

**Federal Oil Valuation Rulemaking Workshop  
Washington, D.C.  
January 20, 2000**

**MINUTES OF PROCEEDINGS**

**Opening statements**

MMS

Lucy Querques Denett

Introduced the panel members and welcomed the participants.

Introduced the purpose of the workshop:

- Focus workshop on changes to the rule
- Intent to publish final rule on March 15, 2000
- Encouraged constructive dialogue
- Encouraged comments from States, industry, and public interest groups
- Comment period ends January 31, 2000
- Any opening statements?

State of Wyoming

“Thank you for providing the State of Wyoming an opportunity to comment on this extremely important change in valuation methodology for federal royalty purposes.

If the valuation methodology proposed in the new rule is a valid, defensible methods, it might be difficult for the state to justify adopting a different valuation method for royalties in state leases, and maybe even for taxation purposes. This is why it is not lightly that we comment on the proposed rule.

The calculations required to arrive at a netback value from Cushing, Oklahoma may have two opposite effects, neither one yielding a fair value. An independent’s gross proceeds at the lease may actually be higher, based on the local supply and demand forces for his quality of crude, than the Rocky Mountain Region value adjusted for transportation. Both State treasuries and US treasuries would lose royalty revenue. On the opposite side, and for the same reasons, adjusted Rocky Mountain Region value may be higher than gross proceeds. In this case the lessee would pay royalties on phantom income. Neither situation is fair. This is a serious concern.

We applaud the efforts to simplify the administration of the valuation function. However, we must take great care not to paint with too broad a brush for fear of creating another set of complexities that might be tainted with unfair results, or result in unintended administrative burden for industry, as well as, State and federal auditors. For example, there are still questions regarding the Rocky Mountain Region value in terms of having to make adjustments for applicable location and quality differentials, and for transportation costs. These concerns are particularly well-founded given the fact that it is rare for Wyoming oil to ever actually be physically transported to Cushing, Oklahoma. [Thus,] this begs the question, to what will transportation be based on? These uncertainties can not help but increase the administrative burden and costs for industry, as well as, State and federal auditors.

Wyoming encourages MMS to continue to dialogue with the states, Congress, and industry in order [to] resolve these valuation issues. And finally, Wyoming reiterates its position that States should be allowed to take their production in kind, thus resolving all valuation issues.”

(No other opening statements given)

### **MMS overview of current proposal**

Debbie Gibbs Tschudy summarized changes and general provisions in the proposal:

- (1) Affiliate definition: rule would eliminate presumption of control for ownership between 10 and 50 percent; also gives criteria for determining control.
- (2) Same two arm's-length exceptions as in 1988 rule - total consideration/breach of duty to market.
- (3) Preamble and rule have specific language saying MMS won't "second guess" lessee decisions.
- (4) Removed some language such as crude oil "calls."
- (5) Lessee has two options after arm's-length exchanges or non-arm's length transfers followed by arm's length sales: gross proceeds, or index/benchmarks.
- (6) For oil not sold at arm's length, use: index (spot) prices with adjustments for California, benchmarks in Rocky Mountain Region (RMR), and market center spot prices with adjustments for the rest of the country.
- (7) Form MMS-4415 has been eliminated.

- (8) Quality adjustments would be permissible where quality banks exist and do not duplicate other deductions.
- (9) Actual costs for transportation continue to be required, but there is no option to request the use of FERC tariffs in lieu of actual costs in situations involving non-arm's-length transportation agreements.
- (10) A new depreciation schedule would be permitted for new owners based on the amount paid when a pipeline is sold at arm's length.
- (11) Return on investment - even after full pipeline depreciation, the owner can take a rate of return (ROR) against 10 percent of the original capital investment.
- (12) MMS did not propose changes to ROR, but is asking for comments on potential changes, such as multiples of the Standard and Poor's BBB industrial bond rate, weighted average cost of capital, or other methods.
- (13) Summarized "binding determination" language:
  - By Assistant Secretary for Land and Minerals Management (AS/LM): binding on lessee/MMS until AS/LM modifies or rescinds; final DOI action.
  - By RMP staff: binding on MMS and States with delegated audit agreements, but not on lessee; valid until AS/LM modifies or rescinds; not appealable unless an order is issued based on the determination.
  - Or, MMS would not issue a valuation determination if the request is hypothetical or inherently factual, or if the issue is in litigation.

