Indian Oil Rulemaking Meeting
Denver, Colorado
February 8, 2000

MINUTES OF PROCEEDINGS

Meeting began at 9:15 a.m.

Opening statements

MMS

Debbie Gibbs Tschudy (MMS)

- Introduced the panel members and welcomed participants.

- Gave an overview of the Indian oil rulemaking process:
  1. First Proposal -- January 1997 (Federal and Indian);
  2. February 1998 Proposal -- Separated rulemaking for Indians owing to unique lease terms; and
  3. January 2000 – Supplementary Proposed Rule with changes to the February 1998 proposal.

Noted that this workshop provides opportunities for the public to comment.

- Asked for opening statements from the public: No statements from the public

Dave Hubbard (MMS)

- Gave overview of February 12, 1998, proposed rule and January 6, 2000 , supplementary proposed rule.

- Value under the February 12, 1998, proposed rule would be determined by the highest of three values:
  1. Gross proceeds received by the lessee or its affiliate under an arm's-length contract;
  2. Index price (using NYMEX); and
  3. Major portion price using 75 percentile.

- Transportation from reservation boundary only. A new form was proposed (Form MMS-4416) for oil location and quality differential information.

- Under the January 5, 2000, rule, value would be determined by the highest of three values:
  1. Gross proceeds;
  2. Index price – use average of daily high market center spot prices for the month; and
  3. Major portion price using 75 percentile.

- The January 5 proposal includes several changes from the February 12, 1998, proposal:
  1. Spot price would replace NYMEX;
  2. The spot price calculation would use average of daily high spot prices during the production month rather than 5 highest NYMEX prices;
  3. Major portion value – MMS would publish major portion prices in the <u>Federal Register</u>. The lessee initially reports on the higher of gross proceeds or spot price and, if the MMS-published major portion value is higher, the lessee would have 30 days from publication of the <u>Federal Register</u> notice to make changes to Form MMS -2014;
  4. Transportation would start at lease; and
  5. Form MMS-4416 would be streamlined and include clearer instructions.

<u>**Comments on New Provisions of the Supplementary Proposed Rule**</u>

MMS: Asked for comments on use of the average daily spot price.

Industry:
- Use of the high daily spot prices seems to give high value for royalty.
- Problem with tracking gross proceeds in addition to tracking spot prices under proposed rule for valuation purposes.
- Has MMS noticed that producers are paying above spot prices? Would like to eliminate tracking gross proceeds if it yields no additional value.

Tribes/Indians: In some areas, such as the Northern Ute Reservation, we have seen some higher prices than spot prices. The wax content is higher, but we can understand your problem.

Industry: - The proposed Indian oil valuation rule is an accounting exercise for industry. In order for us to comply with the valuation requirements of this rulemaking, we would have to make major design changes to our current accounting systems. We believe we would have to design a “triple accounting system” to handle the proposed valuation determination methods. This would require us to hire additional people, and we would need to provide additional training for them. Our current accounting system can handle only one pricing determination method for royalty reporting purposes.

- Giant agrees because it would have the same accounting issues for royalty determination. They would need to modify their system to ensure that the proper price is paid.
- Burlington would favor using just the spot price method for royalty determination purposes.
- For some leases, proper value would be down to one alternative.

Tribes/Indian: We would not support elimination of comparing gross proceeds under the sales contract with value determined under major portion pricing method as required under the supplementary proposed rule.

Industry: The Four Corners area is not addressed in rule. Not clear about market centers--other definitions or clarifications are needed. Need definitions of what market centers are, unclear on how value translates back to lease. Gave example where they picked up oil from seller and exchanged elsewhere.

MMS: If production is from New Mexico and applicable spot price is at Midland, Texas, then lessee would claim location/quality differential from the Midland spot price to an aggregation point; then transportation is on actual basis between lease and aggregation point. Form MMS-4416 will aid in the location/quality differential.

Industry: Do aggregation points have pipeline access to the market center? Sometimes there is no pipeline to get to market center.

MMS: How about exchanges? There may be a location/quality differential in buy/sell agreements from the aggregation point to the market center.

Industry: Often there is not a market center nearby. Small producers have outright purchases under arm's-length contracts. If spot price at the market center is transposed to the refinery, then this will distort the picture and cause a problem.

MMS: Do you have a proposed solution?

Industry: Local markets have their own economy. If you use other market centers, then the differential may not be reflective of the local situation. Markets are different at Cushing and Midland. There would be exposure for small companies concerning location/quality differentials. How can a company request approval of location/quality adjustments?

MMS: In situations where a lessee does not have location/quality differential information, the lessee may request that information from MMS. Such a request is similar to requests to exceed 50% limitation under the current regulations. MMS then will approve or disapprove.

Industry: Are there any time limitations for MMS to provide this information?

MMS: There are no time limitations in the proposal.

<u>Approved Publications</u>

MMS: Any comments on the approved publications?

No comment provided from the public.

Notification of Major Portion Prices

MMS: Any comments on the notification procedure?

