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MICHAEL ENZI
WYOMING

COMMITTEES:
Banking, Housing, and Urban Affairs
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Small Business
Budget
Special Committee on Aging

July 7, 2003

Director of MMS Johnnie Burton
1849 C St NW Mailstop 4230
Washington, D.C. 20240

Dear Johnnie:

The purpose of this letter is to request a status report and explanation of reasons for the decision of the Minerals and Management Service (MMS) to revise the agency's oil and gas valuation rule.

For your convenience I have enclosed a copy of a letter sent to me by Wyoming Governor Dave Freudenthal regarding proposed changes to the rule. Governor Freudenthal has carefully articulated his reasons for opposing these revisions. I share his concerns about ensuring that any change in this rule does not have a negative impact on Wyoming and the state's share of royalties.

Thank you in advance for your consideration. I look forward to your reply.

Sincerely,

Mike Enzi

Michael B. Enzi
United States Senator

MBE:ds

DAVE FREUDENTHAL
GOVERNOR

THE STATE OF WYOMING

STATE CAPITOL
CHEYENNE, WY 82002

Office of the Governor

June 13, 2003

Honorable Mike Enzi
U.S. Senator
Russell Senate Building
Washington, D.C. 20510

Dear Senator Enzi:

I hope all is well with you in Washington.

We have had the pleasure of working with the Interior Department's Minerals Management Service as partners on a range of important issues of concern to the state of Wyoming. Our partnership, which was encouraged by the 1996 Federal Oil and Gas Royalty Simplification and Fairness Act, has been particularly beneficial with regard to oversight of the federal royalty collection program.

However, the MMS recently announced several initiatives that have potentially serious impacts on the amount of royalty revenues received by the federal government and numerous Western states, including Wyoming.

These initiatives indicate that MMS is considering changes to a number of long-standing policies, in light of recently held workshops to reconsider several aspects of rules for federal and oil and gas valuation. Some of the changes being considered could be a reversal of policies that are now in place. The state has also received indications from MMS that the service could reverse its policy of disallowing costs to place gas in marketable condition for coal bed methane production.

The U.S. Department of the Interior has gone to court and prevailed on this issue for more than half a decade – we see no need to change the policy now.

Oil and gas valuation rule

We agree with the MMS that both the oil and gas rules "are working well and accomplishing (their) objectives." Never has the old adage "If it ain't broke, don't fix it" held more true. And yet, the MMS is considering some of the following changes:

1) The current regulations under CFR §§206.110, 206.111 and CFR §§206.156, 206.157 already determine the allowable transportation cost deductions. The CFR adequately defines such cost and covers all necessary cost deductions.

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MMS should not allow any indirect deductions for transportation. Most of the deductions being discussed are relabeled marketing costs, and MMS has a long-standing policy of not allowing either direct or indirect marketing costs. There is no reason to change the detailed transportation allowances as currently set out.

2) The rate of return was a hard-fought compromise between industry and the MMS – in which the MMS prevailed. There is, again, no reason to change the current rate, add any factor or otherwise reopen this issue.

3) We emphasized upfront that, if companies have affiliate sales which lead to an arms-length, downstream sale by their affiliate, the downstream sales price should remain the basis for royalty payments.

4) NYMEX could be used for valuing all crude oil, where the use of an index is appropriate. Using the calendar month, rather than the trading month, would simplify its use. NYMEX is widely referenced by traders and representatives and is reflective of the market.

   NYMEX is less susceptible to manipulation than price surveys, as we have seen recently is some well publicized cases. The sweet crudes of southwestern Wyoming frequently have a NYMEX plus differential. The demand of the Salt Lake City refineries have a positive influence on regional differential, such that the preference for southwestern sweet crude results in a selling price greater than NYMEX (i.e., NYMEX P+). In these situations, the differential will be positive. Differentials should only be allowed if they are reasonable and actually incurred – in other words, no theoretical costs, only actual reasonable cost.

There is no need to revise either current gas or oil rules at this time. The proposed changes to the rules would only increase the industry's ability to reduce royalty through ever-expanding deductions. This may result in a loss of royalty revenue for the people of Wyoming, as well as other Western states and the federal government.

Disallowing cost to place gas in marketable condition

Again, the administrative precedent is to resist and deny deductions for converting gas to a marketable condition. Wyoming federal coalbed methane production should be valued at a point consistent with applicable CFRs, controlling federal law, IBLA decisions and MMS's own payor handbook – and that point is the outlet of the processing plant.

Despite administrative history, MMS initially proposed to value the gas after the Bureau of Land Management's royalty measurement point.

There is not a market pipeline in the country that would accept gas at the wetness and pressure of the coal bed methane gas after the BLM's royalty measurement point. There would be no need for a processing plant if the market pipeline would accept the gas in the condition it is in before entering a processing facility. The costs associated with compressing the gas to market pipeline pressure, dehydrating it and removing the CO_2 should not be deducted from the value used to calculate federal royalties.

The consequence of selecting a valuation point other than the processing facility outlet would be disconnecting royalty determination from a practical touchstone. That could result in the loss of millions of dollars in federal royalty revenue – and, in turn, valuable services – for the people of Wyoming and the United States.

The state will continue to work with our counterparts in federal government to ensure that the people of Wyoming will receive their fair share of federal mineral royalties. Please join in the effort to make certain our constituents receive the royalties to which they are entitled.

Best regards,

Dave Freudenthal

Dave Freudenthal
Governor

DDF:MG:la
CC: Sen. Craig Thomas, Rep. Barbara Cubin, Audit Director Mike Geesey, file