INSPECTION

OFFICE OF
INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR

The Bureau of Safety and Environmental Enforcement Should Implement Policies and Procedures For Any Future Special Case Royalty Relief Programs

This is a revised version of the report prepared for public release.

Report No.: 2021-CR-006

January 2022

OFFICE OF
INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR

JAN 2 1 2022

Memorandum

To: Scott Mabry
Acting Director, Bureau of Safety and Environmental Enforcement

From: Mark Lee Greenblatt
Inspector General

Subject: Final Inspection Report – *The Bureau of Safety and Environmental Enforcement Should Implement Policies and Procedures For Any Future Special Case Royalty Relief Programs*
Report No. 2021-CR-006

This report presents the results of our inspection of the Bureau of Safety and Environmental Enforcement's (BSEE's) Special Case Royalty Relief (SCRR) Option 1 program—a program that BSEE created in early 2020 amid the COVID-19 pandemic to provide royalty relief to oil and gas companies on certain leases affected by the decrease in oil prices. These oil and gas leases are contractual agreements between the Government and a lessee that grant exclusive rights to explore, develop, and produce oil or gas from a block of Offshore Continental Shelf (OCS) land.

In April 2020, oil prices fell to unprecedented lows[1] because of a decline in demand resulting from COVID-19 and geopolitical and market instability. Falling commodity prices rendered much of the industry's oil and gas production uneconomic and threatened to result in companies suspending production and capping or abandoning wells. According to BSEE's idle iron[2] program documentation, inactive facilities or nonproducing wells pose environmental and safety risks. In addition, a 2019 report[3] from BSEE and the Bureau of Ocean Energy Management stated that shutting down production could potentially result in a permanent loss of recoverable oil and gas resources and the associated royalties paid to the Government. Therefore, BSEE considered it in the Government's best interest to provide temporary relief so these companies could continue to operate and recover resources from the infrastructure in place. The relief BSEE granted temporarily offset the royalties owed by companies producing oil and gas on the OCS, and it allowed companies to continue producing resources on leases that would otherwise be uneconomic.

We conducted this inspection to determine whether BSEE consistently and appropriately evaluated and processed royalty relief applications submitted under the SCRR Option 1 program.

[1] The price of oil fell below $0 per barrel (-$36). When prices fall below $0, holders of oil futures contracts pay *not* to receive the oil.

[2] Idle iron is inactive infrastructure on active leases that is no longer useful for lease operations.

[3] "Gulf of Mexico Data and Analysis/Leasing, Drilling and Production; Gulf of Mexico Shallow Water Potential Stranded Assets," November 2019.

We reviewed documentation for 30 of the 114 SCRR Option 1 applications submitted to BSEE between April and September 2020, including monthly worksheets that claimed more than $1.8 million in royalty relief, to determine whether BSEE evaluated the applications according to Federal regulations (30 C.F.R. § 203) and BSEE's guidance to industry. Attachment 1 provides our scope and methodology.

Although BSEE generally evaluated SCRR Option 1 applications consistent with existing regulations and guidance it had provided to industry in April 2020, we found that the program did not include formal policies and procedures that identify the roles and responsibilities of BSEE personnel involved in overseeing the program or evaluating applications, monthly worksheets, and quarterly true-up reports. In addition, BSEE did not provide formal training to personnel responsible for evaluating documentation submitted by the oil and gas companies claiming relief.

Even though BSEE created this program quickly to provide relief amid a drop in commodity prices, management is responsible for designing and implementing controls to achieve program objectives and respond to risks.[4] Due to the risk of abuse or mismanagement in this program that allows companies to reduce the amount of royalties paid to the Federal Government, BSEE must establish standard policies, procedures, and training to ensure consistent program execution when establishing these types of programs.

In our draft report, we made three recommendations to help BSEE formalize its new SCRR program, apply consistent evaluation standards, and ensure the Federal Government receives the appropriate royalty revenues from oil and gas development on the OCS. In response to our draft report, BSEE stated it agreed with our findings and recommendations and "recognize[d] the importance of developing and implementing consistent formal policies and training" and that it would "take this information into consideration for future activities." BSEE also stated, however, that its Acting Director had issued a memorandum withdrawing and discontinuing the Option 1 program after analyzing the effectiveness and administration. Specifically, the Acting Director stated that this analysis "brought the integrity of the program into question." BSEE stated that it was unable to validate the accuracy of quarterly true-up reports and therefore could not ensure royalty relief was awarded in the proper amounts.[5] In this report, we offer three suggestions to ensure effective program administration that BSEE can consider if it reinstates this program or creates a similar program in the future.

