

Report from DOI's Office of the Inspector General

<http://www.Osages-You-Need-To-Know.com>

October 25, 2014

The results of an investigation commencing over 2 years ago into the operations of the Osage Agency at Pawhuska have finally been made public. I have chosen to list several highlights of the report below. Following that, I have included a link to the entire report. This report is a long read, but please don't miss a word of it. This is very important to every Shareholder.

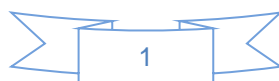
In My Opinion:

Councilmen Yates, Crum, and Abbott took a lot of heat from their fellow Councilpersons and from a few Shareholders and many Producers for taking the positions they did during the Negotiated Rulemaking process. Now it looks like the OIG has endorsed about everything they did. This will no doubt cost the Producers a little money to get into compliance, but these CFR's haven't been substantially updated in over 20 years, and some of the rules in the old CFR's were not being enforced. It's going to be a little tough on some of our Producers for a while, but it can't be helped. Lower oil prices and this Donelson lawsuit aren't helping either.

Accountability at BIA is coming, but it is going to take at least 2 more years to get everything up and running. I like everything I see in this report and the responses, except #22 concerning well plugging and remediation. Much more needs to be done with this issue, but at least this is not an issue that is causing us a lot of lost revenue. I guess it will still be there when the other revenue producing issues are better under control.

Oil prices are still down, and although going to the NYMEX based price for royalty oil will help some late next year, it is still looking pretty grim for our March and June, 2015 payment checks. December, 2014 is still looking fairly decent, and we were told at the last Council meeting that OST will be adding some money that has been long overdue, and has finally been released by the US Congress. I have found out that this is money owed since Hulah Lake was built, and also money from a "whereabouts unknown" account maintained by the OST. The additional funds will be about \$1.5 million, a welcome boost for December.

Ray McClain, Osage Mineral Estate Beneficiary



Report from DOI's Office of the Inspector General

<http://www.Osages-You-Need-To-Know.com>

October 25, 2014

HIGHLIGHTS FROM THE OIG REPORT

Page 1: Council has been impeding BIA's efforts to improve by exerting significant influence over the Agency, which inhibits the Agency's ability to manage the Tribe's oil & gas program. Specifically, we found weaknesses in many aspects of the Agency's oil and gas activities, including issues with policies and procedures, environmental compliance, planning and mineral resource management, and data management. **A substantial cause for these deficiencies is poor oversight by a prior Agency superintendent, and insufficient staffing and training.**

Poor oversight by Agency leadership is a major cause of these deficiencies, especially relating to oil and gas activities. Considering that interpretation of many of the regulations is left to the superintendent, this person should be proactive and knowledgeable in oil and gas issues.

Page 3: The Agency operates under BIA's Eastern Oklahoma Regional Office, and oversees and provides services to the Osage Nation. The Osage Nation's mineral estate covers approximately 1.5 million acres in Osage County, OK. The combined oil and gas royalties in fiscal years (FYs) 2010 and 2011 were \$224 million.

Agency records indicate that the Osage Nation has 4,453 current leases with approximately 14,500 producing wells. Agency officials expect that operators will drill an additional 7,500 wells between FYs 2012 and 2027, generating \$13.6 billion in estimated royalties.

Page 5: We found weaknesses in many aspects of the Agency's oil and gas activities, including issues with policies and procedures, environmental compliance, planning and mineral resource management, and data management. A substantial cause for these deficiencies is poor oversight by a prior Agency superintendent and insufficient staffing and training.

Report from DOI's Office of the Inspector General

<http://www.Osages-You-Need-To-Know.com>

October 25, 2014

The Agency is obligated to manage the program in the most prudent manner and in the best interest of the headright holders. We found, however, significant external influences over Agency policies and procedures that inhibit effective management, including resistance of additional oversight and accountability by the Council.

We found, however, that BIA has the ultimate responsibility to manage the Osage Nation's oil and gas program under the Act and 25 C.F.R. part 226, and it does have the authority to make changes to the program. Specifically, BIA can change 25 C.F.R. part 226 to mirror other Indian oil and gas regulations in many respects. Not only does BIA have the authority, but it also has the obligation to manage the Osage Nation's oil and gas resources effectively so that headright holders receive the best value for their oil and gas.

