

OFFICE OF NATURAL RESOURCES REVENUE
PUBLIC WORKSHOP
HOUSTON, TEXAS
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MR. GOULD: Good morning. What we'll do is we'll take a minute just to introduce ourselves to get started, and then we'll get moving into the program. So, I'm Greg Gould, I'm the director of the Office of Natural Resources Revenue. I'm also the acting deputy assistant secretary Office of Natural Resources Revenue of the Department of the Interior. I think some of you remember us as the Minerals Management Service or Mineral Revenue Management. This is the

1 new organization within the department.

2 MS. TSCHODY: My name is Deb Tschody, I'm
3 the deputy director of ONRR.

4 MR. ADAMSKI: Good morning, Richard Adamski.
5 I'm the program manager for asset valuation and audit.

6 MR. DEBERARD: I'm Mike DeBerard. I'm
7 manager of the economic and margin analysis office
8 with ONRR.

9 MR. KUNZ: Good morning, I'm John Kunz with
10 the solicitor's office. The regional office in
11 Denver.

12 MR. STEWARD: I'm Jim Steward, program
13 director for asset management.

14 MR. CHRISTRAEUT: Peter Chirstraeut, I'm the
15 manager of royalty valuation unit.

16 MR. GOULD: Okay. Let's get started. So,
17 good morning, and welcome to the public workshop to
18 discuss the Federal oil and gas valuation regulations
19 This is the first of three public workshops we'll be
20 having. We'll be having another public workshop in
21 Washington D.C., Thursday; and I believe a week from
22 today we're having one in Denver, as well. I think
23 everyone in this room knows the purpose of the Federal
24 oil and gas valuation rules are to ensure that the
25 American public receives every dollar due on the

1 Federal resources. Through these public workshops and
2 the Advance Notice of Proposed Rulemaking, the Office
3 of Natural Resources Revenue is requesting comments
4 and suggestions from affected participants and the
5 interested public before proposing changes to the
6 existing regulations governing the valuation of the
7 oil and gas produced from Federal onshore and offshore
8 oil and gas leases for royalty purposes.

9 In proposing changes to the current
10 royalty valuation regulations, ONRR has three goals
11 in mind. One, provide clear regulations that are
12 easy to understand and that are consistent with
13 fulfilling the Secretary's responsibility to ensure
14 same fair value of the public's resources. Two,
15 provide methodologies that are as efficient as
16 possible for lessees to use; and, three, provide
17 early certainty that correct payment has been made.

18 The potential benefits from our
19 discussions today include, simplifying and
20 clarifying aspects of the rules, decreasing
21 industry's cost of compliance and government's cost
22 of enforcement, streamlining audits by providing
23 more certainty and reducing potential litigation.

24 We feel it's important to obtain
25 stakeholder input to see if further clarification of

1 our rules is, in fact, worth pursuing. The issues
2 we'll be talking about today will include, one, use
3 of index prices to value oil and gas; two, examining
4 possible alternatives to the requirement to track
5 actual costs for determining transportation
6 allowances; and, three, examining possible alternate
7 methods for valuing wellhead gas volumes by
8 eliminating the requirement to trace the value of
9 liquids removed from processed gas.

10 We do have a court reporter today. So,
11 what I ask is you give your name and your
12 affiliation before you start speaking. Finally
13 based on feedback we receive today and from the
14 other workshops clarifications of the Federal oil
15 and gas rules may be in order. If so, ONRR will
16 take the next step to issue a proposed rule,
17 followed by written comment period. So, before we
18 begin, are there any questions from anybody? No?
19 So, I think I'll turn it to you, Panel.

20 PANEL MEMBER: Good morning. ONRR has over
21 23 years of experience valuing gas and current gas
22 Federal gas regulation and has over 10 years
23 experience on valuing oil under the current Federal
24 oil valuation regulation which was substantially
25 updated in 2000. Additionally, we have over 10 years

1 experience valuing gas under the Indian gas valuation
2 regulations. Indian gas valuation regulations provide
3 early certainty and greatly simplify compliance.

4 The lessons learned from this experience
5 suggest that the current Federal gas valuation
6 regulations could be improved to provide greater
7 certainty that royalties have been paid correctly to
8 reduce the burden to both industry and government.
9 We are interested in determining ways to simplify,
10 clarify and provide consistency in product
11 valuation. We have examined the written comments
12 submitted for the Advanced Notice of Proposed
13 Rulemaking which closed on July 26, for Federal oil
14 and gas valuation and are interested in further
15 input regarding the need to modify current oil and
16 gas valuation regulations to meet the above stated
17 objectives.

18 We received comments from 19 parties
19 representing a good cross-section of stakeholders.
20 So, let's begin by looking at the valuation, for
21 royalties purposes, of Federal oil. Generally
22 commenters agreed that the current use of the spot
23 prices and NYMEX prices for non-arm's-length sales
24 of oil is working. So, the first question today
25 we'd like feedback on is: Should the use of index

1 pricing for non-arm's-length -- that's currently
2 used for non-arm's-length be expanded or altered?
3 Would anyone like to comment on that?