Background

Royalty Revenues and Relief

An oil and gas lease grants the exclusive right for a company to explore, develop, and produce oil or gas for a specific period and from a specific block of OCS land. Companies holding offshore leases pay royalties to the Government to produce energy and minerals on the

[4] "Standards for Internal Control in the Federal Government," GAO-14-704G, Principle 10.02, September 2014.

[5] We did not validate data from quarterly true-up reports because the reports were under review by BSEE and had not been accepted at the time of our inspection.

OCS.[6] In fiscal year 2020, royalty revenue collected from Federal offshore leases totaled more than $3.3 billion, a decrease of $1.6 billion from fiscal year 2019. The Office of Natural Resources Revenue (ONRR) collects these payments and distributes them to States and the U.S. Treasury to support Federal funds like the Land and Water Conservation Fund and the Historic Preservation Fund. Royalties help ensure the public receives a fair return for the development of offshore energy resources.

Companies may, however, offset the royalties owed by applying for certain types of royalty relief. Federal law (43 U.S.C. § 1337) provides the Secretary of the Interior the authority to grant various types of royalty relief to promote development and increase production of offshore oil and gas resources. The Secretary delegated the authority for offshore oversight and regulation to the BSEE director, and the authority to grant royalty relief was further delegated to the BSEE regional directors.

BSEE grants various types of royalty relief to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. If the specifics of a lease or project are such that none of the formal relief programs apply, companies can request royalty relief under 30 C.F.R. § 203.80, which is often informally referred to as special case royalty relief.[7] Between 2004 and 2019, BSEE received 13 applications for relief under its SCRR program.

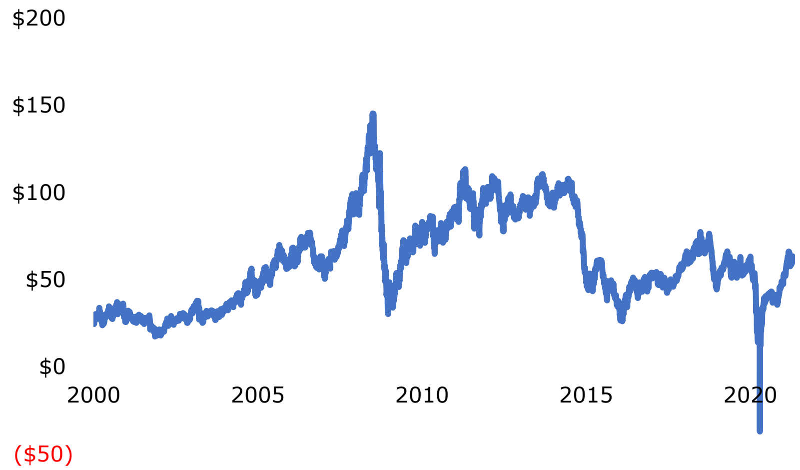
BSEE's Response to 2020 Drop in Commodity Prices

At the end of 2019, the price for a barrel of oil was more than $60. In April 2020, oil prices fell to unprecedented lows (below $0 per barrel to -$36 per barrel) because of a decline in demand resulting from COVID-19 and geopolitical and market instability. Falling commodity prices rendered much of the industry's oil and gas production uneconomic and threatened to result in companies suspending production and capping or abandoning wells. These financial challenges led oil and gas companies to request royalty relief to sustain production and operations. Figure 1 illustrates the drop of oil prices in 2020 as well as the overall trend in prices over the past 20 years.

[6] Royalties are payments for extracted natural resources, determined by a percentage of the production value of the resource. The Bureau of Ocean Energy Management sets royalty rates for oil and gas leases in Federal waters. In 2020, lease sales included a 12.5-percent royalty rate for shallow-water leases and an 18.75-percent royalty rate for deep-water leases.

[7] 30 C.F.R. § 203 outlines BSEE's authority to provide royalty relief, lease eligibility conditions, and required supplemental reports. It does not, however, dictate how royalty relief decisions will be made by BSEE for eligible leases.

Figure 1: Oil Price Per Barrel Between 2000 and 2020



Source: U.S. Energy Information Administration.

Before 2020, BSEE's SCRR program allowed companies to request relief for leases or projects that included the drilling of a well, but BSEE did not have an SCRR option specifically designed for companies with existing wells in production. Accordingly, when oil and gas prices fell in early 2020, companies with existing wells in production had no option to apply for royalty relief. Without such relief, oil and gas production was uneconomic, and companies considered shutting down production temporarily or abandoning wells entirely, which could lead to environmental and safety risks if wells are left unplugged. In addition, shutting down production could potentially result in a permanent loss of recoverable oil and gas resources and the associated royalties paid to the Government.

