

September 7, 2004

Minerals Management Service
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COMMENTS ON PROPOSED GAS VALUATION RULE

The Council of Petroleum Accountants Societies (COPAS) appreciates the opportunity to comment on the MMS proposed Federal Gas Valuation Rule published in the Federal Register on July 23, 2004 (pages 43944-43955). COPAS members have extensive experience with Minerals Revenue Management (MRM) rules and handle royalty valuation, determining applicable deductions, adjustments, audits and other royalty matters on a regular basis. Therefore, we believe our comments will be beneficial in improving the MRM processes for both the MMS and industry.

Use of Publicly Available Spot Prices and Location Differentials

COPAS supports a move towards simplifying the current process and providing certainty in the valuation of non-arm's-length gas sales. The current regulations are not only administratively burdensome, but provide little to no certainty, resulting in costly and manpower intensive audits. The usage of published natural gas indices and location differentials for gas not sold under arm's-length contracts should be pursued. At the same time, it is a complex subject so COPAS recommends that the MMS and industry work together to develop a process and regulations that are clear, simple and fair. The MMS and industry also need to identify how to handle non-arm's-length situations where there currently are not any published natural gas indices.

COPAS also recommends that the MMS allow lessees the option to use gas index pricing points for their arm's-length gas sales. The use of index pricing points for arm's-length gas sales would be limited to areas where there is an active spot market and published indices.

This was recommended in 1995/6 by the Federal Gas Valuation Negotiated Rulemaking Committee.

We also noticed that the MMS did not address NGL valuation in the proposed Federal Gas Valuation Rule. As with the valuation for gas sales, COPAS supports a move towards simplifying the current process and providing certainty in the valuation of non-arms length (and possibly arm's-length) NGL sales. The current regulations for NGL valuation are also administratively burdensome, provide little to no certainty, and result in costly and manpower intensive audits. COPAS recommends that the MMS and industry work together to develop a process and regulations that are clear, simple and fair.

Proposed Amendment of Section 206.150(b) Written Agreements

COPAS believes this is a good change to the current regulations concerning written agreements between the lessee and the MMS Director.

Section 206.157 Determination of Allowances – Rate of Return

The MMS should use the same rate of return to calculate all costs being used for non-arm's-length calculations. COPAS commends the MMS for increasing the rate of return in calculating transportation costs in non-arm's-length situations for both oil and gas royalties. COPAS recommends that the MMS appropriately change the rate to calculate costs for non-arm's-length processing plants to be the same as the rate for transportation costs.

Non-arm's Length Processing and Transportation Allowances

Under the current regulations producers are allowed to estimate the processing and/or transportation allowance for a given year for non-arm's length processing and/or transportation agreements and then adjust the reported allowance after the actual is calculated. This procedure requires the reversal of the twelve months of estimated processing and/or transportation allowance deductions and then having to report them again to the MMS with the actual processing and/or transportation allowances for those same twelve months. This is an extremely burdensome process on the producers, as it results in the reversal and rebookings for thousands of lines for each month. COPAS recommends the MMS and industry work together to develop a process and regulation that meets the needs of the MMS but reduces the reporting burden on both industry and the MMS. The MMS may want to look at how this is handled by New Mexico (eg. use last year's actual costs and volumes to calculate the rate to be used for the current year reporting). This would significantly reduce the number of amendments having to be filed each year.

Section 206.157(b)(5) – More Restrictive Use of Approved Transportation Tariffs

COPAS disagrees with the MMS proposed limitations on what exceptions the MMS will approve to the requirement that companies compute actual costs. We believe the current

use of FERC/State approved tariffs provides certainty to both industry and the MMS and represents fair and reasonable transportation charges. The proposed limitations that MMS would apply would result in the duplication of effort between the MMS, the FERC and State agencies. Furthermore, obtaining the information to do these calculations would be problematic and burdensome at best due to the governmental restrictions placed on pipeline companies in sharing information with shippers. It should be noted that this proposal is in direct opposition to FERC Order 2004. The proposed changes will result in industry having to calculate their actual costs in more situations than they currently do, and the new uncertainty will unnecessarily increase industry's, the MMS's, and the state's audit and resolution costs. Finally, the proposal is not sufficiently clear on what the MMS intends by "adjudicated" or "analyzed". How can we determine whether an approved tariff has been "adjudicated" or sufficiently "analyzed" to meet the MMS criteria?

Section 206.157(1) Firm Demand Charges

COPAS agrees with the proposed change which allows the deduction of unused firm capacity as transportation costs.

Section 206.157(f)(7) Actual and Theoretical Line Losses

COPAS supports the change to allow the deduction of "actual" line loss under non-arm's-length transportation arrangements. We would also appreciate the MMS fully defining what is "line loss".

Section 206.157(f)(10) Letter of Credit/Surety

We also agree with the MMS proposed change to allow the cost of obtaining a letter of credit or surety under arm's-length contracts to be deducted for transportation.

Recapitalization

The Gas Proposal does not address the recapitalization and depreciation of gas transportation equipment, and therefore is not consistent with the Oil Valuation Rule.

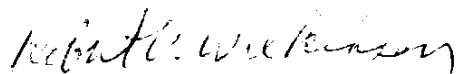
Keepwhole Accounting

Finally, COPAS supports a move towards simplifying the process of reporting and paying royalties due the MMS. Progress continues to be made in the latest proposed revisions to the gas valuation. However, there appears to be no consideration toward simplification as it relates to keep-whole accounting. The only information on keep-whole accounting is found in the Oil and Gas Payor Handbook Section 4.3.5. It is in that section that the MMS has provided the reporting requirements and illustrates how to value gas under a keep-whole agreement. The illustration shown assumes the producer/reporter has available the plant efficiencies necessary to calculate the NGL's and that the processor provides the value received for the NGL's it sold. By its nature, keep-whole agreements do not provide the producer with the processor's plant efficiencies nor is the producer knowledgeable of

the value the processor receives for the NGL's sold. Without this information, the producer is forced to estimate plant efficiencies and NGL values to comply with the MMS reporting requirements for keep-whole accounting (report as processed gas). The MMS should review the keep-whole accounting requirements and take the opportunity to simplify the current procedures which are administratively burdensome, provide little to no certainty, and result in costly and manpower intensive audits.

COPAS appreciates the opportunity to provide comments to this proposed rule. If you have any questions regarding our comments, please call me at (918) 925-7055.

Sincerely,

A handwritten signature in black ink that reads "Robert O. Wilkinson". The signature is written in a cursive style.

Robert O. Wilkinson
Chairman, COPAS Federal Affairs Subcommittee

Cc Marvinette Ponder, COPAS Revenue Chairperson