4 MR. REEMER: Dan Reemer, Marathon Oil
5 Company. The index price methodology for oil is
6 prescribed by area and there are certainly regions or
7 areas, producing areas that are excluded, like the
8 Rockies, California and Alaska because it was
9 determined, at least in 2000 when the rule was
10 promulgated, that there were not viable indices in
11 those areas. Has ONRR done any market assessment
12 since 2000 to determine whether those areas; Rockies,
13 Alaska and California, whether the market conditions
14 have changed such that there may be indices that would
15 be applicable?

16 PANEL MEMBER: That's one of the questions
17 we're asking about with this ANPR, you know, is there
18 information out there that we can use to take a look
19 at those areas.

20 PANEL MEMBER: You want to add to that?

21 PANEL MEMBER: Well, the Rocky Mountain
22 region is an area if you remember in the 2000 rule we
23 had some issues. I believe we went -- we had few
24 slight modifications to that with one of the
25 benchmarks and went to instead we had three benchmarks

1 for tendering which nobody seemed to use and I think
2 now we slightly modified, I believe, it was the third
3 benchmark; but, you know, side markets are evolving
4 right now with the Bachman comment and we're looking
5 to see if any of you have any thoughts on whether that
6 dynamic is really changing the game. We'd love to
7 hear any of your impressions on that.

8 PANEL MEMBER: Can you guys hear him okay
9 out there?

10 PANEL MEMBER: Do I need to repeat it?

11 PANEL MEMBER: To kind of answer or
12 follow-up on Dan's question a little bit; and again
13 echoing what Greg Gould said is that we are really
14 looking for, you know, the experts from, you know,
15 those of you in this room, industry to provide some
16 background direction if possible and, you know, maybe
17 different things for us to take a look at and
18 follow-up with an analysis to see, you know, what's
19 going on out there, but independently, no, we really
20 haven't done any full-blown studies or any expanding
21 on what's already in the regulations for oil. We know
22 the marketplace changes constantly. Again we get a
23 lot of that information from what we see coming from
24 industry; and, you know, we tend to when that comes
25 into us follow-up on that. So, that's what we're

1 really looking for hopefully in these forums in the
2 next three public workshops.

3 MR. MASSEY: Dan Massey, with Argus Media.
4 Just one comment that I think if I heard your response
5 correctly with Bachman as it relates to the Rocky
6 Mountains. Argus spent a year trying to develop a
7 Bachman spec (inaudible) in Clearbrook, Minnesota, and
8 simply because there was inadequate spot market
9 activity, it's difficult. We've seen enough spot
10 market activity now to come up with an assessment
11 there, but not in the transparency, which a lot of
12 people have asked us to do, which would include the
13 Rocky Mountain Region. We continue to monitor that
14 and when we see enough transparency in the spot market
15 activity, we have no problem coming up with an index
16 for that location. There are very few other crude
17 streams in the Rocky Mountains that trade
18 transparently; and, therefore, an index published
19 would come up with a robust assessment.

20 I do think in the case of Alaska, the ANS
21 group is a viable alternative profile in terms of
22 prices. One of our buyers should take a look at
23 studying and Argus would be happy to cooperate in
24 that regard in terms of information we may have
25 instead of the buyer.

1 PANEL MEMBER: Other comments?

2 Just a couple more questions on oil.
3 See if there's any input. Should ONRR consider any
4 other methods to value oil that is not sold at
5 arm's-length? Anyone like to comment on that?

6 Next let's consider the
7 transportation of oil. ONRR is examining possible
8 alternatives to the requirement to track actual
9 costs for determining transportation allowances for
10 oil. What methods should be considered that would
11 adjust for location differentials between the lease
12 or unit and index pricing and publication point?
13 Any comments on transportation of oil other than the
14 current method used? Are there any other
15 suggestions to improve the current oil valuation
16 regulations before we move on to Federal gas?
17 Anything about oil?

18 MR. REEMER: Dan Reemer. Yeah, I think as
19 far as actual costs, lessees reasonable actual costs,
20 when the 2000 oil rule was promulgated, there was no
21 provision for what a lessee or an owner of the
22 pipeline system -- for that transportation rate,
23 whether it was a published tariff or contract rate if
24 it's proprietary pipe, it was on a buy/sell agreement.
25 There was no provision in the regulations for that

1 rate to be used. The lessee had to default to actual
2 costs calculation based on operation, maintenance
3 costs, overhead and return on unappreciated capital.
4 That's burdensome on industry and it's burdensome on
5 minority interest owners in pipelines that don't have
6 the financial data necessarily that they need to be
7 able to go through the calculation.