To avoid the abandonment of resources, BSEE developed SCRR Option 1 within 2 weeks of oil prices falling below $0 per barrel to allow companies with existing wells in production to apply for enough relief to break even on current production expenses. It issued guidance on this application process on April 30, 2020. To be eligible for this relief option under 30 C.F.R. § 203, BSEE required companies to document that the lease was uneconomic but would become economic with relief.[8] More specifically, a company may apply for Option 1 relief if it can provide documentation showing a particular lease is eligible for SCRR and ongoing production on the lease is not profitable due to commodity prices or other economic situations.

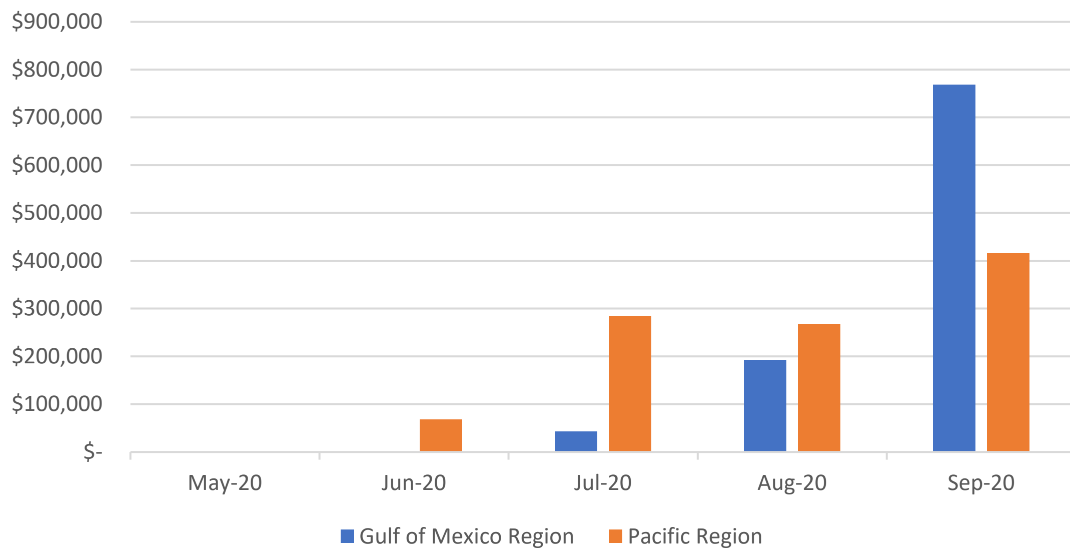
Subsequently, between April and September 2020, the BSEE Gulf of Mexico and Pacific OCS regions received 114 SCRR Option 1 applications from companies seeking royalty relief.[9] BSEE regional directors approved 74 of the 114 applications submitted, and the companies approved for relief then claimed more than $2 million in royalty relief. Figure 2 shows the amount of Option 1 relief claimed by companies from implementation of the program through

[8] BSEE officials stated that, for the purposes of SCRR Option 1, they defined a lease to be "economic" at the breakeven point of revenue and expenditures.

[9] BSEE has three OCS regional offices: Gulf of Mexico, Pacific, and Alaska. The Alaska OCS region did not receive any SCRR Option 1 applications between April and September 2020.

September 2020. BSEE personnel emphasized to us during the inspection, and reiterated in response to this report, that they developed the SCRR Option 1 program to respond to depressed oil prices and related issues in 2020 and that the program was not created to specifically address COVID-19. Rather, at the time, BSEE stated it intended to continue using this option to address future drops in commodity prices that may make production uneconomic without royalty relief.

Figure 2: Amount of SCRR Option 1 Relief Requested During Fiscal Year 2020



Source: OIG.

SCRR Option 1 Application Process

To apply for SCRR Option 1, companies must follow a multistep process that begins with a preapplication to demonstrate that the lease meets certain eligibility conditions. Specifically, the company must establish that the lease meets at least two of five regulatory characteristics: (1) a history of production and available resources to recover, (2) valuable facilities exist that may not be used by successor lessee, (3) a substantial risk that no new lessee will recover the resources, (4) recent reduction in costs does not allow use of other relief, and (5) circumstances beyond the lessee's control do not allow other forms of relief.[10]

The BSEE regional office then reviews the preapplication to determine whether the lease is eligible for SCRR Option 1. BSEE has discretion when evaluating the preapplication, but the lease must meet at least two of the five regulatory characteristics to qualify for SCRR Option 1.

If the preapplication is approved, BSEE informs the company that it may submit a formal royalty relief application, which requires a cost recovery fee[11] and the following documentation:

[10] 30 C.F.R. § 203.80, "When can I get royalty relief if I am not eligible for end-of-life or deep-water royalty relief?" (a)–(e).

