Minutes from Meeting with Inter-Association Royalty Strategies Task Force
Proposed Federal Gas Valuation Rule
September 9, 2004

On September 9, 2004, representatives from MMS met with the Inter-Association Royalty Strategies Task (RSTF) in Houston, Texas. Among the numerous agenda items, was a discussion of the proposed Federal gas valuation rule. Because the comment period was open, MMS took notes during the discussion. Following is a summary of the discussion:

The RSTF provided comments on four provisions of the proposed rule:

- The rate of return used to determine the return on investment for calculation of the actual costs of gas processing;
- The exception to use FERC tariff in lieu of calculating actual costs;
- Valuation benchmarks for non-arm's-length sales; and
- Joint operating agreements.

Regarding the valuation benchmarks for valuing gas not sold at arm's-length, the RSTF stated that the dust has settled with respect to spot market prices. They are comfortable with spot market indices at pipeline points. They were disappointed that MMS did not propose the use of index prices as a means to value gas not sold at arm's-length. Index prices are a simple and certain way to go

Regarding treatment of joint operating agreement, the RSTF advocated putting language in the preamble of the Federal gas rule that provides reporting guidance. They questioned how to report JOA's when pool pricing is involved.

RSTF representatives asked why MMS did not propose a change in the rate of return used to determine the return on investment for calculation of the actual costs of gas processing. MMS representatives explained that it lacked data on the cost of capital of that particular sector of the oil and gas industry. The RSTF explained that the companies that own processing plants are the same companies that own oil and gas pipelines. They also indicated that they may commission a study to analyze the cost of capital of the gas processing sector of the oil and gas industry.

Regarding the proposed language for MMS to approve the use of a FERC-approved tariff in lieu of calculating actual costs, the RSTF commented that they would like a clean usable process for requesting the exception. They also commented on the current reporting requirement for having to retroactively adjust their Form MMS-2014 lines in March of every year for the previous year's actual costs of transportation. They asked about the possibility of using the prior year's actual costs in the current year so as to eliminate the retroactive adjustments.

The RSTF also commented on the definition of non-arm's-length. They indicated that we need a better way to define opposing economic interest.

They also commented that the recapitalization allowed for oil pipelines should also be allowed for gas pipelines as there are a lot of non-arm's-length natural gas pipelines for which FERC does not have jurisdiction and for which the lessee must calculate actual costs.

Finally, the RSTF asked why MMS did not propose that line pack costs be an allowable deduction from royalties. They noted that line fill was an allowable deduction under the recently-amended Federal oil valuation rule.