8 I would like ONRR to consider a process, I
9 think we already have in the gas system, where a
10 lessee can petition or request to use a published
11 rate or a contract rate and at least allow there to
12 be a review to see whether ONRR agrees that rate was
13 either established by parties with opposing economic
14 interests or adjudicated through some form of tariff
15 through cost of service process and then it wouldn't
16 be necessary to go through that extra step of
17 calculating actual costs.

18 PANEL MEMBER: Thank you, Dan. Any other
19 comments on the oil valuation regulations before we
20 switch gears and start talking about natural gas?

21 PANEL MEMBER: Is the lack of comment an
22 indication of that the Federal oil rule is working
23 relatively well and does not need to be modified?
24 Dan's head is shaking.

25 MR. MORBY: Greg Morby with Chevron.

1 Repeat the question.

2 PANEL MEMBER: My question is: Is the lack
3 of comment on the Federal oil ruling an indication
4 that it is actually working well, the 2000 and 2004
5 modification, and we don't need to change the Federal
6 oil rule; or are there changes that need to be made
7 that can further reach our goal of trying to simplify
8 uncertainty and clarify?

9 MR. MORBY: Generally speaking, yes, they
10 are working well. We could use some tweaking or
11 improvements such as the previous commenter suggested
12 on transportation. Also overall the comments seem to
13 generally be accepting of the index prices for
14 non-arm's-length crude oil sales. Suggestion to
15 change would be go ahead and allow your arm's-length
16 sales of crude oil to be valued using the accepted
17 indices.

18 PANEL MEMBER: I'm glad that Debbie made
19 that last comment because I was going to comment on
20 that also. We do appreciate, you know, any positive
21 insights or, you know, if things are working also
22 because that helps us, you know, frame whatever we're
23 going to further analyze going forward for either oil
24 or gas and from the comments that we received or the
25 advance notice of proposed rulemaking. Again, we kind

1 of got that impression that it's -- you know, things
2 could always be tweaked a little bit but oil was
3 probably going to be less controversial than gas, and
4 I think one of the reasons for that is we did make
5 some major changes to oil in the valuation arena in
6 2000 and then again in 2004. So, we wanted to start
7 off with the easy stuff first.

8 Now, we are going to move into Federal
9 gas, which is more complicated and more involved
10 just because of the nature of the product and the
11 different markets that it could be sold into Federal
12 gas. As Jim mentioned earlier the valuation piece
13 of that really hasn't been substantively changed
14 since the 1988 rules. We've tried on several
15 occasions over the last ten or more years -- and
16 again gas is complex, there is a lot of different
17 players in that market. So, it makes it more
18 difficult to make any changes across the board that
19 are satisfactory to everyone involved. So, Federal
20 gas, we'll start out with just looking at the area
21 of using index prices. Again, we've had some
22 experience using index prices for Indian gas with
23 the 2000 rule. We've also had some positive
24 experience using indexes to NYMEX and spot market
25 prices to value oil, and we'd like to bring the

1 indexes to some degree into the Federal gas arena.

2 Now, there is a provision on using index
3 pricing in the second benchmark for sales of gas
4 that are not at arm's-length; but, again, it's kind
5 of -- it's a second benchmark, prioritized
6 benchmark. So, you kind of have to get to that
7 provision before you can use it. We would like to
8 expand the use of index pricing for purposes of
9 simplicity and clarity in the rules, if that's
10 possible.

11 Comments on the use of index pricing in
12 valuing Federal gas for royalty purposes were
13 varied. Some commenters stated they would support
14 an index pricing methodology if it was an option and
15 not subject to any later true-up calculations,
16 again, in the interest of simplicity and
17 uncertainty. Some commenters raised concerns basing
18 value on index prices may yield values that could be
19 higher than their actual gross proceeds. Still
20 other commenters on the other side had the opposite
21 concern, that index pricing may be higher than they
22 actually get for their gross proceeds.

23 So, therein lie the conundrum. ONRR
24 invites more specific comments as to whether index
25 pricing could possibly replace gross proceeds in

1 valuing Federal gas production. So, our first
2 question: We want to hear from those that support
3 index pricing as an option and how that would meet
4 the intent of any changes to regulations to add
5 simplicity and clarity. How would that option be
6 applied?

7 Again falling back on the written comments
8 that we received from the ANPR, those that seem to
9 be in favor of some sort of use of index pricing to
10 value Federal gas with the caveat that they'd like
11 that to be an option; and we're just trying to get
12 more specific about what they mean by an option, how
13 that would work, where that would come into play in
14 that pricing methodology. Any comments?

15 MR. HAYNES: My name is Gordan Haynes with
16 Transparent Energy; and as you referred to index
17 pricing, are you talking about gas daily prices or
18 first of the month prices?

19 PANEL MEMBER: Yes, exactly.

20 MR. HAYNES: And are you going to be taking
21 off gathering fees, like transportation charges and
22 fuel for that?

23 PANEL MEMBER: Well, actually we do have --
24 the next two sections deal with transportation and
25 processing. So, that will obviously come into play.

