State of Louisiana

M.J. "MIKE" FOSTER, JR.
GOVERNOR

JACK C. CALDWELL
SECRETARY

DEPARTMENT OF NATURAL RESOURCES
OFFICE OF THE SECRETARY

September 16, 2003

Mineral Management Service
Attention: Sharon Gebhardt
P. O. Box 25165
Mail Stop 320B2
Denver, Colorado 80225

Dear Ms. Gebhardt:

The State Of Louisiana is a recipient of material amounts of Federal Oil and Gas royalties though its participation in royalty revenues associated with leases in the 8G zone in the Gulf Of Mexico. The Louisiana Department of Natural Resources (LaDNR) is the state agency responsible for auditing royalty revenues received by the federal government (through the offices of the Minerals Management Service, or the MMS). As such, the LaDNR is familiar with federal regulations that determine how oil and gas royalties are to be calculated and are directly affected by those regulations.

On August 20, 2003, the MMS proposed changes in the existing crude oil valuation regulations and asked for comment on these proposed changes. As an interested and affected party, the LaDNR wishes to submit the following comments to the MMS.

In the last round of oil valuation rule making, the LaDNR's comments were generally favorable to most of the components of the proposed rule. The final rule adopted by the MMS and effective June 1, 2000, was, in our opinion, a fair and reasonable rule. It is our understanding that the proposed changes in the existing rule are the result of a better understanding gained by the MMS of crude oil markets over the last few years.

Regarding the change proposed to the price to be used in valuing oil in non arm's length sales, in general we are in favor of MMS's proposed changes. MMS points out that the new proposed starting point of oil valuation, the NYMEX, is more reliable since it is less susceptible to market manipulations. We understand that serious allegations have been made concerning gas spot price manipulations.

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Additionally, MMS is requiring that two adjustments be made to the NYMEX price in order to more accurately reflect market values in the month of production for specific market centers. One adjustment to the NYMEX price for the production month requires that a "roll" be added on. In MMS's opinion, the addition of a roll (either plus or minus) more accurately reflects the market price in the production month. MMS has made this determination based on their belief that including a "roll" "....best represents current market practice in establishing the sales price for crude oil production...".

Also, since the price that this NYMEX formula establishes results in a market value at Cushing, Oklahoma for Light Sweet Oil (the standard for NYMEX trades), MMS proposes an adjustment to equate this price to local market centers, located distant from Cushing where different quality oil is traded. MMS proposes to adjust the NYMEX based formula by the difference in spot prices in various market centers, vis a vis the spot price at Cushing for WTI.

All three of these valuation criteria, NYMEX starting point, addition of a "roll", and adjustments to local market centers, seem to have merit and LaDNR agrees with them.

MMS has also proposed that there be changes in the transportation rate calculation that impacts lessees who transport oil in their own pipelines. Currently, lessees are allowed to deduct a charge for return on investment by applying the BBB bond rating to the undepreciated balance for the transportation system. MMS is requesting comments on whether a multiple of 150% of this bond rating is a better factor to use in this calculation.

The LaDNR commented on a similar provision in the first iteration of the oil rule that became final in June 2000. At that time we commented that unlike drilling activity, the building of a pipeline was a relatively low risk venture. That is, pipelines were built to move established, discovered production to market and as such, do not bear an unusually large amount of risk. We also note that MMS's own reasoning at that time was similar to ours and no multiple of the BBB bond rating was granted at that time. We do note that more current MMS studies show that needed rates of return for pipelines currently being built were in the range of 1.1-1.5 times the BBB bond rating.

We would urge MMS to maintain the status quo in regard to currently existing pipelines. In regard to new pipelines, if MMS determines that a rate higher than BBB is appropriate, we would urge that in be at the low end of the range their own study showed to be appropriate. It should be noted that the rate of return, whatever it eventually is, will affect not only non arm's length transportation rates, but would affect other areas of transportation as well. These areas are carrying costs of pipeline inventory (whether on arm's length or non arm's length systems) and costs incurred in securing letters of credit (again, whether arm's length or non arm's length). Therefore, the impact of any decision will have negative economic impact to the federal government far beyond the allowance of this increased cost component to the mainline transportation rate.

MMS has also delineated certain costs as marketing, and whether or not they are incurred in non arm's length or arm's length transportation systems MMS considers them to be non deductible. The LaDNR agrees with MMS decision.

MMS has also proposed allowing some costs which they have traditionally not allowed as transportation. While the LaDNR does not have a position one way or the other on these costs being allowed, we do urge the MMS, if they so choose to retain these elements in their final rule, to insert a provision stating that reimbursements for any or all of these costs elements received by the lessee, its affiliate, or its marketing agent, be included either in gross receipts or included as offsets to the expenses incurred in calculating transportation allowances.

In general, LaDNR is pleased with most of the changes proposed affecting the current rule. We appreciate the opportunity to have input on these proposed changes and hope that MMS takes these comments into consideration when formulating a final rule.

Very truly yours,

Jack Caldwell

Jack C. Caldwell

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