### **"Second-guessing" language**

Industry: Additional language and examples in the preamble would be helpful. Duty to market can represent second guessing. However, MMS has provided additional certainty, especially regarding joint operating agreements and "designee." Many in the industry are now more comfortable in their ability to pay on gross proceeds.

Public Interest Group: We previously supported the new second-guessing language if the rule also included language regarding overall balancing. But the new language does not address overall balancing; this is a problem.

State of California: This is the only change that the State Controller's office supports.

Industry: This proposal, including duty to market and second-guessing concerns, will affect the independents' actual marketing procedures. This rule imposes on actual marketing operations.

### **Binding Valuation Determinations**

Industry: Further preamble examples would be helpful. The previous workshops have helped to clarify MMS's position.

Industry: There are five factors regarding "control" that affiliates are concerned with. If an affiliate needs to know if they have "control," or how to classify, where do they look?

MMS You can request a value determination under 206.107.

State of California: Value determinations for individual companies should be printed in the Federal Register so the information is available for everybody. How does the new rule impact delegated States' rights? MMS should not rescind a decision before all the needed documents have been acquired.

MMS: Should MMS put time limits on valuations?

State of California: Yes, under some circumstances.

Industry: The existing rule states that MMS can employ any provision in the rule. An earlier version of the proposed rule also stated this, but the most recent version does not. This should be put back into the rule. Large companies with multiple sales types would have to allocate each barrel under each disposition. The rule should include an option to apply any method across the board that would be advantageous to the company as long as it is not a disadvantage to the government.

Industry: If MMS is so concerned with value, independents suggest they take in-kind.

### **Definition of Affiliate**

No additional comments were made.

### **Transportation Allowances**

State of California: Form MMS-4415 should not be deleted. The information is needed. State of California: Also opposed method for valuation at alternative disposition points; important points are the market center and the lease. The differential would be understated or overstated and thus not fair to the lessee or the lessor.

Public Interest Group: Agrees that neither Form MMS-4415 nor MMS published differentials should be deleted. It puts MMS at a disadvantage, and the form is useful for tracking. Without the form, there will need to be some standards set otherwise.

Regarding tracing, MMS is going in the right direction, but the new rule puts a large burden on auditors. Perhaps better to limit the number of exchanges after which arm's-length sales values would be accepted for royalty value.

MMS: Most companies will have the necessary information in internal files, and these files are subject to audit.

State of California: For movement to a refinery, MMS would permit deduction of transportation costs to the refinery. The true costs could be greatly overstated. By removing Form MMS-4415, MMS is hurting its ability to confirm those costs.

MMS: MMS would only allow the actual costs to transport to the refinery.

Industry: Thinks MMS headed in right direction regarding transportation. Agrees that ROR should be changed. Regarding the ten percent "base" investment, there should be some return allowed.

State of California: At an earlier meeting, industry was asked to provide information on actual return/costs. Did they provide this information?

MMS: No.

Industry: The regulations would allow actual transportation costs as a deduction. What is MMS' view on specific allowable costs?

MMS: The MMS Payor Handbook will give details on anything that is an allowable, actual cost of transportation.

Industry: Has MMS thought about how to allocate those costs or providing a specific cents-per-barrel deduction as a general allowable cost?

MMS: No, but please submit comments.

Industry: Has MMS made a decision regarding deepwater gathering?

MMS: Yes, that decision was made and is available on the Internet.

Industry: Regarding the RMR benchmark number two, there remains concern about quality adjustments. Appreciates the ability to use arm's-length sales following arm's-length

exchanges. The rule has improved in some areas, but not in RMR. Does MMS see the new proposal as an improvement?

MMS: Yes.

Industry: The MMS proposal shows that MMS is trying to increase certainty. But some uncertainty still exists concerning the 10-50 percent ownership range and the “opposing economic interests” criteria.