1 Right now we're just looking at the broader use of the
2 index pricing, just conceptually.

3 MR. HAYNES: Right. Also there's seems to
4 be a major push with the, like, major pipelines for
5 offshore and they're starting to spin down these
6 pipelines to smaller affiliates and they're going to
7 impose gathering fees, you know, as much as 20 to 25
8 cents and would that be deductible from the
9 transportation -- I mean, from the index price?

10 PANEL MEMBER: It depends. And that's one
11 of the things we're trying to accomplish here is
12 simplify the regulations because right now within the
13 context of transportation, the regulations don't allow
14 deductions for gathering, but sometimes what FERC
15 classifies as gathering or what pipelines classify as
16 the gathering is really transportation. Our current
17 regulations give a definition of what is gathering and
18 what's not.

19 One of the things we're hoping here is can
20 we get out of the business of trying to figure out
21 what pieces of transportation or what pieces of
22 processes are deductible. Could we look at a flat
23 rate per any BTU that we can deduct from indices so
24 we wouldn't be constantly fighting about what is
25 deductible and what's not?

1 MR. HAYNES: It seems like that would be
2 sort of difficult because, you know, all the different
3 pipelines have different gathering fees and pulling
4 fees and this seems like it would be unfair, if you
5 were, like, on one pipeline they didn't have the
6 gathering fee and another one they did. Thanks.

7 PANEL MEMBER: We appreciate the comment,
8 thank you. We're looking for feedback like that to
9 know what your concerns are, what you feel could
10 possibly work, what you feel would be very difficult
11 to work with; but, again, for us to -- information for
12 us to take back from these public workshops. Again,
13 from what we got on the comments on the notice of
14 proposed rulemaking, this is going to give us more
15 information to analyze and do, you know, possible
16 economic analysis to see, you know, what we can
17 feasibly go forward with. So, again, we appreciate
18 any feedback we can get from anybody because you are
19 the experts in the field and you know what your
20 difficulties are and just the situation -- the
21 different situations in which gas is sold.

22 The next question kind of follows up to
23 the first. Again we stated that comments were
24 varied on the issue of going to index pricing to
25 possibly replace gross proceeds, and some people

1 expressed the opinion that they're opposed to that.
2 We'd like to know from that side of the house what
3 their concerns were from anybody that, you know,
4 wouldn't be in favor of going to just an index
5 pricing methodology and getting away from gross
6 proceeds?

7 MS. SALINAS: Mary Salinas, ExxonMobil.
8 While we actually applaud the idea of going to index
9 pricing and see the positive side of that, we also
10 recognize that depending on when contracts were
11 written for different companies, going to an index
12 price could be harmful to those folks at least until
13 those contracts were resigned. So, we can understand
14 why with many companies proceeds is working for them
15 currently. It's currently working for our company.
16 It also creates more complexity sometimes when you've
17 got bearing royalty owners on the same property with
18 government and private and therefore your systems,
19 computer system have to be able to handle proceeds
20 with index pricing and other options depending on the
21 different owners. I think that's why you questioned
22 in an earlier question, why people were looking for an
23 optionality, I think that's why because there could be
24 a burden put on different companies based on the index
25 prices.

1 PANEL MEMBER: Do you mind answering a few
2 more questions? I hate to put you on the spot. We
3 did get a lot of comments from the industry about the
4 idea of options. What are your thoughts as to how
5 that option would work for Federal oil? Right now you
6 have the option of the index or affiliate retail sale,
7 but you're locked in for two years. Is that the kind
8 of option for gas or more frequent option, and how
9 would having that option give both the government and
10 the lessee certainty?

11 MS. SALINAS: Hang on a second. Exxon/Mobil
12 really hasn't thought about that particularly. We'll
13 have to give it some thought.

14 PANEL MEMBER: We appreciate that, thank
15 you.

16 Next question and again we're trying
17 to as we go along delve more deeply into the
18 difficult concepts involved in changing valuation
19 methodologies. We mentioned in the advance notice
20 of proposed rulemaking that in making these changes
21 conceptually we'd like to strive for revenue
22 neutrality; but, you know, revenue neutrality has a
23 lot of meanings; and we could start out looking at
24 it at a high level. And, so, the next question
25 would be: Is there anyone that would support going

1 to index pricing methodology that would replace the
2 gross proceeds calculation if it was not revenue
3 neutral for every transaction? Would the economic
4 benefits of simplicity, certainty and consistency
5 offset any potential increase in royalty revenues
6 paid?

7 Again you could look at revenue
8 neutrality in a higher level or a global viewpoint
9 that, you know, in any given transaction it may be a
10 little more or a little less; but overall with the
11 administrative savings, with the certainty and any
12 possible follow-up audit situations, that could
13 offset any additional price that would be maybe paid
14 up front. So, we ask you to look at it again at a
15 higher level of that concept and with that, would
16 that work in any respect?