[11] BSEE charges cost recovery fees to reimburse the bureau for the cost to process applications.

- Company certification that, in the absence of requested relief, the company is at significant risk of failing to meet its contractual requirements to the Government

- Support that the requested relief would increase production

- Attestation that the lease is uneconomic but would become economic if royalty relief were granted

Once a formal application is submitted, approval of royalty relief also remains within BSEE's discretion. If BSEE determines that the formal application meets all regulatory requirements, it may issue an approval letter to the company, including conditions of relief and reporting requirements. This approval letter also contains the period in which a company may request relief—typically 1 year from the date the company submitted its complete application.

After the BSEE regional director approves an SCRR Option 1 application, the company must submit monthly worksheets that report estimated revenues and expenses for any month in which the company claims royalty relief. BSEE regional personnel evaluate these worksheets for mathematical accuracy and consistency with production volumes reported to ONRR. After BSEE documents its final determination regarding the royalty relief claimed on the worksheet, BSEE forwards the worksheet to ONRR for royalty adjustments and reporting.[12]

Within 120 days after the quarter during which relief was granted, BSEE requires the company to submit a report, called a post-production true-up report, that reconciles estimated and actual revenues and expenses contained within the monthly worksheets. An independent certified public accountant, hired by the company, adjusts and certifies monthly revenues and expenses as appropriate, prepares the report, and confirms it is consistent with Generally Accepted Accounting Principles. Using the true-up report, BSEE and ONRR then reevaluate the propriety of prior relief and, as appropriate, adjust the amount of relief accordingly.[13]

BSEE personnel provide all Option 1 royalty relief decisions, worksheets, and true-up reports to ONRR, which collects royalty payments and adjusts for any royalty relief. Figure 3 summarizes the SCRR Option 1 application and reporting processes.

[12] In August 2021, the DOI OIG issued a draft audit report entitled, "ONRR Royalty Reporting and Adjustments" (2020-CR-009), which found that ONRR needed to strengthen its controls over adjustments made to Federal oil and gas royalty reporting. While the scope of this audit did not include adjustments made due to BSEE's SCRR Option 1 program, findings identified in that report could impact royalty adjustments resulting from SCRR Option 1, if ONRR does not make timely improvements to its controls over the reporting system.

[13] At the time of our review, BSEE was still determining the best approach for review and acceptance of quarterly true-up reports. Therefore, we did not validate data from the true-up reports.

Figure 3: SCRR Option 1 Application and Reporting Process

Preapplication

- Company submits preapplication
- BSEE determines whether lease meets 2 of 5 regulatory requirements
- If lease meets requirements, BSEE sends the company a confirmation letter, which includes information required in formal application

Formal application

- Company submits formal application with supporting data and fee
- BSEE analyzes supporting data to ensure lease is uneconomic and relief would increase production
- If application meets all regulatory requirements, BSEE may issue an approval letter

Monthly worksheets

- Company submits monthly worksheet with production volumes as well as revenue and expense data
- BSEE reviews propriety and amount of relief and makes determination
- If accepted, BSEE provides copy of worksheet to ONRR

Quarterly true-up reports

- Company provides Post-Production True-up Report after each quarter, prepared by independent accountant
- BSEE ensures that the True-up Report meets all conditions of the original approval and, if accepted, provides a copy to ONRR.

Source: OIG.

Results of Inspection

Although BSEE generally evaluated SCRR Option 1 applications consistent with regulations and guidance it had provided to industry in April 2020, we concluded that improvements are needed to strengthen the program, especially because BSEE had planned to keep this program in place as an option for companies during future market events that render continued production uneconomic. Specifically, we found that BSEE's SCRR Option 1 program did not include formal policies and procedures identifying the roles and responsibilities of BSEE personnel involved in overseeing the program or evaluating applications, monthly worksheets, and quarterly true-up reports. In addition, as of April 15, 2021, BSEE had not provided formal training to personnel responsible for evaluating documentation submitted by companies.

Formal policies, procedures, and training are needed to provide standardized oversight and decision making regarding this type of program. Inconsistent oversight increases the risk that the Government may improperly grant royalty relief and thereby forfeit royalties it is owed or fail to grant relief when it is in the Government's interest. Implementing policies and procedures and providing training to BSEE personnel responsible for reviewing submitted documentation would strengthen program controls to ensure consistent evaluation and solidify the program's goals and intent for possible future use.

