory royalty)."

Office of Inspector General Reply. We have revised the statement to include the reference to late payment interest.

Proprietary Data

Service Response. The Service stated that "the specific examples cited in the report involve matters that contain proprietary information." The Service further

stated that in each case, “the public will be able to identify the settlements involved” and “may be able to guess the Service’s settlement strategy.” The Service requested that the examples be removed from the report.

Office of Inspector General Reply. We disagree that the report contains proprietary data or compromises the Service’s settlement strategy. The July 5, 1996, legal review by our General Counsel stated:

The issuance of statements in 1993 by President Clinton and Attorney General Janet Reno regarding FOIA [Freedom of Information Act] policy established a strong new spirit of openness in government under the FOIA. “Attorney General Reno’s FOIA Memorandum articulated the FOIA’s ‘primary objective’ -- that of achieving ‘maximum responsible disclosure of government information.’” . . .

The information presented in the specific examples in the audit report does not present proprietary information that would result in competitive harm for any private party involved in a settlement with MMS [Minerals Management Service]. Therefore, the information does not meet the requirements to be withheld pursuant to the FOIA. . . .

The examples do not name any private parties involved or identify what particular “issue” or “issues” the prenegotiation values or the final settlement apply to. Further the “issues” being presented represent numerous and complex factors including, but not limited to, the amount and type of minerals involved. None of these factors are included in the examples and none of those factors can be extrapolated from the examples

The examples do not expose . . . quantity of the mineral involved, actual costs, profits, profit margins, losses, labor costs, pricing strategy or equipment information. The numbers presented are general in nature and even if they could be associated with a specific party, they do not expose any information that could lead to competitive harm. . . .

The information presented in the specific examples in the audit report does not expose MMS’s [Minerals Management Service’s] settlement negotiation strategies or decision making processes in reaching a settlement. Therefore, the information does not meet the requirements for being withheld pursuant to the FOIA. . . .

Because the circumstances of each settlement differ so greatly, there is no way to establish a pattern of how MMS reaches a settlement based on the examples provided in the audit report. The opinions and reasoning of how

and why a settlement was reached are not exposed by providing the final settlement amount along with the estimated prenegotiation value regarding an “issue” or “issues.”

Findings

Service Response. In its response, the Service said that it: (1) often could not accurately estimate the value of issues before engaging in settlement discussions; (2) did “adequately document” the reasons for resolving disputes through the alternative dispute resolution process in the memorandum to the Director; and (3) maintained sufficient documentation for settlements through the alternative dispute resolution process.

Office of Inspector General Reply. Our comments to these issues are presented in the “Recommendation 1” and “General Comments” sections of this report.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by December 6, 1996. The response should provide the information requested in Appendix 2.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Service personnel in the conduct of our audit.



United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240



JAN 29 1996

Memorandum

To: Assistant Inspector General for Audits

Through: ^{for} Bob Armstrong *John V. Bawa* JAN 30 1996
Assistant Secretary, Land and Minerals Management

From: Cynthia Quarterman *C. Quarterman*
Director, Minerals Management Service

Subject: Office of Inspector General Draft Audit Report C-IN-MOA-005-94(D)
"Negotiated Royalty Settlements, Minerals Management Service"

I appreciate the opportunity to respond to this draft report on our royalty settlements process. We are in general concurrence with two of the three recommendations in the report. We're sending you our general comments on the audit findings and specific ones on the recommendations.

Please contact Bettine Montgomery at 208-3976 if you have any further questions.

Attachment

**MINERALS MANAGEMENT SERVICE RESPONSE TO DRAFT AUDIT REPORT
“NEGOTIATED ROYALTY SETTLEMENTS
MINERALS MANAGEMENT SERVICE”**

Audit Agency: Office of Inspector General (OIG)

Audit Number: C-IN-MOA-005-94(D)

GENERAL COMMENTS

We appreciate the opportunity to comment on this draft report on the Minerals Management Service’s (MMS) negotiated settlement process. We consider this process to be a major success in improving our customer service, in decreasing costs, and in decreasing the time required to collect monies due the United States and our Indian trust beneficiaries.

In 1992, MMS constituted the Office of Enforcement to coordinate royalty settlements and promulgated a preliminary set of procedures. These procedures were put into place before MMS had any substantial experience in conducting a large-scale program of negotiated settlements. Those procedures have been studied and revised in form and practice over the past three years as MMS has gained experience closing large numbers of cases through use of alternative dispute resolution (ADR) techniques (primarily settlements). Therefore, we disagree that failure to follow those preliminary procedures should form the basis of the conclusions and recommendations presented. We believe that looking at the process from the basis of what is needed, the process used by MMS has adequate internal controls, and results in the closure of disputes consistent with the best interest of the lessors.