17 MR. MORBY: Greg Morby with Chevron. If I'm
18 understanding your question, the answer would be, yes,
19 it's a compelling thought. Overall in Chevron's
20 Federal gas royalties we come out revenue neutral
21 because we're not spending a lot of time, money and
22 effort on the deductions. You've asked several
23 questions about what did you mean in your comments
24 when you said you want an option. Well, we wanted an
25 option. It's the unknown, it's like, okay, here are

1 your new regulations, under our calculation they're
2 revenue neutral based on the fact that C would pay X
3 and it would cost you Y to administer. That's just a
4 big gray number.

5 I think the optionality we wanted could be
6 just considered almost a comfort until you know what
7 the answer is that you're suggesting these regs
8 would look like or spending time talking about how
9 do you feel about index prices for gas. Well, we
10 think they are reflective of market value, but as
11 the previous comment from ExxonMobil, we can
12 administer gross proceeds on gas very well. It's
13 the subsequent questions around unbundling of
14 transportation and processing kind of rolls up into
15 that bigger optionality equation because it's just
16 too big of an unknown to say, yes, we support it
17 wholeheartedly without some additional detail, but
18 the administrative savings is, I know from our
19 perspective, from Chevron's, part of the equation of
20 the way we examine these thoughts and the questions
21 that you ask of industry and others.

22 PANEL MEMBER: Greg, what I was trying to
23 get at an option every month, an option every quarter?
24 I mean, again we're trying to achieve simplicity here.

25 MR. MORBY: You know, we thought about it in

1 several ways. Chevron like other large corporations
2 runs a big enterprise software that's not always
3 especially nimble. But, you know, the fact that we
4 have a lot of columns on the 2014 and you would place
5 into a sale that, oh, by the way this is the new index
6 approach or this is arm's-length and if it switched
7 month to month or whatever, you still have the
8 opportunity to audit. So, I don't know what the right
9 answer to that is. Two years is a long time, but we
10 change a lot of things monthly and if we were
11 declaring on a royalty report, oh, by the way this is
12 index method or the gross proceeds method, don't know.

13 But this all goes into the later questions
14 around where do deductions fit into that equation?
15 You know is it like, okay, here's your answer, five
16 bucks that's net of any deduction you're entitled to
17 and that's what you could use, we just don't know
18 how the transportation processes fits into it. I
19 use 100 words, when 10 will do.

20 PANEL MEMBER: My final question on index
21 pricing or I guess pricing in general is the age old
22 question of we seek input on how to best value gas for
23 royalty purposes in situations where gas from Federal
24 leases is produced in areas not covered by index
25 prices or where limited reported spot market activity

1 exists. Are there any thoughts on that, and I know
2 this is a difficult area.

3 (No response.)

4 PANEL MEMBER: The next two sections we have
5 are, I guess, what everybody has kind of alluded to or
6 waiting for trying to get into the deductions for
7 transportation and processing from whatever valuation
8 methodology that we would initially construct for
9 valuing Federal gas. And the main, I guess, idea or
10 theory here is trying to find an alternative to the
11 requirement to track actual costs for determining gas
12 transportation. Comments during the advanced notice
13 of proposed rulemaking were divided with some
14 commenters generally supporting retaining the use of
15 actual cost and other commenters supporting the
16 location differential with an escalation factor to be
17 separate component for fuel, a fixed percentage of the
18 produced volume.

19 There was general consensus that a flat
20 percentage of index value would likely not provide
21 revenue neutrality and is not preferred. So, what
22 we're seeking feedback on today, you know,
23 appreciate any comment: In the interest of
24 simplifying the determination and verification of
25 the location adjustments ONRR requests any

1 alternative methods to calculate actual
2 transportation costs that would adjust for location
3 differences between the lease or the unit and index
4 pricing and publication point. So, is there any
5 scheme out there that we could apply or formula so
6 we don't have to, we and industry, does not have to
7 trace their actual costs, deductions involving
8 transportation?

9 Again keeping in mind that the thrust of
10 what we're trying to do is simplify and provide
11 certainty that what you're paying the first time on
12 the 2014 is correct. And, you know, we appreciate
13 again if anybody has any situations or just would
14 like to say, you know, that they're comfortable with
15 calculating the transportation costs now or it's
16 difficult to come up with the costs that are
17 acceptable for royalty deductions, we'd like to hear
18 those comments also.

19 So, the thoughts are we would publish a
20 proposed rule that would say that value for all
21 Federal gas index less a nickel, that's the general
22 concept. Extreme simplicity. Would there be
23 support for such a proposal?

24 MR. BENBOW: Troy Benbow with Transparent
25 Energy. It just -- I mean, with fields across the

1 Gulf, especially with pipes acquiring other pipes
2 right now, we are working these things right now with
3 FERC and with some other parties. You know, we've got
4 some pipes here that have no fuel or very little fuel
5 at this the time and you've got pipes that have in
6 upwards -- I mean, I know one is 75 cents, average
7 rate is 45 cents. Some of them are 10 cents
8 gathering, some of them are 15 gathering and
9 transport. To get an average cost across the Gulf of
10 Mexico is almost impossible. I don't have a clear
11 theory on how to make it simple at this time. I do
12 know it's very hard to do something across the board
13 and make every producer to pay their fair rate.