In order to correct deficiencies, however, BIA will need to make significant changes to the program. These changes will ultimately be in the best interest of the Osage Nation and its headright holders.

In 1990, we reported similar deficiencies in the Agency's management of the Osage Nation's oil and gas program. The Agency has not corrected these deficiencies. As such, it still struggles with vague regulations, insufficient policies and procedures, an antiquated data system, and inadequate capabilities in oil and gas management.

Page 6: *Nothing prohibits BIA from delegating responsibilities for many of the Osage Agency's functions by using interagency memoranda of understanding (MOUs) with BLM and ONRR for those agencies to use their expertise and perform specialized work while leaving ultimate responsibility and accountability with BIA.*

Page 10: *We calculated almost \$47,000 lost in potential royalty payments from eight lessees during the month of January 2013 (see Appendix 3). These lessees paid \$178,569 in royalties. If the lessees had paid royalties based on the full market price, however, the royalty payments would have been \$225,221, a 26 percent increase in royalties to the headright holders. The*

Report from DOI's Office of the Inspector General

<http://www.Osages-You-Need-To-Know.com>

October 25, 2014

potential royalties would be substantially higher since our analysis only covered 1 month.

Page 11. **Oil & gas transportation deductions—**

We noted inconsistencies in how companies and the Agency interpreted and applied allowances, thereby making it difficult or impossible for the Agency to regulate them effectively. We found one company that has used the wrong regulations since 1977 to calculate transportation allowances. The company used ONRR's, or its predecessors', regulations, which do not apply to the Osage Nation. As a result, the Agency has allowed the company to continue to deduct transportation allowances, reducing its royalty payments to headright holders for over 35 years under the wrong regulations.

Furthermore, the Agency could not provide a comprehensive list of leases claiming these allowances or determine the full impact on royalties due to limitations by the Agency's information system.

Page 14: *DOI and the Agency are responsible, however, for managing the Osage Nation's lands appropriately; being accountable to Federal laws, rules, and regulations; and fulfilling their mission of stewardship. Central to those responsibilities is the **NEPA**, which requires agencies to evaluate whether a given Federal action will have a significant environmental impact.*

The Agency currently relies on a single environmental assessment from 1979 for its Osage mineral leasing NEPA compliance. The fact that the Agency has not conducted any further NEPA review of these activities since its 1979 environmental assessment has exposed it to litigation risk under the NEPA. We have noted this litigation risk throughout the course of our evaluation, and now such lawsuits have been filed.

Page 22: *BIA disagreed with our NPFR's recommendation to work with USGS to request a mineral resource assessment of the Osage Nation's mineral estate, but said it would facilitate contact between USGS and the Osage Nation if the Council requested it. We believe it would be in the best*

Report from DOI's Office of the Inspector General

<http://www.Osages-You-Need-To-Know.com>

October 25, 2014

interest of the Agency to know the size and energy potential of the Osage Nation's mineral estate for long-term planning.

Page 32: **Conclusion**

The Osage Nation's mineral estate has the potential to generate billions of dollars of oil and gas royalties and provides annuity payments to headright holders. As noted in this report, BIA faces challenges to correct the deficiencies of a fundamentally flawed program. These deficiencies include inadequate oil and gas policies and procedures, problems in environmental compliance, poor planning and mineral resource management, and inefficient data management. A strong management emphasis from the Agency is needed to bring program consistency and guidance over the Osage Nation's oil and gas operations to ensure that headright holders receive the full royalties they are due.

Page 32 thru 42

The DOI's Office of the Inspector General found 33 major problems, and offered suggestions on how to resolve them. The BIA agreed with 27 of the findings, and have already begun or have finished implementing resolutions on 5 others. BIA did not agree with the recommendations concerning well plugging and remediation (#22). RMc

Page 48: BIA Director Mike Black's response to the OIG evaluation is of particular interest.

Clicking on the following link will bring up the full report from the Office of the Inspector General----

<http://www.doi.gov/oig/reports/upload/CR-EV-BIA-0002-2013Public1.pdf>