



Office of the Governor

September 17, 2004

Minerals Management Service
Minerals Revenue Management
Chief of Staff
P.O. Box 25165, MS 302B2
Denver, Colorado 80225-0165

Via email: mrn.comments@mms.gov

Attn: RIN 1010-AD05

Thank you for the opportunity to comment on the Minerals Management Service's (MMS) proposal to amend the existing regulations governing the valuation of gas for royalty purposes produced from federal leases.

Section 206.150(b) Written agreements between Lessee and the MMS Director

We do not believe it is in the States' nor the publics' best interest to allow the MMS Director to avoid the regulations that are subject to notice and comment. Any agreement reached between the MMS Director and the lessee should be consistent with the regulations, or the regulations should govern to the extent of the inconsistency. At the very minimum, the regulations should require that such agreements obtain state approval if such agreements affect a State's interest or the State's share of the federal royalties. Requiring a state's approval on written agreements encompassing federal leases located within that state preserves the Secretary of Interiors' policy of the four Cs: conservation through communication, consultation, and cooperation. This language was not discussed at any of the workshops.

Section 206.151 Definitions

Affiliate

We support the added language further clarifying the definition of Affiliate. We would further recommend that the word "only" be removed, or changed to "any of" in the definition of

Marketing affiliate in keeping with the United States Court of Appeals' rational in *Fina Oil and Chemical Company v. Gale Norton*, 332 F.3d 672 (C.A.D.C., 2003) as to what is necessary to require valuations based on down stream resales. The proposed language of §206.157(b)(5) removes "only" without even commenting on its removal, and yet it was the presence of "only" in the definition of Marketing Affiliate that the court in *Fina* addressed as a regulatory flaw that could be changed in precisely this manner. We hope this opportunity to conform to the *Fina* decision is not missed.

Allowance

We support the added language further clarifying that Transportation Allowance means reasonable, actual costs. However, we do not support the definition to the extent it could be applied inconsistent with the marketability rule, such as providing for an allowance for the movement of unprocessed gas to a point of delivery off-lease, if that point of delivery is a gas plant or gas treating facility.

Arm's-length contract

We support the added language further clarifying the definition of Arm's-length contract. However, we question whether the definition adequately addresses reciprocal trading based on an index. We have experienced industry "mischief" in reporting and paying royalties under reciprocity deals and would expect the MMS will encounter the same if the definition excludes that specific type transaction.

Section 206.157 Determination of Transportation allowances

The MMS proposes to allow industry to increase the rate of return for determining transportation allowances from Standard Poor's BBB bond rating to 1.3 times the BBB bond rate. Industry's efforts to increase the rate of return were rejected during 1988 and 2000 rulemaking. MMS explained that this junk bond rate "is higher than these companies actual borrowing rates would be." 65 Fed. Reg. at 14051. Interest rates have recently hit all time lows so why increase return on investment in a period of historically low cost of capital rates. MMS's own Economics Division study found that the BBB bond rate is a fair rate, if an ROI should be allowed at all.

We support MMS changes to the use of FERC tariffs in non-arms length situations. We support MMS's allowance of an exception based on the weighted average of rates paid by third parties as a comparable. However, industry is adamant and we concur that comparables should be of "like quantities." The exception should be based on the weighted average of rates paid by third parties for "like quantities."

September 17, 2004

We support the clarification provided by the new paragraphs §206.157 (c)(1)(iii) and (c)(2)(v). Furthermore, we support MMS's addition of three new paragraphs §206.157(g)(5), (g)(6), and (g)(7) to redesignate the current paragraph (g)(5) as (g)(8). These new paragraphs further specify and clarify costs that are not allowable in determining transportation allowances.

Unused firm demand and costs of surety are indirect costs. MMS should only allow actual direct reasonable transportation costs to be deducted. Not only are line losses indirect costs they are a direct result of metering differences and very inaccurate; as such, they should not be an allowable deduction carved out of the royalty owners remaining 1/8 interest.

Unused firm demand charges, the cost of securing a line of credit, and the Rate of Return for the determination of transportation allowances are all costs of doing business. Line loss is the risk of doing business. The economics of any development project is contingent upon the value of the gas in the field. The royalty owner owns all of the gas in the field. Therefore the entire costs of any project are going to be borne by the royalty owner, as derived through the value of the royalty owner's gas as it exists in the field in its entirety prior to dividing it up. The royalty owner pays 7/8 of its gas to the producer to bring the remaining 1/8 of its gas out of the ground in a marketable condition. The royalty owner has already compensated the producer for his services, when the royalty owner pays the producer 7/8 of the royalty owner's gas in the field. Therefore the producer has already been compensated for the costs of doing business -- such costs are included in the 7/8's of the gas relinquished by royalty owner to producer for his services. Additional allowances and deductions transfer costs from the royalty owner's relinquished 7/8's gas to the royalty owner's remaining gas, thus inappropriately reducing that last 1/8 ownership interest even further.

Thank you for the opportunity to comment. I hope these observations are useful and will be implemented in determining the final form of the regulations.

Best regards,



Dave Freudenthal
Governor

DF:bjw