14 PANEL MEMBER: That helps a lot. Thank you.
15 We really do appreciate those comment and
16 clarifications. Like Debbie mentioned that does help
17 us kind of frame the discussion and analysis and,
18 again, I think Federal gas is difficult because we are
19 dealing with onshore situations and offshore
20 situations which are, you know, a lot different in the
21 way the market plays out. You know, we've had some
22 experience in the past in the Gulf of Mexico,
23 especially with our royalty-in-kind program. So, you
24 know, we understand, we've played in the
25 transportation costs, things like that also. Any

1 other comments for either onshore or offshore gas
2 transportation and what the specifics are of the
3 difficulties?

4 PANEL MEMBER: Can I get a little bit more
5 information about the spin off that's occurring with
6 pipelines in the Gulf? Are they generally spinning
7 off to nonaffiliates? So, are we seeing more of the
8 pipelines in the Gulf are going to arm's-length
9 situations?

10 MR. HAYNES: Gordan Haynes, Transparent
11 Energy again. We're seeing a combination. We're
12 seeing some of the pipelines are selling to other
13 pipelines that historically weren't pipeline companies
14 that are sitting -- you know, like, Tennessee is
15 selling to Connecticut, and then also we're seeing
16 other pipelines spinning down the gathering system to
17 affiliates. So, you're seeing a combination of both;
18 and, you know, I guess it's just a way of getting
19 around to -- so they can charge gathering fees.

20 PANEL MEMBER: So, I'm sorry -- so, are we
21 going to see in the Gulf more and more bundling of
22 fees where our lessees are charged bundled rates?

23 MR. BENBOW: It won't be charged bundled
24 rates. It will be based on -- it would be based on
25 whether they consider you gathering or transporting.

1 For example with the Tennessee right now if you
2 transport to Tennessee pools, there is no gathering or
3 transport to get the fuel for pool service. When
4 Connecticut comes around, there will be. They're
5 saying there's going to be an average rate of
6 gathering and transport of about 25 cents. One being
7 10, one being 15. I think 10 cents for gathering, 15
8 for transport. That one I think has pretty much been
9 finalized. I don't know if it's been approved by
10 FERC, but I know it's real close. You know, Sea Robin
11 is spinning down. We got notification yesterday that
12 Trunkline is going to spin down to sell their assets
13 over to Sea Robin. You know, they're going to apply
14 or file their order with FERC this week or next week,
15 you know, and there's a few questions on that, too,
16 with hurricane pieces, as well.

17 But, I mean, everybody is just -- the
18 Gulf of Mexico is consolidating and, so, the fees
19 are -- the fees are very variable across the Gulf of
20 Mexico at this point and what exact fees are and
21 what's going to now being considered gathering and
22 what's going to be considered transport is yet to be
23 seen. We're still waiting to be finalized.

24 PANEL MEMBER: The last big area for Federal
25 gas that involves, you know, allowable and

1 nonallowable deductions from royalty is processing.
2 We've had experience with the Indian gas pool going to
3 a "bump" type of method to the wellhead gas account
4 for the liquids value in the gas stream and which
5 provides, you know, some certainty and some simplicity
6 in that calculation. So, conceptually we're thinking
7 of something similar that might work for Federal gas.

8 So, ONRR is considering accounting for the
9 value of liquid hydrocarbons contained in the gas
10 stream by applying an adjustment or "bump" to index
11 price, applicable to residue gas when gas is
12 processed, in lieu of valuing residue gas and
13 extracted liquid products separately, calculating
14 the actual processing costs and deducting those
15 costs from the value of the extracted liquids.

16 Again, there was not a consensus that we
17 saw from the commenters to the ANPR. Some
18 commenters preferred actual costs and said that, you
19 know, you track and calculate those anyway so that
20 you're comfortable doing that. Other commenters
21 believed that a proxy is workable and suggested that
22 adjustments should be plant specific and frequently
23 updated to reflect changing market conditions. So,
24 again, we're just going to throw it out there that
25 we're seeking suggestions regarding other

1 methodologies that would simplify the reporting
2 associated with gas processing allowances; or, if
3 possible, eliminate the allowances by substituting a
4 market-based proxy to reflect the variable of
5 hydrocarbon contained in the gas stream.

6 So, if anyone could address that area just
7 from your personal experience, we'd appreciate it.
8 Any comments?

9 MR. HAYNES: Your natural gas plants if
10 you're not an owner, you know, you're probably going
11 to get a percent of proceeds and percent of proceeds
12 is taken with the value of the natural gas liquids
13 less the PGI costs, less the transport and percent of
14 proceeds will vary and, you know, I've seen it from
15 60 percent to 85 percent on up to 90 percent.