BSEE Generally Evaluated Applications Consistent With Guidance

We found that BSEE generally evaluated SCRR Option 1 applications consistent with guidance it provided to industry. Specifically, for the 30 application packages we sampled, we found that BSEE:

- Verified that leases associated with each application met two of the five regulatory requirements to be considered for relief
- Ensured that companies certified that relief would result in increased production for all sampled applications
- Confirmed that companies certified that the lease or project was not economic without relief
- Obtained and reviewed monthly worksheets for all months in which companies requested relief

In addition, BSEE consistently collected a $2,000 cost recovery fee for each application and provided a notification letter to the company when approving the application or when denying the application and returning it to the company for more information. We also confirmed that the amount of relief requested on the monthly worksheets matched BSEE data. As described below, we did, however, identify areas of improvement for BSEE's SCRR Option 1 program.

BSEE Did Not Formalize Policy, Procedures, or Training Related to the SCRR Option 1 Program

We found that BSEE did not issue formal policy for its SCRR Option 1 program before accepting and processing applications. Instead, the two BSEE regions processing Option 1 applications used a guidance document intended to instruct industry on the application process as BSEE's policy for the Option 1 program. The guidance document, developed by personnel in BSEE's Headquarters and Gulf of Mexico Region, with assistance from the Department's Office of the Solicitor, was disseminated to industry in April 2020 and included instructions for companies to apply for relief under the SCRR Option 1 program. This document was not, however, intended to provide detailed internal instruction to the BSEE employees responsible for assessing the documentation provided by industry. The guidance for industry did not, for example, outline BSEE personnel responsibilities or Headquarters' directives regarding implementation of the program. The guidance document also failed to outline the general strategy and purpose of the Option 1 program. Establishing the general strategy and purpose of the Option 1 program would allow BSEE to formally communicate its authority and goals for SCRR to its own personnel, the oil and gas industry, and the public.

In addition, BSEE did not develop written procedures for its employees to evaluate SCRR Option 1 applications or to reconcile the required monthly and quarterly reports. BSEE's Office of Policy and Analysis confirmed that it had not codified procedures for the SCRR program at the national level. BSEE personnel stated that they relied on two documents for guidance in processing relief applications: BSEE's April 2020 guidance to industry and an expired Gulf of Mexico regional document that was not recognized as an official bureau directive. Neither of these documents provided BSEE personnel with specific guidelines and procedures for how to review and consistently evaluate applications or document the review.

For example, BSEE personnel stated they needed procedures or instructions to evaluate amounts categorized as "other expenses" on monthly worksheets to determine if those amounts were appropriate and allocable to the lease. In addition, neither the guidance to industry nor the unofficial Gulf of Mexico regional document included detailed procedures for BSEE's own internal review of preapplications, monthly worksheets, and quarterly true-up reports. Instead, the documents used vague or general language regarding BSEE evaluations, which resulted in inconsistent interpretations of the guidance across regional offices. For instance, BSEE's Pacific OCS Region sent a single complete approval package to applicants; in contrast, the Gulf of Mexico Region used a two-part application process to initially establish lease eligibility. As a result of the lack of detailed procedures, Pacific OCS regional personnel misunderstood the preapplication process and had to revise their response to companies after five applications were approved. According to Pacific OCS regional officials, after initial confusion, the region has since required a separate preapplication from all applicants. As these examples illustrate, the review of preapplication eligibility and the acceptance of monthly worksheets were performed on a case-by-case basis and were open to interpretation by regional personnel.

Furthermore, BSEE did not formally train personnel responsible for implementing the new SCRR Option 1 program. BSEE personnel from its Gulf of Mexico and Pacific OCS regional offices confirmed that they had not received any formal training related to SCRR Option 1 application processing. BSEE did train personnel from other units on how to organize and compile SCRR data, but it did not train those responsible for processing applications and making approval determinations. Instead, BSEE used informal guidance, ad-hoc discussions, and experience with other types of royalty relief to guide SCRR application processing.

These issues occurred because BSEE developed the Option 1 program within 2 weeks in response to the precipitous decline in oil and gas prices in early 2020. However, without formal policy, procedures, and training, BSEE personnel may misinterpret SCRR requirements or accept relief requests inconsistently, potentially resulting in reduced revenues to States and the Federal Government. Implementing these controls would not only strengthen BSEE's execution of this type of program but would also ensure future relief is granted only when needed and when in the Government's best interest.

Conclusion and Recommendations

We found that BSEE quickly implemented a royalty relief program to keep oil and gas companies producing during the economic downturn in early 2020. BSEE personnel generally processed SCRR applications, worksheets, and true-up reports consistent with regulations and its guidance for industry. BSEE did not, however, issue formal policy and procedures for the SCRR Option 1 program or train personnel on implementation of the program. Instead, it relied on guidance intended for industry rather than standardized procedures to assist its own personnel in assessing industry applications.