Industry: Will notification be in the Federal Register?

MMS: That's exactly what the rule says. We could also put information on the Internet.

Indians/Tribes: We would like this information to be immediately available on the Internet. Would there be any distribution problems?

MMS: No, since it is an MMS-calculated price.

Industry: Could there be a "Dear Payor Letter?" Some payors don't have access to the Federal Register or Internet.

MMS: Good comment; lessees can also call us as they are doing under the Indian gas rule.

Industry: Requiring additional payments and adjustments 30 days after major portion price is published is an aggressive deadline; it may be outside of industry's standard accounting cycle. Suggest extending beyond 30 days. If someone represents 30-80 payors, that's a lot of information to process – would be better to have 90 days to process adjustments.

Transportation Allowance Comments

MMS: Are there any comments on transportation allowances – from the lease to the reservation boundary?

Industry: Likes change.

Location Differentials

MMS: Any comments on location differentials?

Industry: Giant provides a service for transportation on behalf of lessees. Pricing is based on arm's-length contracts at the lease, and they factor in transportation and oil quality. There could be 6,000 leases in the Four Corners area; this can be very complex for each of these leases. They may truck oil to refinery or have many other transportation scenarios; they would have multiple transportation rates for one lease. Never a constant – how do they account for this?

For valuing oil at the lease using a spot price, if a lessee sells at the lease – there is no transportation; but there is a cost. There needs to be some consideration of the transportation cost from the lease to the aggregation point in addition to the location differential between the aggregation point and the market center.

MMS: We may have to get information from the purchaser or transporter. Would Giant provide transportation costs?

Industry: Probably (response from Giant).

Tribe/Indians: If there are multiple destinations for the oil, will this affect the price for that oil?

Industry: No.

Tribe/Indians: Does the delivery location significantly change sales prices?

Industry: It's generally based on quality aspects; where it goes; balancing condensate and crude by truck. They consider these costs when negotiation is at the lease.

Agreements on transportation absorbed within the price negotiated. It is not a huge difference between properties, but it is a cost in terms of volumes, quality, etc.

Tribe/Indians: We have been told that Giant is not in the transportation business and we would have to get contracts from producers – we are now hearing differently. Giant will have to provide transportation costs to the producers.

Industry: Transportation rates are fairly easy to access; a lot of costs are not easy to get.

Tribe/Indians: We find it hard to believe that producers do not want this information – it affects value received.

Industry: There is easy access to rates; published rates are easily obtainable. Exchange agreements are made with reference to Midland.

Giant has no problem getting full value for the Navajo Nation. The issue is how this will work.

Contracts changing all the time – more outright purchases than exchanges.

Tribe/Indians: Current regulations tie Navajo hands on arm's-length contracts. New rule should have been out long ago, but Congress put on moratoria. Giant has never given this transportation information.

Industry: Just trying to understand how proposal works.

Tribe/Indians: Can we get contract access?

Industry: Contracts are confidential. Why doesn't the Navajo Nation take its royalty in kind?

Tribe/Indians: Navajo is taking some royalty in kind; we were forced into that. This is a separate issue. This new regulation allows better value at the lease and access to information.

<u>Form MMS-4416</u>

MMS: Any comments on Form MMS-4416?

Industry: Why is it necessary, if you have an evergreen, long-term contract, to file annually?

MMS: If there are no other changes, then only the first few lines need to be filled in on Form MMS-4416.

General Comments

MMS: Are there any general comments?

Industry: Major portion price notification – will MMS make available to lessees? What process does MMS go through? How fast will MMS get information to lessees?

MMS: We will provide notification of major portion prices similar to present procedures for gas. We can't reveal individual information – it's proprietary. You have the right to appeal as well. You must make an appeal within 30 days.

Industry: Lessees would like the verification information when the published prices are out. Needs information in time to appeal. Might also consider putting whatever information possible on Internet.

Changes for Indian Rule Based on Federal Rule

MMS: What if we made the same changes to the proposed Indian rule as proposed for the Federal rule? (e.g., new depreciation schedule if transportation facility sold.)

Industry: If applicable to Indian rule—agree, but we wouldn't want changes to drive the Federal rule.
We would want consistency between all regulations – we would favor that.

MMS: Rate of Return – increase above BBB rate?

Industry: Same response as previously-- consistency is beneficial.

Industry: Any thoughts of publishing an estimated differential up front? For example, lessee may have to use spot price at beginning without published differential.

MMS: Location/quality differentials would be published at inception of rule and annually. Under the proposal, MMS would collect location/quality differential data on its new Form MMS-4416. Industry must complete this form and send it to MMS within 60 days of publication of the final Indian oil valuation rule. MMS will then publish location/quality differential data in the Federal Register within 60-days; i.e., 120 days after the final Indian oil rule is published. After that MMS will publish by January 30 of each year location/quality differential data received on Form MMS-4416.

Industry: How would a differential be calculated if there is no exchange from Wind River to Cushing?

MMS: You would have to make a proposal to us.

