a complete loss of allowance due to the untimely filing of required forms "was not consistent with the crime." The study group addressed several alternatives to a payback penalty under the current concept of requiring a form to be on file prior to the taking of an allowance. The group observed that the payback penalty was rooted in the concept that qualification for an allowance deduction was subject to the filing of a form. While the study group did not reject this concept, it concluded that the penalty of a loss of allowance was not necessarily consistent with the agency's objectives.

The group observed that the agency's primary interest is effectively administering allowances through a regulatory information gathering and notice process. The objective is to gather timely and accurate actual cost information to assess the legitimacy of allowance deductions as opposed to generating a revenue stream by focusing sanctions on the filing dates of forms containing estimated cost information. The group was able to reach agreement that the current payback sanction was excessive after considering a number of alternatives. The study group reached an agreement on the option of "Federal Oil and Gas Royalty Management Act (FOGRMA) Late Payment Interest plus a Fixed Percentage of the Amount of the Allowance" as the preferred alternative to the payback. However, the group was not able to reach agreement on the specific fixed percentage of the allowance amount.

## c. The Need for Regulatory Approval Thresholds

The study group concluded that the current thresholds should remain in place. Their conclusion was based on the relatively low activity level of requests to exceed the current thresholds of 50 percent for transportation allowances and 66% percent for processing allowances. It also was based on the reasonableness of providing increased agency scrutiny to those instances involving allowance costs that consume an unusually large amount of the royalty value.

## d. Alternative Approaches to Administer Allowances

The study group formulated a proposed alternative approach to information gathering for allowance administration. This approach is further discussed later in the preamble.

## III. Recommendations of the Study Group

The study group recommended that MMS:

- a. On a prospective basis, pursue changing its current regulatory reporting requirements in several respects. These changes should reduce the focus on the submittal of estimated allowance information that has little value to the agency and increase the focus on the actual information that has substantive value to the agency. Complete implementation of this recommendation could involve changes in regulations, forms, and systems software over a period of several years. In the near term, MMS should expedite those changes that do not require regulatory action; e.g., changes to the current allowance forms.
- b. On a prospective basis, pursue changing, consistent with the first recommendation, the current regulatory sanctions for failure to timely file required allowance forms. Sanctions should be changed to create meaningful incentives for payors to file actual cost allowance forms. Existing sanctions in the form of allowance payback and late payment interest for the "estimated" cost information should be changed consistent with the proposed alternative approach to administering allowances.
- c. Retain the existing regulatory requirements that payors receive annual agency approval prior to taking transportation and processing allowances that exceed 50 percent and 662/3 percent, respectively, of the royalty value of the product subject to the allowance deduction.
- d. Publish the results of the public commentary received in response to the **Federal Register** Notice dated November 28, 1988, regarding extraordinary cost allowances. Further comment should also be solicited to identify circumstances that may have developed in the interim that MMS should consider.
- e. Pursue establishing automated data bases to capture the detailed actual allowance cost information payors submit and develop and implement edits and exception processing routines to monitor actual allowance costs reported on allowance forms and the Form MMS–2014.

## IV. Alternative Approach Suggested by Study Group

The study group's report provided an alternative approach to administering allowances based on its conclusions that:

- MMS should continue to focus on the administration of allowances through information gathering methods that supplement the Form MMS-2014.
- MMS should focus its allowance administration efforts on actual costs instead of estimated costs.

• The current penalty structure for failing to file required forms not only places undue focus on estimated allowance information but also results in penalties "inappropriate for the crime."

The study group believed that the alternative approach would provide MMS with the necessary notice and information that it needs to properly administer allowances, reduce current information reporting requirements, and possess sufficient incentives for payors to comply with the reporting requirements of the regulations. Prototype forms were also developed that could be used in the process of implementing the alternative approach.

The framework of the alternative approach the study group developed is described below:

a. Royalty payors would continue to be required to submit a Notice of Intent to Take Transportation and Processing Allowances prior to the beginning of each allowance year or within the allowance year. One form, instead of three, would be used for all allowance types and would be filed at the payor code/lease level rather than the payor code/lease number/revenue source/ product code/selling arrangement level. The report would not include an estimated rate. Failure to file this notice would constitute a missing report with the payor being assessed \$10 per allowance line required on the Notice of Intent To Take Transportation and Processing Allowances.

b. Three months following the end of each allowance year, the payor would continue to file an actual cost allowance report. For arm's-length allowances, the report would show the payor code/lease number/revenue source/product code/selling arrangement on which allowances were taken. MMS would gather actual cost data from the AFS as needed. For non-arm's-length allowances, the detailed cost breakouts currently required would continue to be provided. MMS would continue to grant, upon request, extensions of up to three months to file actual cost reports.

Payors failing to timely file required forms would be assessed an amount equal to a fixed percent, to be determined through rulemaking, of the total allowance amount deducted on Forms MMS–2014 during the year plus an amount calculated as equal to late payment interest from the date the actual cost form was due until the date the form is actually received.

MMS concludes that the recommendations of the study group will serve to improve its administration of oil and gas allowances, particularly as related to forms filing requirements and