Written Testimony of Beth Daley
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Interior Department: A Culture of Managerial Irresponsibility and Lack of Accountability?
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The Project On Government Oversight (POGO) applauds the efforts of House Government Reform Chairman Tom Davis and House Energy and Resources Subcommittee Chairman Darrell Issa to take a much-needed look at the Department of Interior’s oil and gas leasing and royalty collections. In addition, we applaud the efforts of Ranking Member Henry Waxman and Committee member Representative Carolyn Maloney who have conducted investigations and led many initiatives over the years to ensure that the oil and gas industry pay their fair share for royalties on federal and Native American leases.

We sincerely hope that yesterday’s and today’s hearings are the beginning of more Congressional oversight to come, particularly given the history of these issues and indicators today that point to the need for much more vigorous efforts to protect Native Americans and the taxpayers from waste, fraud, abuse.

Founded in 1981, POGO is a nonpartisan and independent nonprofit organization that investigates and exposes corruption and other misconduct in order to achieve a more accountable federal government. POGO is committed to honest, accountable, and open government.

Department of Interior (DOI) Inspector General Earl Devaney’s testimony yesterday outlined in part how an “institutional culture of managerial irresponsibility and lack of accountability” – as the Subcommittee put it – allowed a complacent Minerals Management Service (MMS) to fail to collect royalties owed to the taxpayer. In POGO’s experience spanning more than a decade of investigating in this topic area, aggressive Congressional and watchdog oversight has played a central role in ensuring that the MMS adequately protects the financial interests of the federal government and Native Americans.
The Oil and Gas Industry: a History of Fraud

In the 1990's, POGO issued a series of investigative reports documenting how the oil industry had shortchanged the government by as much as several billion dollars in oil royalties. Some of that money was ultimately recovered as a result of a False Claims Act lawsuit filed by POGO and whistleblowers as well as by audits conducted by MMS. In 1998 to 2001, companies reached settlements totaling roughly $500 million with the Justice Department in lawsuits alleging that they shortchanged on oil and gas royalties owed to tribes and the federal government.¹

In 2002, POGO identified more than $11 billion in lawsuit settlements that the oil and gas industry had reached with states, tribes, the federal government, and private parties concerning royalty underpayments.² Dozens of cases involving gas and oil royalty underpayments illustrate that a variety of players in the oil and gas industry may be engaged in widespread oil and gas royalty fraud.

Auditing and Enforcement: How is MMS Doing?

Since 1981, the Minerals Management Service has operated an auditing and compliance division which conducts audits and oversight of mineral leases. Collections from the auditing and compliance division of MMS have declined in recent years. In the four years from 2002 to 2005, MMS’s auditing and compliance program collected an average $48 million annually, less than half the average $115 million collected annually in the division’s first 20 years.³

The decline in funds collected has occurred on the heels of changes in the way the MMS compliance programs provide accountability and oversight over royalty collections. Since 2000, MMS has altered its priorities, shifting resources away from auditing to a computerized checking system based upon information provided from the industry, known as “compliance review.” In FY 2000, $22 million was spent on auditing and $12 million was spent on compliance review. By comparison, in FY 2005, the priorities were reversed: just $12 million was spent on auditing while $22 million was being spent on compliance review.⁴

The most recent budget from MMS indicates that since 2001 it has reduced its auditing and compliance revenue collections.


³ In deriving this figure, POGO analyzed auditing and compliance revenue collections from FY 2002 through FY 2005 then compared that to collections for the twenty-year period from FY 1982 to FY 2001. Auditing and compliance revenue collections from FY 1998 to FY 2001 were larger due to collections made in part as a result of POGO’s investigations, outside litigation, and effective audits performed by MMS.

staff by 65 full-time employees, or 26% of its then-total staff of 250.\footnote{Budget Justifications and Performance Information Fiscal Year 2007, U.S. Department of Interior Minerals Management Service. http://www.mms.gov/PDFs/2007Budget/FY2007BudgetJustification.pdf} While POGO supports efforts to make the government more efficient, cut backs in the number of auditors at this particular juncture is hard to justify given the evidence of underpayments which surfaced in the late 1990s.

MMS argues that the growing use of Royalty-in-Kind has minimized royalty uncertainty and resulted in the need for fewer audits. This may or may not be true. An independent analysis of this issue would ensure that MMS’ assumptions on this point are correct.

In addition, as will be discussed later, a variety of whistleblowers have raised substantial questions about whether the Interior Department is meeting its full potential in overseeing royalty collections.

In response to questions about how many random and referral audits are conducted, MMS replied in a letter to Representative Carolyn Maloney (D-NY): “While we remain committed to the strategies, MMS has not yet made full use of random audits and referrals as means to improve our compliance process. As we continue to adapt and refine our processes, we expect to make greater use of these approaches in the future.”\footnote{Letter to Representative Carolyn Maloney from MMS Director Johnnie Burton, May 17, 2006.}

MMS added: “During FY 2002, MMS initiated 13 such random audits – 1 Indian, 9 offshore, and 3 onshore. The MMS has 49 more such random audits underway or planned for FY 2006-2007, including 1 Indian, 15 onshore, and 33 offshore...Additional random audits are performed periodically as resources are available. For example in FY 2003, 15 Federal onshore properties were selected for audit randomly from those states without delegated compliance and audit authority.”\footnote{Ibid.} One unresolved question is whether this minimal amount of audit activity has a deterrent effect against possible fraud for the 27,000 producing federal and Indian mineral leases under MMS’ jurisdiction.