In our draft report, we made three recommendations to help BSEE establish and formalize its new SCRR Option 1 program. In response to our draft report, BSEE concurred with our findings and recommendations but noted that on September 13, 2021, the BSEE Acting Director issued a memorandum withdrawing and discontinuing the Option 1 program, citing an internal analysis of the program's effectiveness and administration that "brought the integrity of the program into question." Specifically, the Acting Director stated that BSEE was unable to validate the accuracy of quarterly true-up reports and therefore could not ensure royalty relief was awarded in the proper amounts. We did not validate data from quarterly true-up reports because the reports were under review by BSEE and had not been accepted at the time of our inspection.

Because the program was discontinued, we will not make formal recommendations. However, if BSEE plans to establish a similar program in the future, it should consider the following suggestions to ensure effective program administration:

- Implement formal policy that establishes the strategy, purpose, and use of the royalty relief program, along with associated roles of BSEE personnel

- Implement standard procedures for reviewing and approving program applications and any required follow up documentation required under the program

- Provide training for BSEE personnel processing applications and reviewing the required follow up documentation

Because we are not offering recommendations, we do not require any further response to this report. We will notify Congress about our findings, and we will summarize this work in our next *Semiannual Report to Congress*, as required by law. We will also post a public version of this report on our website.

If you have any questions, please contact me or Kathleen Sedney, Assistant Inspector General for Audits, Inspections, and Evaluations, at 202-208-5745.

Attachments (2)

Attachment 1: Scope and Methodology

Scope

The scope of our inspection included a review of the implementation of the Special Case Royalty Relief (SCRR) Option 1 program, application packages received from April 30, 2020, through September 30, 2020, and the associated post-production reports. However, we did not validate data from quarterly true-up reports because the reports were under review by BSEE and had not been accepted at the time of our inspection.

Methodology

We conducted our inspection in accordance with the *Quality Standards for Inspection and Evaluation* as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

To accomplish our objective, we:

- Gathered and reviewed general, administrative, and background information to provide a working knowledge of the Bureau of Safety and Environmental Enforcement's (BSEE's) royalty relief programs

- Obtained and reviewed relevant studies and reports, as well as applicable laws and regulations

- Identified and reviewed BSEE guidance related to its SCRR program

- Interviewed BSEE regional personnel about the implementation of the SCRR Option 1 program and evaluation of relief application packages

- Identified the universe of 114 SCRR Option 1 application packages received from April 30, 2020, through September 30, 2020, which included 74 approved applications with monthly worksheets that requested $2 million in royalty relief

- Judgmentally selected and analyzed a sample of 30 SCRR Option 1 application packages received from April 30, 2020, through September 30, 2020, which included 25 approved applications with monthly worksheets that requested $1.8 million in royalty relief (88 percent of the total SCRR Option 1 requested in fiscal year 2020)

- Determined whether BSEE personnel evaluated applications, monthly worksheets, and quarterly true-up reports according to applicable regulations and BSEE's guidance it provided to industry in April 2020

We sought to determine whether BSEE consistently and appropriately evaluated and processed royalty relief applications submitted because of COVID-19. We note, however, that the SCRR Option 1 program was not limited to or defined as a COVID-19 program.

Attachment 2: Response to Draft Report

The Bureau of Safety and Environmental Enforcement's response to our draft report follows on page 14.

United States Department of the Interior

BUREAU OF SAFETY AND ENVIRONMENTAL ENFORCEMENT
WASHINGTON, DC 20240-0001

Memorandum

To: Mark Lee Greenblatt
Inspector General

Through: Laura Daniel-Davis
Principal Deputy Assistant Secretary,
Land and Minerals Management

Laura Daniel-Davis Digitally signed by Laura Daniel-Davis Date: 2021.10.29 15:36:19 -04'00'

Scott Mabry
Acting Director
Associate Director for Administration

SCOTT MABRY Digitally signed by SCOTT MABRY Date: 2021.10.26 18:11:09 -04'00'

From: Molly K. Madden
Chief, Office of Policy and Analysis

MOLLY MADDEN Digitally signed by MOLLY MADDEN Date: 2021.10.25 07:28:24 -04'00'

Subject: Response to Draft Inspection Report on Special Case Royalty Relief (2021-CR-006)

The Department of the Interior (DOI) appreciates the Office of Inspector General's (OIG) interest in the Bureau of Safety and Enforcement's (BSEE) Special Case Royalty Relief (SCRR) Option 1 program, as laid out in the draft inspection report, *The Bureau of Safety and Environmental Enforcement Needs to Develop Policies and Procedures to Strengthen Its Special Case Royalty Relief Program*. In the report, the OIG made the following recommendations to BSEE:

> **Recommendation 1:** *Implement formal policy that establishes the strategy, purpose, and use of the SCRR Option 1 program, along with associated roles of BSEE personnel.*
>
> **Recommendation 2:** *Implement standard procedures for reviewing and approving SCRR Option 1 applications, monthly worksheets, and quarterly true-up reports, including reconciliation of the monthly and quarterly reports.*
>
> **Recommendation 3**: *Provide training for BSEE personnel processing SCRR Option 1 applications, monthly worksheets, and quarterly true-up reports.*

BSEE agrees with and recognizes the importance of developing and implementing consistent formal policies and training and will take this information into consideration for future activities. Regarding Recommendations 1-3, however, the BSEE Acting Director issued a memorandum on September 13, 2021, withdrawing and discontinuing the Option 1 guidance and process (see Attachment 1). As stated in this memorandum, BSEE developed Option 1 in early 2020 during a period when the Bureau was concerned that prevailing circumstances could have led to premature abandonment and stranding of oil and gas reserves in the absence of a "special case royalty relief process" to address operations that did not include drilling. These circumstances subsequently improved over the last year with no new applications under SCRR Option 1 received by BSEE since December 2020. In addition, over the past year BSEE Regional Offices have analyzed the effectiveness and administration of the Option 1 process, and brought the integrity of the program into question. Challenges identified included providing sufficient assurance that the proper amount of royalty relief would be awarded, potentially to the detriment of the American taxpayer and in excess of the Bureau's regulatory authority. As a result, BSEE leadership made the decision to withdraw and discontinue the Option 1 program.

Given that BSEE will no longer offer this program as an option for companies, we believe that the September 13th memorandum addresses Recommendations 1-3 and supports closure of these recommendations. A copy of the memorandum is provided as Attachment 1. Additionally, in Attachment 2, BSEE provides some additional clarifications for the OIG's final report.

Should you or your staff have any questions concerning this response, please contact Chanielle Williams, BSEE Audit Liaison Officer at [redacted].

Attachments

Attachment 1

September 13, 2021

Memorandum

To: Regional Director, Gulf of Mexico Region
Regional Director, Pacific Region
Regional Director, Alaska Region

SCOTT MABRY Digitally signed by SCOTT MABRY Date: 2021.09.13 10:46:47 -04'00'

From: Acting Director, Bureau of Safety and Environmental Enforcement

Subject: Royalty Relief

On April 30, 2020, BSEE issued guidance regarding "special case royalty relief" (SCRR) available pursuant to 30 CFR 203.80. The guidance explained two processes for requesting discretionary royalty relief under this regulation: 1) Option 1 – a new process established for SCRR requests for leases/units on which the drilling of well(s) was not contemplated, and 2) Option 2 – a clarified existing process for SCRR requests for leases/units/projects that did involve the drilling of well(s). While Option 2 reflects a long-standing process, BSEE developed Option 1 in early 2020 during a period when the Bureau was concerned that prevailing circumstances could have led to premature abandonment and stranding of oil and gas reserves in the absence of an SCRR process to address operations that did not include drilling. However, these circumstances have improved over the last year. Further, the Regional Offices have now had time to analyze the effectiveness and administrability of the Option 1 process over the last year. As previously identified and discussed, complications encountered with analyzing the accuracy and adequacy of the independent CPA "True-up" reports have brought the integrity of this program into question. Without the ability to ensure accurate True-up reports, BSEE cannot provide assurance that the proper amount of royalty relief would be awarded, potentially to the detriment of the American taxpayer and in excess of the Bureau's regulatory authority. Lastly, it is my understanding that BSEE has not received any new applications under Option 1 since December 2020.

Therefore, I have determined that the Option 1 guidance and process should be withdrawn and discontinued. Please ensure that the proper changes to the BSEE website are made promptly and, for transparency reasons, that proper outreach to stakeholders is accomplished.

With respect to Option 2, I have determined that the current guidance and process should continue in effect. However, I request that each Region review the policy changes established in the memorandum dated November 21, 2019, sent from the previous Director to the Regional Director, Gulf of Mexico Region. The Regions now have sufficient experience administering a number of royalty relief applications under Option 2 to inform recommendations as to whether or not any improvements or changes to the process should be considered. However, the particular discount rate identified in the November 2019 memo, as recommended by BOEM for the shallow water Gulf of Mexico, should remain in effect unless and until BOEM modifies its recommendations in the future.

Attachment 1

Please provide any recommendations regarding Option 2 within 30 days of the date of this memorandum.

Attachment 2

BSEE Comments for the OIG Draft Report # 2021-CR-006

- (Pg 1, Footnote 2) – Suggest removing "decommissioned infrastructure" as this information is not consistent with what is written in NTL 2018-G03 (Idle Iron Decommissioning Guidance for Wells and Platforms).