We disagree with OIG’s assertion in the Introduction that “the Service did not maintain sufficient information to substantiate that the settlements were negotiated in the best interests of the Government, States, Indian tribes and Indian allottees.” Our current procedures are consistent with our belief that ADR should have internal controls similar to the appeals process; i.e., 1) a team is used to assure that all viewpoints are represented and that no settlement is made if anyone believes that the agreement is not in the best interests of the lessor(s), and 2) all settlements must be accompanied by a memorandum to the Director (or her delegate) explaining why the settlement should be accepted.

In addition, prior to your review, the MMS Office of Policy and Management Improvement (PMI) conducted a survey and review of our internal (employee, state and tribal) and external (lessee) customers. That survey concluded that, most individuals are reasonably satisfied with the settlement process and believe the

process to be quite useful in resolving outstanding issues. In addition, based on interviews and detailed examination of the process, the reviewers concluded that the revenues resulting from settlements represent a fair return to the U.S. Treasury on royalty claims because: 1) those most directly involved in the process expressed satisfaction with results, and 2) organizing settlement teams to represent all points of view within the Department and constituencies provides the needed internal controls on revenues received.

OIG should correct the statement that “From April 1993 through March 1995, the Service negotiated 97 settlements, which will result in additional royalty payments of about \$322 million, ” Actually, the payments were for royalty and late payment interest (and compensatory royalty). It is also important to note that no royalties are owed on Federal leases to State governments. State governments share through an indefinite appropriation. The leases are the Federal government’s responsibility and States are delegated certain limited functions regarding audit, through the Federal Oil and Gas Royalty Management Act. MMS does include the States in the process because MMS believes in comity.

ADR Background and Benefits

In the legislative history of the Administrative Dispute Resolution Act of 1990 (P.L. 101-552), the House Report accompanying H.R. 2497 states as background:

The purpose of ADR [(alternative dispute resolution)] is to produce better decisions at less cost, Because ADR techniques encourage compromise and settlement, they tend to recognize and address the valid concerns of all parties to a dispute, And, for the same reason, they can dramatically reduce “transaction” costs. Such costs [include] . . . discovery costs In addition, the use of ADR can help change the ‘culture’ of agency decisionmaking from one in which there are only “winners” and “losers” to one in which the best and fairest result is achieved. House Report No. 101-513 (June 1, 1990)

The MMS enforcement process involves multiple steps and multiple stages of review, An order is first given by an operating division. It may require the payment of a billed amount or may require performance of other compliance steps such as submitting revised royalty or production reports. If the order requires performance, payment may be owed at the completion of compliance. A payor may choose to comply with the order or it may appeal the order, in which case the order is stayed pending appeal, under the regulations at 30 C.F.R. § 243.2.

If the order is appealed, traditionally MMS resolved the dispute through the appeals process, which is considered to be an informal adjudication according to

the Administrative Procedure Act (APA) (5 U.S.C. § 551(7)). No hearing is required, and a review of the record is performed by the Appeals Division. The reasons for the decisions are contained in the written decision. The internal controls on the formal process are the written decision and the surname process. While decisions by the Director or officials delegated the authority to decide on behalf of the Director often resolve disputes, these decisions are costly to prepare and often require several years or more to complete. Additionally, 15 percent or more of these decisions are further appealed to the Interior Board of Land Appeals (IBLA), and some IBLA decisions are further appealed to Federal court, resulting in further delays, costs, and risks of decisions inconsistent with MMS policy.

Three years ago, MMS codified the ADR program. For several reasons, this approach has been successful at resolving complex matters that were not easily resolved through the appeals process. The ADR process allows MMS and the payor to jointly determine a reasonable basis or methodology for estimating additional royalties that will be paid. ADR is more attractive for several reasons:

- The appeals process cannot determine how much a payor owes when a payor appeals an order such as to retroactively correct a systemic reporting error. (Such orders are issued when the MMS has evidence that a payor has not complied with the regulations, but has insufficient information to accurately estimate the amount owed.) MMS will only have a basis for determining the amount of the underpayment if the payor is ordered to comply and does so without further appeal. And even in that case, MMS must perform tests to verify compliance.
- While additional royalties may be owed, they may be owed for slightly different reasons than the original order enunciated. When the Appeals Division decides such a case, it remands the case to the issuing division. Obviously, even if an estimate of additional royalties had been made, it will not be correct if the basis for the order were incorrect.
- Many large companies have received orders that have more or less merit. Decisions in the formal appeals process are win - lose decisions. Often the parties in the ADR process are able to trade off losers for winners when many issues are to be resolved at once. This is helpful in situations where the agency and lessees do not need a clean decision to establish precedent for future action.

OIG Report Compromises Proprietary Data

The specific examples cited in the report involve matters that contain proprietary information and that can be identified by the parties. They should not be

published in a report available to the public. In each case, members of the public will be able to identify the settlements involved and may be able to guess at MMS's settlement strategy. As they should be removed from the report, we will not comment on the specific examples.