Industry: We would need to talk to our traders before making a proposal to MMS concerning calculation of differential data.

Industry: How about where no exchanges occur? You need to have a fallback procedure. If there are no indexes that fit a company, need to know what we could use in their absence.

MMS: Any comments on recapture of part of allowance previously claimed where lessee sells transportation facility?

Industry: Should not try to recapture; MMS doesn't permit some other costs that possibly should be allowed – also, what if there is a loss? Could happen, if sold a few years into facility life.

You don't offer accelerated depreciation – only straight line or units of production.

It is possible to sell at a loss. Your costs should include everything – how about environmental, etc.?

Break at 10:20 a.m.

Start at 10:40 a.m.

Further comments

MMS: Are there further comments?

Industry: IPAMS requests an extension of time for comment period. We would like a 45-day extension.

Tribe/Indians: Nothing we have heard here today would warrant an extension of time.

Proposed rule generally reflects the compromise between Indians and industry. Unfortunately, we were subject to moratoria for two years because of the vague language of Congress' intent. Comments and feedback on original proposal resulted in changes favorable to industry. We have allowed enough time for comments. Need to finalize and implement as soon as possible with no time extensions.

Another tribal representative concurred that MMS needs to finalize as soon as possible.

Ute Tribe agrees with the Navajo Nation to move on with the rule; we have people depending on this money. No need for new extensions.

Is there anything specific industry is looking at in terms of further changes? If there were a time extension – need to discuss – preferably at Farmington.

Industry: We will have other comments.

Industry: Question on tracking gross proceeds independently of index. We need time to develop this information. Is the economic analysis available?

MMS: Yes, from Mr. Dave Guzy. (Regulations and Publications Staff of MMS)

Industry: Issue of major portion not based on proceeds paid in field or area. Also, asks for extension of comment period. We will have significant comments.

Tribe/Indians: Believes there is sufficient time (120 days) for system adjustments. We like the rule because we can get differentials, transportation, and have better idea of value of oil. No further extension warranted. If the true value of oil were reported, we would not be here.

Industry: Believes there was no industry participation in this rulemaking effort.

Doesn't think small producers understand proposal. Don't know impacts of rule.

Carla Wilson works on behalf of hundreds of independents; needs extra time to coordinate comments.

Tribe/Indians: Form MS-4416 – likes information provided, thinks reporting burden is minimal. There should be enough time to determine the true value. From these reports we should get what is being paid and produced. As long as this is correct, then this derives value. Form MMS-4416 provides valuable information that doesn't require divulging specific contract information, such as parties involved.

Industry: Needs contracts to report correctly. Wind River -- they sell at wellhead with no transportation. The price accounts for all charges – there are no hidden charges here. It's a contract made at a price. Purchasers would have double the work.

The purchasers will not pay royalties on behalf of the lessee anymore. Why not take it in kind? Payors will have twice as much work as they do now.

Rule has some positive aspects -- major portion has certainty. Thinks value under proposal is a major portion proxy. Tracing is burdensome because of difficulties in allocating value back to lease. Consider doing away with tracking gross proceeds. Suggest just reporting on formula price.

This rule gets to a proxy value, not actual value. Same with gas rule. Allocating production back to lease is also a proxy value method. Major portion is a proxy.

At some point purchasers won't want to be burdened with tracing – payor responsible.

It can affect what the independents pay out of pocket. At the market center, they would pay above what they actually receive for the oil. Add administration costs and you have a problem.

Tribe/Indians: Navajo was referring to the marketing experts used by MMS and not industry participants (referring to an earlier issue concerning industry participation).

Industry: For a wellhead sale, the purchaser provides the transportation for the lessee – this is not captured on Form MMS-4416. The form will not get everything.
The purchaser may include transportation under the purchase price – differential may be imbedded.

MMS: Do you have a suggestion on how to change Form MMS-4416?

Industry: This is a major clarification. We won't have invoices to show costs; conceptually, lessee would have to find out transportation cost that may be imbedded in purchase price.

MMS: We may need to clarify that purchaser must provide the transportation cost to MMS if they won't give to the lessee.

Industry: Giant has one comment -- anyone who provides services may have to step out of the way. If there are 80 lessees that they report for, then there's a problem. The proposed rule is too complex, lease-by-lease, and is not as simple as proposed. Leases get transferred and sold. Giant could be liable for later re-determination of value.

MMS: Any specific changes to reflect these concerns?

Industry: Giant provides reporting services. They want a provision that they're not responsible after the fact. MMS should go to the producer, not the remitter. Giant will not continue to report for others if it is an exposure to Giant. They don't want the liability of re-determination.

Purchasers won't continue to provide reporting service.

MMS: The intent of the rule is simplification; removing the uncertainty benefits everyone.

Industry: Yes, but don't think certainty is provided. It's a good concept, but we can't follow it. Who pays for additional royalty when we are doing this as a service to others? We may have a liability in this case. If there is a re-determination that we paid the wrong price, we may be liable.

Meeting closed ---- 11:25 a.m.