When the situation does not involve an affiliate or exchange, commenter requests that MMS let industry choose to pay on arm’s-length value or non-arm’s length methods (index/benchmarks as appropriate). There should be a limit to multiple types of calculations, thus limiting the amount of tracking and preventing some adjustments.

Public Interest Group: Thinks they would support suggestion to give option to pay on arm’s-length value or index/benchmarks.

State of California: Not sure whether they would support it.

Industry: Commenter wanted to represent the views of independents, especially offshore:

The proposal would widen the gap of distrust between MMS and producers. It would not ease administrative burden for independents unless they changed their procedures to sell all their crude outright, at arm’s length, at the lease.

Litigation likely will result if the final rule stays substantially the same as this proposal. Going beyond the lease for valuation is an intrusion, and MMS is creating an ever-increasing duty to market. Believes lessee’s obligation is at the lease only; any farther is beyond the lessee/lessor relationship.

MMS proposal, including duty to market and second-guessing concerns, will affect and intrude on actual marketing operations. If MMS is so concerned with value, it should take the oil in kind. Independents see the proposal as an increasing cost of business. Businesses must control their costs, and given that many independents have gone out of business in recent years, this proposal aggravates the situation.

Proposal would continue to limit independents’ returns and lead to changes in their marketing efforts. In some areas of the world, lessors are hoping independents are successful, unlike in U.S. The larger goal of sustaining domestic production will slip away with implementation of this rule.

MMS: Regarding the new depreciation schedule when pipelines are sold at arm’s length, should MMS account for recapture by the previous owner of sales price paid by the

new owner? If so, how? Should the previous owner adjust past allowances taken, or how else account for the recapture?

Industry: Not sure; perhaps let the IRS take care of it. Will provide written comments on this.

Industry: Will need time to comment on applicability of fixed differentials.  
Moving away from the lease causes difficulty in making appropriate location and quality adjustments.

Asks that MMS take Exxon's successful California litigation into account in using Alaska North Slope (ANS) spot prices. Has MMS addressed the Exxon case? Will submit more information for the record on this case.

MMS: No, MMS did not address the Exxon case in the proposal. The proposed rule is not based on theories rejected in the Exxon case.

State of California: The issue of fair market value was not decided by the Long Beach jury. That case does not impact the validity of the ANS method. Where the AS/LM does a determination in the RMR, suggests the decision be based on transparent market information. MMS should state this in the preamble.

Industry: The preamble suggests that you could go to the nearest market center applicable to your lease. MMS should consider "common" exchanges that don't necessarily involve the nearest market center. For example, West Texas intermediate may not represent either the nearest market center or oil of like quality. Industry should be able to use the most applicable market.

MMS: We will look at this.

-adjournment-

<b>Attendees</b>	<b>Organization</b>
Sara Tays	Exxon Mobil
Debbie Haglund	Exxon Mobil
Sensimone Williams	Exxon Mobil
Gerald Moynier	Equilon Pipeline
George (Chip) Rothschild	Marathon Oil
Roger Good	Marathon Oil
Dow Campbell	Marathon Oil
Danielle Brian	POGO
Beth Daley	POGO
Zehra Nagui	POGO
Lee Helfich	SCO/Lobel, Novins & Lamont
Dave Deal	API
Greg Washington	Texaco
Michael Geesey	State of Wyoming
Mike Matthews	State Of Wyoming
Henry Banta	Lobel, Novins & Lamont
Spofford Canfield	Coastal Corp.
Carl Schmid	DOE
Gary McGee	Devon Energy
Richard H. McPike	Fina Oil and Chemical Co.
George Butler	Chevron
Ben Dillon	IPAA
Bill Whitsitt	DPC
Alby Modiano	US Oil & Gas Association
Shirly Neff	Senate Energy
Mary Katherine Ishey	Senate Energy
Marc Humphries	Congressional Research Svc.
Nancy Marland	DOE, Fossil Energy (SPR)
Mary Ann O'Malley	BP Amoco