- (Pg 2, par 1) – The report says, "…monthly worksheets that requested…", implying that operators request SCRR on the Monthly Worksheets. However, operators *request* SCRR prior to the original BSEE approval (or denial) letter. That is, before the first Monthly Worksheet is submitted, the royalty relief would have already been requested by the company and approved by BSEE. Therefore, it would be more appropriate to say that operators are "claiming" royalty relief on the Monthly Worksheets rather than "requesting" it. Similar "request" wording is used incorrectly throughout the report.

- (Pg 3, Footnote 6) – This footnote ties to only special case royalty relief and not the other forms of relief allowed by regulation. Footnote 6 mentions "required supplemental reports" but if this phrase is pointing to the reports found at 30 CFR 203.83 – 91, note that these reports are not applicable to special case royalty relief.

- (Pg 4, par. 1) – The report says "BSEE did not have an SCRR option for companies with existing wells in production." It would be more accurate to say that "BSEE did not have an SCRR option *specifically designed* for companies with existing wells on production." The historic SCRR program does allow companies to submit applications for leases or projects with existing production. Utilizing the historical BSEE process to evaluate SCRR applications with capital expenditures for production only cases, however, may be more involved and take longer to complete for each application. The End-of-Life royalty relief program might be a more applicable avenue for a royalty relief application for leases already on production and without significant capital expenditures planned, but that program has strict eligibility requirements.

- (Pg 4, par. 2) –Note that this process was developed consistent with regulations and to help avoid the stranding of reserves/abandonment of resources. However, this paragraph states that "to avoid company bankruptcies" was also a reason. Note that this may have been a by-product of the program but cannot be a reason to grant relief consistent with our regulatory authority.

- (Pg 4, par. 3) – The report says BSEE commented that Option 1 was not developed "solely to address COVID-19". Note that Option 1 was created due to the depressed oil prices and the possibility of stranding reserves and not to address COVID-19. That said, it could be that COVID-19 pandemic played a role in the oil price decline.

Attachment 2

- (Pg 6, par. 2) – Suggest adding the word "estimated" between the words "report" and "revenues" in the first sentence.

- (Pg 6, par. 2) – The report says, "BSEE regional personnel evaluate these worksheets for reasonableness, mathematical accuracy, and general appropriateness of revenue and expenses." To more accurately capture the tasks BSEE performs, suggest rewording to say, "BSEE regional personnel evaluate these worksheets for mathematical accuracy and consistency with production volumes reported to ONRR." Note that the Option 1 program was designed with the intent to minimize BSEE analyses as the initial monthly worksheets may contain only estimates and place the vast majority of that burden on the independent CPA at the True-up Report stage when actual expenditures are being certified.

- (Pg 6, par. 3) – The report lists some, but not all, of the things that the independent CPA must do in the post-production true-up report. The report authors might want to consider adding the fact that the CPA must also confirm that it read and understands BSEE's Allowable Expenses document. Also, suggest starting the second sentence with "An independent CPA" vs "An independent accountant".

- (Pg 7, fig. 3) – The figure says "…BSEE may issue an approval letter". The word "may" implies that BSEE sometimes denies pre-applications even though they meet all regulatory requirements. Historically, we have not denied pre-applications that met all regulatory requirements, and do not envision doing so in the future.

- (Pg 7, fig. 3) – The figure also says, "BSEE and ONRR reevaluate propriety of prior relief and adjust amount if necessary." It is more accurate to say "BSEE ensures that the True-up Report meets all conditions of the original approval and, if accepted, provides a copy to ONRR."

- (Pg 7, fig. 3) – The figure also says, "Company submits monthly worksheet with revenue and expense data." It is more accurate to say, "Company submits monthly worksheet with production volumes, revenue data, and expense data."

- (Pg 8, 1st par. under 2nd bold heading) – The report states "The guidance, developed by personnel in BSEE's Gulf of Mexico Region". It would be more accurate to say "The guidance, developed by BSEE HQ, Gulf of Mexico Region, and SOL".

- (Pg 9, par. 3) – The report says "…it did not train those responsible for processing applications and making approval determinations." We would like to clarify that "approval determinations" are made by the Regional Director. The report implies that employees processing applications make approval determinations but such employees only evaluate applications and make the appropriate recommendations. The Regional Director is provided with information in support of the recommendations and briefings provided as needed. Note that Monthly Worksheets and True-up Reports are only submitted after the Regional Director has approved an SCRR application. Therefore, it is preferable to say BSEE "accepts" (or "returns") True-up Reports and Monthly Worksheets rather than "approves" (or "denies") them, in order to avoid confusion with the actual approval (or denial) of SCRR.

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