16 So, that's going to throw off this
17 coming up with a simple fee. Also fuel varies in
18 your processing plants. You know, it can be
19 .6 percent to, you know, 2 or 3 percent. Then
20 depending on the quality of your natural gas, some
21 natural gas has, you know, very lean GPMs, other
22 natural gas has really high. So, for some streams
23 it's profitable. Other streams it's not profitable.
24 So, to me it would be very difficult to come up with
25 this "bump."

1 PANEL MEMBER: If it were possible for us to
2 go on a plant by plant basis so that you have a fee or
3 a rate for each given plant that receives Federal gas,
4 would it ameliorate any of that or improve that?

5 MR. HAYNES: You know, with a plant by plant
6 basis, you know, some of the plants -- like offshore,
7 a lot of producers are actually owners in the plant
8 and they receive, you know, 100 percent of revenue,
9 less your capital costs and your operating costs. And
10 then, you know, the most of them don't really have a
11 standard, you know, percent of proceeds contract.
12 Then also the streams will vary. I mean, your GPM
13 could range anywhere from 1 to, you know, 3 GPMs.
14 It's going to depend upon the stream, you know, that
15 particular block or that particular well of how much
16 money you're going to make in that particular plant or
17 lose.

18 MR. PRICE: How you doing, I'm Harry Price;
19 and I echo what Gordan is saying the variability of
20 gas streams and liquid content even the variability of
21 prices at the plant basically eliminates any benefit
22 you might gain by trying to calculate what would be
23 reasonable for each and every stream. It's just not
24 going to happen. If you're going to track prices, use
25 the real ones.

1 MR. REEMER: When we produce on some of the
2 Indian nation things index on pricing has worked well
3 and following the scale for BTU/NGH content has worked
4 well, and in a particular situation things go well.
5 When we were discussing this ANPR, we anticipate kind
6 of some of the same questions and comments you've
7 received is how do you administer this from
8 California, Rocky Mountains area down to Gulf of
9 Mexico, variability in plants? Don't really know the
10 easy answer to that. It kind of goes back to previous
11 comments. If it's tremendously simplified and doesn't
12 tremendously increase the royalty due, it's still a
13 compelling reason. We used to know what actual costs
14 mean. I read in some of comments from the state that
15 said actual costs you should use actual cost that is
16 transportation processing and actual costs come on an
17 invoice. Now, we're told, well, for that invoice you
18 receive, X percent is disallowed because it's really
19 gathering, X percent is disallowed because it's
20 recompression for a cryogenic plant. So, actual cost
21 is a mystery for years 2008 through 2011 for most
22 facilities on and offshore except for a handful in the
23 San Juan Basin.

24 So, administratively speaking for
25 companies to even administer it obviously has to be

1 prepared. It goes to back to the initial comments,
2 of, well, tell us what your bump looks like, tell us
3 what kind of deduct would be allowed with it and
4 that helps us get our brain around it. But this,
5 you know, checking the Web site once a week to see
6 if there's any unbundled systems and then looking at
7 it with one eye open just to see what those
8 percentages are, is not efficient either. We all
9 know that.

10 The other is just a mystery when it comes,
11 okay, here's your percentage and that's the end of
12 the discussion is sort of new and different than the
13 way I think we administer royalties or actual costs
14 and just taking a leap of faith that percentage is
15 what it is and that's all the information you would
16 get is not really tenable.

17 PANEL MEMBER: Again, we appreciate that
18 comment and actually it's perfect sequel into the last
19 question that we had that we specifically want to
20 focus on the unbundling issue and unbundling is a --
21 occurs with both transportation and processing when
22 we're involved in processing sometimes, but as
23 Mr. Morgan said over the last five years or more,
24 we've seen more and more costs to the lessee, the
25 producer that you're just given a cost for processing

1 or for transportation and that cost or fee is a
2 bundled fee that could involve costs that are
3 allowable deductions, such as for transportation or
4 processing, you know, maybe some compression and
5 things like that; but also some of those fees that are
6 not allowed as deductions from the royalty value again
7 maybe involve compression, dehydration sweetening,
8 things to put the gas into marketable condition. So,
9 on our side of the house we could not blanketedly
10 accept a bundled charge without looking at it further
11 to see what the components of that fee may be not
12 allowable.

13 So, there is a burden on the lessee to the
14 producer and the government to look at that fee and
15 try and break things out. So, we're looking for
16 ways to basically get around that situation by
17 coming up with, you know, some sort of methodology
18 that would, you know, either give an adjustment for
19 processing or transportation, you know, where we
20 didn't have to look at or break out those specific
21 costs to come up with some sort of processing or
22 transportation differential to the royalty value.
23 Are there any thoughts on that to get us out of
24 having to look at specifics of a bumped fee?