COMMENTS ON FINDINGS

The Report has three findings, 1) the MMS official settlement files did not always contain adequate documentation on the *estimated values of the issues to be settled and arguments for reducing the values*, 2) and those files did not explain why certain issues had their estimated values reduced; and 3) in one global settlement Indian tribal issues were resolved (with payment in full to the tribes), but *without prior consultation*.

The first finding deals with a lack of documentation (in the official settlement files) concerning the value of issues before and after settlement. MMS often cannot accurately estimate the value of issues prior to engaging in settlement discussions. The entire point of an order compelling a payor to perform recalculations is for the payor, rather than MMS to perform the accounting effort. In such instances, MMS is usually unable to accurately perform the estimation without going through the settlement process. While MMS is currently studying the use of statistical procedures to estimate underpay merits, that project is not completed,

Documentation of the reasons for resolving disputes through the ADR process are included in the memorandum to the Director. Every settlement is signed only after such a memo is prepared, surnamed by appropriate parties, and found acceptable by them and the Director. This process is no different in principle from the appeals process. We do not believe any additional documentation is needed. The ADR process documents estimates, where applicable, and reasons for litigation risk. The appeals process documents legal reasoning.

The MMS is firmly committed to a government to government relationship with the Indian tribes whose minerals royalties we collect and manage. Normally when an order is decided in the appeals process, no tribal assent is required. In two early global settlements, when there was no compromise of the estimated amount of Indian royalties we determined that it was equitable and more efficient to collect disputed amounts through the settlement process even though tribes were not informed until later. While this process may be more efficient, MMS policy is now to consult with tribes prior to undertaking a global settlement that we believe includes their leases, or to exclude tribal leases from the settlement if that is not possible. MMS recognizes the importance of process and has adjusted its process to accommodate the tribal interest. On the other hand, it is worthwhile to note that none of the tribes involved complained about the amount of royalties and

interest that was collected in the settlement agreements that were criticized for failure to include them.

COMMENTS ON RECOMMENDATIONS

1. Document the estimated values of issues to be settled, arguments for reducing values of royalties before negotiations commence, and reasons why the values were reduced.

AGREE IN PART. MMS does document estimated values of issues, the arguments for compromising and reasons why compromises should be accepted currently when such information is accurate and available. However, MMS does not believe that any purpose is served by MMS attempting to estimate values of issues when orders to perform are at issue prior to conducting settlement discussions. Without the assistance and data of the payor, such estimates are highly inaccurate and very costly to attempt. The MMS does make estimates on all other orders, and each division whose issue is at issue has ownership of those estimates. In all cases RMP explains in a memorandum to the Director, generally surmised by the Associate Solicitor for Energy and Resources, the reasons for the settlement. Depending on the issues involved, that explanation may be more or less detailed. At that time, the Director may request additional information if she deems it necessary to enter into an agreement. MMS believes that this process is adequate to meet all the legitimate goals of this recommendation and does not believe the increasing complexity recommended is beneficial.

2. Obtain a written opinion from the Office of the Solicitor on whether the Service is required to release information on the Service's negotiation strategies to royalty payers under the Freedom of Information Act that could compromise future settlement negotiations. If the Office of the Solicitor opines that such information must be released, then the Service should develop alternative procedures to ensure accountability and assure that settlements are negotiated in the best interests of the Government, States, Indian tribes, and Indian allottees.

DISAGREE. Once again, MMS believes it has adequate accountability for ADR as it parallels the accountability in the appeals system. In addition, regardless of what the Solicitor opines, it is no protection if we are later required by a court to produce such information. The benefit of knowing that the Solicitor believes that MMS could protect information that reveals the government's negotiation strategies is less detrimental than if the Solicitor opines that such information is protectable and they are wrong.

3. Offer Indian tribes the opportunity to exclude their issues from global settlements. In addition, tribal representatives should be included in negotiations

of issues applicable to Indian tribes.

AGREE. This recommendation is consistent with our practices and longstanding policy. Since the two early global settlements mentioned, MMS has consistently included tribal representatives in all cases, or excluded their issues, if that was their desire. MMS will continue that practice; no change is needed.

STATUS OF AUDIT REPORT RECOMMENDATIONS

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
1 and 2	Unresolved	Reconsider each recommendation, and provide action plans that include target dates and titles of officials responsible for implementation.
3	Implemented	No further action is required.

**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO
THE OFFICE OF INSPECTOR GENERAL BY:**

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1550 Wilson Boulevard
Suite 402
Arlington, Virginia 22210

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(703) 235-9399

TDD for hearing impaired
(703) 235-9403 or
1-800-354-0996

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U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
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Arlington, Virginia 22209

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North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

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