Minerals Management Service
Minerals Revenue Management

Re: State and Tribal Royalty Audit Committee comments on RIN 1010-AD05 received verbally on 9/16/04 – as amended 9/24/2004

Vote taken by STRAC on 9/15/04 to have verbal comments represent all STRAC delegations

Section 206.150 (b)(3) A written agreements between lessee and the MMS Director establishing a method to determine the value of production from any lease that MMS expects at least would approximate value established under this subpart; or

STRAC does not believe it is a good idea to circumvent the regulations. Especially when valuing coalbed methane. What is meant by approximate value in the regulations? The regulation is not clear. Approximate value opens doors to more problems. The regulations require notice and comments but the agreements do not. STRAC wants to include language in the final regulation requiring that agreements have State approval where a state interest is involved. Neither the State nor the public's interest is protected in avoiding the regulations by entering into these agreements. Any agreement reached between the MMS Director and lessee should require State approval if it impacts the State royalties. Approval by the State concerned would codify the Secretaries 4 C's (conservation through communication, consultation, and cooperation) into the regulations and commit to the policy.

Technical addition: expand State approval for 8G area as well.

Section 206.151 Definitions

STRAC supports the language clarifying the definition of affiliate. However, STRAC believes there is an opportunity to modify a regulatory flaw addressed in the Fina decision (*Final Oil and Chemical Company v. Gale Norton, 332 F.3d 672 (C.A.D.C., 2003*). STRAC recommends "only" be removed or changed to "any of" producers production in the current definition of marketing affiliate. In STRAC's experience payors find it difficult to find comparable sales under the benchmarks as they may not have access to that information.

The proposed language for Section 206.157(b)(5)(i) did remove the word "only" when determining if MMS will grant an exception to computing actual costs for transportation allowances. The proposed language is "The MMS will grant the exception if (A) the transportation system has a tariff …." vs. the previous language of "The MMS will grant the exception only if the lessee has a tariff…." STRAC recommends removing "only" from the marketing affiliate definition as well.

STRAC supports the change to the definition of Allowances to reasonable, actual costs and also supports clarifying the arm's-length contract definition.

Section 206.157 Determination of transportation allowances

206.157 (b)(2)(v), STRAC recommends no ROI at all. STRAC does not see any reason to change it. Costs of capital and interest rates have hit all time lows. The onshore investment structure is already in place for transportation and requirements of debt/equity are different and built on current economics. However, if it remains STRAC recommends applying it to just offshore transportation and not onshore.

STRAC also highly recommends no ROI for processing allowances onshore. STRAC sees no need to increase ROI on plants that have been in place since the 1940's or 1950's. Since offshore plants are not "offshore" but onshore, if an increase to ROI for processing is applied, STRAC supports no multiplier just the BBB rating for onshore plants processing offshore production.

STRAC questions if there should be an ROI at all and if changed just apply to new facilities offshore where risk is greater.

Shoshone Arapahoe provided the following comment: their view is MMS is injecting a profit by using the ROI multiplier to the State. Indian properties have a BBB, Federal multiplier may give companies an argument as to why they do not have a multiplier on Indian properties.

Section 206.157 (b)(5). STRAC supports the tightening up the exception of using the FERC tariff in non-arm's-length situations. However, in making that determination the arm's-length production volume transported on the system should be of like "quantities" to the non-arm's-length transported volume.

STRAC supports adding the language in § 206.157(c)(1)(iii) and (c)(2)(v) terminating a transportation allowance in effect before March 1, 1988 (the grandfathered transportation agreements).

206.157(f) *Allowable costs in determining transportation allowances*. STRAC does not support including in transportation allowances costs for unused firm capacity/firm demand charges, line loss and cost of surety. These costs are already paid for under the 7/8ths interest. We are giving the lessee the 7/8ths and costs should be borne under this interest. Private landowners do not share in the cost associated in producing their gas. MMS has lost sight that we are reimbursing the cost by giving up the 7/8ths. .STRAC does supports the language that if a lessee receives a payment for release or sale of firm capacity or payment or credit for penalty refunds, that they must repay or reduce any allowance claimed for firm demand charges already deducted.

Costs of surety or letter of credit –STRAC believes that MMS's position has always been that if it is a service fee it is never deducted . Under this position, this service is not an allowable deduction.

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 and as such should not be an allowable deduction carved out of the royalty owners remaining 1/8th 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 exist in the field in its entirety prior to dividing it up. The royalty owner pays 7/8ths of their gas to the producer to bring the remaining 1/8 of their gas out of the ground in a marketable condition. The royalty owner has already compensated the producer for his services, when he 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 in effect reducing that last 1/8 ownership even further.

Section 206.157 (g)(5),(6) & (7) STRAC supports the proposed changes to costs that are not allowable

Index pricing

MMS affiliate re-sale on natural gas is market value. MMS lost this issue in court under Fina. MMS has an excellent opportunity to change the regulations. STRAC believes that MMS missed the opportunity in not proposing to re-write that affiliate resale or some other tracing method be used to value lessees royalty.

Due to the complexity and historical failure of REGNEG, STRAC does not support use of an index pricing methodology.