September 21, 2004

VIA E-MAIL (MRM.comments@mms.gov)
Attn: RIN 1010-AD05

ORIGINAL TO FOLLOW BY OVERNIGHT MAIL

Minerals Management Service
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MINERALS MANAGEMENT SERVICE, FEDERAL GAS VALUATION PROPOSAL, 30 C.F.R. Part 206, 69 Fed. Reg. 43,944 (July 23, 2004)

To Whom It May Concern:

ChevronTexaco Exploration & Production Company, a division of Chevron U.S.A. Inc ("ChevronTexaco"), appreciates the opportunity to comment on the subject notice regarding proposed revisions to the federal gas valuation rules. As one of the largest payors of royalties on gas produced from federal leases, ChevronTexaco is significantly affected by the proposed rule.

ChevronTexaco endorses and incorporates by reference the comments filed in response to this proposal by the Council of Petroleum Accountants Societies dated September 7, 2004, and the comments filed by the Royalty Strategy Task Force ("RSTF") dated September 21, 2004. Additionally, ChevronTexaco calls the attention of the Minerals Management Service ("MMS") to Section 9 of those comments, "Valuation Standards – Benchmarking or Indexing". We augment that discussion with the following further comments.

ChevronTexaco supports revising the current gas rules to rely on index prices to value gas not sold at arm's-length because reliance on indices will provide lessees and the Government with the most certainty reasonably possible that lessees' initial valuations will be correct and thus avoid audit and adjustment costs. Practice has shown that the current regulations do not provide lessees with any guarantee that a good faith effort to apply them will result in a royalty value that is acceptable to MMS or delegated state auditors. Moreover, certainty that lessees' initial valuations are correct has a dollar value because it will result in a significant lowering of administrative costs for both the Government and lessees.

The recent decision of the Interior Board of Land Appeals (the "Board") in Tom Brown, Inc. ("Tom Brown"),1 exemplifies the uncertainty regarding valuation inherent in the current rules. The decision demonstrates that, even following the resolution of the gross proceeds rule dispute by the decision in Fina Oil & Chem. Co. v. Norton,2 the proper application of the benchmarks remains a subject of debate. In Tom Brown, the Board struck down an MMS decision holding that the gross proceeds rule required Tom Brown, Inc. ("TBI"), to value its production based on gas sales prices received by its affiliate. However, the Board also remanded the case to MMS for a further determination as to whether TBI's valuation was correct under the benchmarks.3 It remanded over TBI's objection that valuation was appropriate under the first benchmark because TBI used the price it paid to its affiliate, and that price was identical to prices the affiliate paid at arm's-length for gas from the same field.4 The Board, nevertheless, was persuaded by MMS's argument that remand was necessary because the evaluation of comparability under the first benchmark required consideration of "such factors as price, time of execution, duration, market served, terms, quality, and volume of gas."5

To resolve the uncertainty problem inherent in the current gas rules, ChevronTexaco supports promulgation by the MMS of a rule relying on index prices to value natural gas. Adopting market based index prices would provide a balanced, reliable, and transparent mechanism for federal royalty valuation of natural gas not sold at arm's length. Indices are highly representative of market prices because they are derived from actual prices transacted at numerous locations across the pipeline grid. The benefit of adopting market-based index prices is that their adoption ensures that federal royalty valuation of gas not sold at arm's length is accurate and minimizes royalty disputes.

Further, adoption of indices by MMS would be appropriate because most natural gas producers and other significant industry participants, including the MMS in its royalty-in-kind program, rely heavily on indices in conducting their business. Recognizing the importance of indices to the gas markets, some of these market participants and FERC have recently taken critical action to ensure the accuracy and integrity of the price data being reported. Their efforts culminated in FERC's issuance on July 24, 2003 of a Policy Statement on Natural Gas and Electricity Price Indices ("Policy Statement").6

In May of this year, FERC staff published a Report on Natural Gas and Electricity Price Indices ("Staff Report") evaluating the effect of the Policy Statement on natural gas price reporting based on surveys of market participants and finding that many positive changes have occurred. The Staff Report found that index developers have "taken significant steps to conform to" the rigorous control policies set forth in the Policy Statement regarding the way pricing data should be gathered.7 It also found that both the quantity and quality of price reporting have improved since issuance of the Policy Statement.8 Further, the Staff Report indicated that respondents to FERC staff's survey "cite[d] a high level of dependence on natural gas indices as price references in contracts . . . ."9 This dependence evidences confidence on the part of market participants in index prices. In fact, the survey showed confidence among participants to average at 7 on a 1 to 10 scale.10

ChevronTexaco is supportive of steps being taken by index developers that collect the data being reported to ensure that the indices published are true and accurate. Moreover, analytical testing procedures can be used by index developers to identify any questionable pricing. The added security of proper controls and policies over indices is resulting in more industry participants voluntarily reporting prices and thus leading to further improvements in price discovery, transparency, and liquidity at most locations across the pipeline grid.

ChevronTexaco recognizes that in some instances an adjustment between index pricing points and the lease would be appropriate. ChevronTexaco believes, however, that these adjustments could readily be effectuated through the use of actual or published transportation costs from a lease to the pricing point. Additionally, because gas index pricing points tend to be closer to the leases than do oil index pricing points, making such location adjustments should be significantly easier for gas than it has been for oil.

In sum, ChevronTexaco supports MMS's promulgation of a rule relying on index prices to value gas not sold at arm's-length because index prices provide the most accurate and transparent gas pricing information available and, as a result, reliance on indices would add greatly to royalty valuation certainty.

Respectfully submitted,

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1 162 IBLA 227 (July 27, 2004).
2 332 F.3d 672 (D.C. Cir. 2003).
3 Tom Brown, 162 IBLA at 233-34.
4 Id. at 229-30.
5 Id. at 234 (citing 30 C.F.R. § 206.152(c)(1)).
6 104 FERC ¶ 61,121 (2003).
7 Staff Report at 2.
8 Id.
9 Id. at 2-3.
10 Id. at 3.