Since 2000, the MMS has not published on its web site its annual “Report on Royalty Management and Delinquent Account Collection Activities,” which had previously outlined the agency’s activities to audit, monitor, and enforce collection of royalties for products taken from federal and Indian lands. Congress should consider requesting that the MMS revive the annual web publication of this document so that
appropriate oversight can be conducted.

Congress should also examine incentives which are being used in the auditing and compliance division of MMS. Are MMS’ employees rewarded for actually finding underpayments? Or are they rewarded for fulfilling meaningless quotas? Preliminary information received by POGO suggests that the bonus systems could be altered to be more closely aligned to outcomes that benefit the taxpayer. Bonuses for MMS increased in 2005 with 15 Senior Executives receiving $77,000 or an average of $5,000 each.

Whistleblowers, States, Tribes Raise Concerns: Is Anyone Listening?

A variety of industry and government whistleblowers, states, and tribes have come forward to express concerns about oil and gas royalty underpayments and the MMS’ commitment to exposing and correcting those underpayments. In recent years, two senior Interior Department auditors were fired after they sought to improve royalty collections. Retaliation against whistleblowers may be part of a wider cultural problem within the agency of silencing voices who would seek to strengthen the agency’s ability to fairly collect what is owed from the oil and gas industry.

In September 2004, Bobby Maxwell, a senior auditor in MMS’ Offshore Auditing and Compliance, filed a False Claims Act lawsuit alleging that Kerr-McGee under reported the value of the oil it had drilled from federal lands from 1999-2003. That lawsuit has now passed all its legal hurdles and is poised to go to trial in federal court in November, 2006. POGO applauds the efforts of Mr. Maxwell, an auditor with MMS since 1983 who had received numerous awards for his federal service. Mr. Maxwell was fired by the MMS just a few weeks after his False Claims Act lawsuit was unsealed and made public. Mr. Maxwell’s case suggests that MMS may not be issuing demands to pay to oil and gas companies in cases where there are substantial audit findings. In correspondence to Congress, MMS has indicated that despite its maintenance of data on audits and compliance reviews, it “does not maintain statistics on the numbers or amounts of orders [referring to orders to pay issued to companies] issued.”

In addition, attention should be paid to the firing of whistleblower Kevin Gambrell, the former director of the Federal Indian Minerals Office in Farmington, New Mexico from 1996 to 2003. Mr. Gambrell

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8 Ibid.
was a talented and successful auditor within MMS until he was pushed out for raising concerns about whether MMS was fulfilling its duty to collect royalties for Indians. While in his position, Mr. Gambrell was able to renegotiate settlements between MMS and the oil industry so that Navajos would receive eight times more than MMS had determined was owed. According to Mr. Gambrell, MMS had not relied on audits to determine what the oil industry owed the Navajos. In February 2003, Mr. Gambrell began disclosing his concerns to the Court-appointed Special Master overseeing the Indian Trust Fund. In September 2003, MMS fired Mr. Gambrell.

In a June 2006 segment on PBS, Mr. Gambrell said: “I think the American taxpayers are losing billions of dollars....I don't think the American people should walk away from this. I think they need to really question the government that is currently auditing oil and gas royalties and make sure that they do it correctly. I think there needs to be independent review, I mean separate from the government, a review of the agencies that collect royalties, manage the oil and gas properties. There needs to be better oversight and there needs to be independent audits of these agencies.”

Oil industry tycoon Jack Grynberg has also filed a False Claims Act lawsuit, this one alleging more than a dozen ways that companies can underpay gas royalties, particularly by manipulating the volumes of gas downward. Mr. Grynberg estimates that oil and gas companies may end up owing $35 billion as a result of his lawsuit.

Native Americans are also concerned. In a May 2006 Washington Post article, Roger Fragua, deputy director of the Council of Energy Resource Tribes said: “We are convinced that there is serious underreporting of production and serious underpayment of royalties owed to the tribes...The federal government, at least in this administration, is not protecting our interests. So we are looking for ways to go after the companies ourselves.”

In 2006, the Minerals Management Service has stifled criticism from states and Indian tribes which have questioned the wisdom of replacing auditing with computer checks, called “compliance review” in a series of letters. At a meeting of state and Indian auditors in August 2006, the MMS informed the group that it was eliminating the ability of the states and tribes to meet independently, a move that some felt was designed to gut the organization and silence its criticisms. A September 2006 letter from concerned members of Congress concluded: “MMS is retaliating against STRAC [State and Tribal Royalty Audit Committee] for voicing its concerns to Congress about dysfunction in the royalty

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management program.”\textsuperscript{13}

State and tribal participation in audits was authorized by Congress in 1982 after congressional findings that Interior was operating the royalty program as an “honor system,” under which federal lessees (oil companies) were allowed to report and pay whatever they wanted. An independent commission, whose findings Congress adopted, told Interior to implement independent cross checks of industry representations and to avoid blind acceptance of industry “bookkeeping.”\textsuperscript{14}

POGO urges incoming Interior Secretary Dirk Kempthorne to change the dynamic at the Interior Department described by Inspector General Devaney where those responsible for the failures to do their job and collect what is owed the American taxpayer are held accountable. However, we would urge Secretary Kempthorne to take that suggestion one step further and seek out and reward whistleblowers who bring forward evidence of negligence, waste, fraud, or corruption. Firings such as that of Mr. Gambrell and Mr. Maxwell have a chilling effect on employees at the MMS, re-enforcing a culture where wrong-doing is covered up rather than addressed.

Finally, POGO urges the Congress and Secretary Kempthorne to investigate the concerns of states and tribes and do everything possible to ensure that their concerns are being adequately addressed by MMS.
