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## Congress Targets Oil-Drilling Subsidies

**Pressure Mounts to Fix Flawed Leases  
Valued at Billions of Dollars in Future Royalties**

By **JOHN J. FIALKA**  
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WASHINGTON -- With Democrats controlling Congress, the oil industry is in for a rough ride. So is the agency that collects royalties for oil and gas drilling on federal lands.

Democrats and some Republicans have complained for months that the Interior Department's Minerals Management Service -- whose motto is "securing ocean energy and economic value for America" -- has mishandled the royalty program. The issue will hit the spotlight Jan. 18, when the House takes up energy legislation targeting oil-industry subsidies.

### ROYAL TREATMENT

- **What's New:** Congress threatens action; Bush administration aims to deal with losses of government oil royalties.
- **The Players:** The Minerals Management Service and U.S. and foreign oil producers are disputing contract flaws that provided the U.S. with no revenue during a period of rising oil prices.
- **The Bottom Line:** About \$900 million of revenue has been lost and billions of dollars in future payments are at stake.

One goal: untangling a legal mess that could allow companies to escape paying at least \$10 billion in future royalties for drilling in the Gulf of Mexico. As part of the debate, congressional critics are sure to ramp up their complaints about the service, which has said that it failed to include a clause requiring the royalties into leases issued in 1998 and 1999.

Meanwhile, the Government Accountability Office is preparing a report that, some lawmakers say, will blame the service's "culture" for widespread laxity in conducting royalty audits and collecting underpayments from


industry. And by mid-month, the Interior Department's Inspector General will release a report showing that different units at the service working on leases didn't talk to each other and that some officials apparently signed leases without reading them.



The action reflects continuing fallout from the service's handling of oil and gas leases and royalty payments. A 1995 law temporarily waived royalties to encourage drilling in deeper Gulf waters but required the payments to kick in if oil prices exceeded a price threshold of about \$40 a barrel. Under the Clinton administration, the service omitted the price threshold in the 1998 and 1999 leases, so companies haven't had to pay even though oil prices are well above the trigger point. The flawed leases have resulted in a \$900 million revenue loss to the government, the department says.

The department is scrambling to try to assuage critics. C. Stephen Allred,

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an assistant secretary at the Interior Department who oversees the service, announced Dec. 14 that five oil companies -- including **BP PLC**, **ConocoPhillips**, **Marathon Oil Corp.** and **Royal Dutch Shell PLC** -- had agreed to amend their leases to begin paying royalties on oil and gas produced since Oct. 1, 2006, but not before. Dozens of other companies haven't agreed to change the leases.

Mr. Allred, a 63-year-old engineer who formerly headed Idaho's Division of Environmental Quality, says the government can't force the companies to make the changes, but that several have been willing to discuss the issue because of concern about a Democratic crackdown. "They know what's going on on the Hill," he said in an interview.

He also has been dickering with oil giant **Chevron Corp.**, so far without result. In a statement, Chevron said it has made "significant investments" in Gulf production based on the existing leases and that its lawyers "have put a reasonable offer on the table to resolve this matter" with the Interior Department.

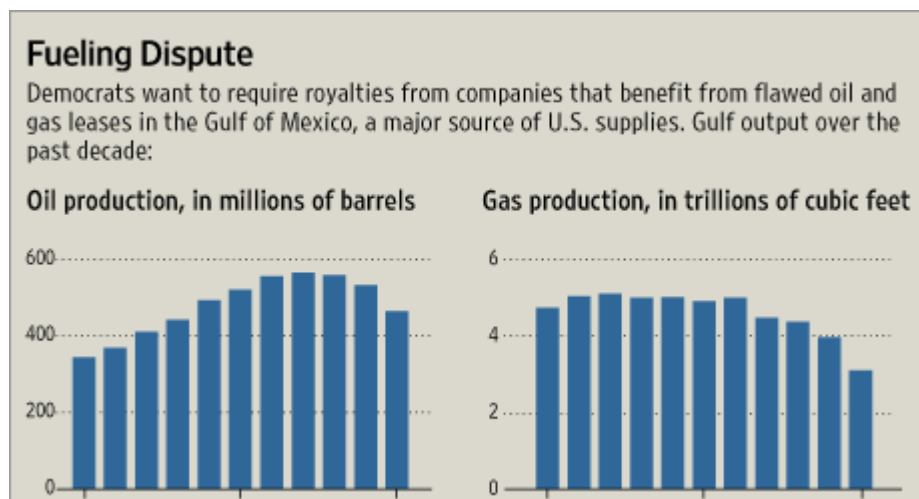
According to Mr. Allred, the department issued 1,023 faulty leases in 1998 and 1999. Of those, 570 are still in force but only about 45 involve current production of oil and gas or discoveries that promise future production. BP and the other companies that have agreed to changes in the leases hold about 20% of those 45 leases, while Chevron holds another 20%. Foreign oil companies, which the department wouldn't identify, hold another 20% and smaller companies hold the rest.

Mr. Allred says the 45 leases could produce \$10 billion to \$11 billion of federal royalty payments, and that the department wants to collect that money before trying to recover royalties from past production. "We want to deal with this potential first," he says.

Congressional Democrats say they plan to increase oversight of the agency. They are eager to fix the royalty snafu as part of a broader attack on subsidies for the oil industry. Besides forcing oil companies to amend their 1998 and 1999 drilling leases to include a clause requiring royalty payments, the still-emerging energy legislation is expected to raise taxes on oil-company inventories and kill certain industry tax breaks.

Last year, the House passed two different measures dealing with the royalty problem, but neither became law. House Speaker Nancy Pelosi of California and other Democrats still are weighing which approach to use this year, aides say.

One approach, pushed by Democratic Reps. Ed Markey of Massachusetts and Maurice Hinchey of New York, would bar companies from future exploration on federal outer-continental-shelf lands if they didn't agree to amend their leases. Another measure, championed



by former Rep. Richard Pombo, called on the government to assess a "conservation fee," roughly equal to the sought-after royalty payments, unless the companies agreed to changes in the leases.

Some lawmakers are exploring a third approach, which would require the Bush administration to take reluctant energy companies to court. It was suggested by Stephen Lowey, a White Plains, N.Y., lawyer, who argues that because Congress required the leases to have a price threshold, officials at the Interior Department had no authority to leave it out. That means, he says, that a judge could change the leases unilaterally to insert the price threshold, thus requiring royalty payments when prices exceed the threshold. Mr. Lowey says he suspects oil companies already know this, and that is why some are willing to negotiate with the government. Several congressmen have asked Attorney General Alberto Gonzales to review this aspect.

Lee Fuller, vice president of the Independent Petroleum Association of America, whose members include several smaller exploration companies holding the leases, argues that the policy of encouraging more oil exploration in "frontier" areas of the Gulf has worked. Tampering with existing leases, he asserts, would discourage future exploration and provoke court challenges that could last years.

The companies "didn't negotiate these contracts," he says. "They were handed to them to sign. If it becomes an issue where the nature of the contract itself is affected, then it becomes a lawyers' field day."

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