25 MR. REEMER: Dan Reemer, Marathon Oil. The

1 Chevron commenter made reference to the ONRR Web site
2 where there are unbundled costs. The last time I
3 looked there were several systems that have unbundled
4 costs and as you look at the systems, some of them
5 just are transportation, some of them are
6 transportation and processing, some of them are just
7 processing and there are transportation components.
8 There is fuel for transportation processing and then
9 there's fuel for processing and when you look at
10 the -- I heard another commenter talking about the
11 range of richness of gas, the range of percent of
12 proceeds, when you look at those unbundled costs and
13 the range of percentages that is either allowed or not
14 allowed, those percentages it's 68 percent up to
15 90 percent and unfortunately that is what it is.

16 As one of the commenters said if you're
17 going to go to the detail of looking at every price
18 for every transportation or every processing so that
19 you can try to be revenue neutral, because that's
20 the objective at end of the day to be revenue
21 neutral, and if you end up doing it at the property
22 level, there are just so many variables that can
23 change and the ranges are so wide, I just don't know
24 how a simple percentage of price -- like with the
25 Indian gas rule for transportation, 10 percent of

1 price was sideways not to exceed or even with the
2 NGH bump.

3 It's extremely challenging because at the
4 end of the day, even if you said, okay, a lot of the
5 commenters, the states and maybe the independents
6 because they market a certain way or they're subject
7 to certain types of cost situations, transportation
8 and marketing arrangements, maybe that's different
9 than offshore and maybe there's a scenario where you
10 can bifurcate it like you did on the oil and say,
11 okay, do it by region or even wellhead sales versus
12 off lease sales, but it's again going back to one of
13 the comments that I think Richard made earlier is
14 bring it up and get it at a higher level so that we
15 can actually achieve some form of simplicity and
16 certainty and at the same time get that revenue
17 neutrality.

18 You can tell from the lack of responses
19 for specificity -- but again going back to Chevron
20 commenter, until you propose a rule and then we step
21 back and look at how it impacts each one of us for
22 each area that we produce and pay royalties, it's
23 difficult to say that there's -- hang your hat on
24 one size fits all that we can look at. I think
25 index price at a nickel is a little bit skinny, but

1 just as an example.

2 PANEL MEMBER: Just a concept.

3 MR. REEMER: Unfortunately, I think that's
4 what it's going to take; and as I go back and look at
5 the record, and I think you were actually there, Deb,
6 back in the Nineties time period when there was the
7 negotiated rulemaking committee and the rulemaking
8 committee kicked off in 1994 with this type of
9 information and input. Both sides saying, okay, if I
10 have one sheet of paper and I could create -- industry
11 said you need, this, this, optionality, and
12 transportation needs, variable, fixed and variable
13 fuels and issues, that's nice to have; but then at the
14 end of the day the committee, ruling committee tried
15 to come down to, okay, what did everybody need to have
16 in order to make this work. And one of the proposals
17 that came out was an index plus, and I didn't see much
18 about that other than the plus based on some expected
19 value and there was a gap for the scoring that
20 internal group did when they looked to adjust the
21 index alone. At least for offshore I think and major
22 producing states there was a 20 million-dollar plus or
23 minus gap. So, the index plus was intended to close
24 that gap.

25 Can you share a little bit in terms of how

1 that was determined, if you were to go down a path
2 like that? So then, we determined that index alone
3 with some type of percentage or a flat rate
4 adjustment doesn't quite get us there, it doesn't
5 get us to revenue neutral, it needs to be an index
6 plus, how would a monitor go about, whether it's
7 market assessment or expected value, to get to that
8 index plus?

9 PANEL MEMBER: That's a good question, Dan,
10 and the negotiated rulemaking is what we came up with
11 so-called safety net where each year we get a report
12 of gross proceeds or actual receipts on behalf of
13 companies, compare that to index plus or minus; and if
14 there's gap, then you adjust that bump or that
15 deduction to try to get to those gross proceeds was
16 the concept.

17 So, when we did the analysis that came up
18 with the 20 million-dollar short, we looked at what
19 was reported on the 2014 versus index and found that
20 gap and the idea with a straight deduct is make up
21 that gap.

22 PANEL MEMBER: The final area that we'd like
23 to talk about a little bit, everybody take a deep
24 breath, we're into the final stretch here and talking
25 about just any other alternatives, you know, that

1 maybe somebody has thought of that we haven't; and,
2 again, that's what we're here for and, you know, doing
3 three public workshops in addition to written comments
4 that we received.

5 One question that we had, again, the whole
6 purpose of this, you know, to take another look at
7 the current regulations and see if there is any way
8 that we could, you know, simplify and clarify things
9 for, you know, the lessees and, you know, the
10 Government and states just to make the process a
11 little more workable. In the code of Federal
12 Regulations Part -- actually 1206 now, we just went
13 to a new numbering schedule -- we do have currently
14 separate Federal regulations for Federal and Indian
15 oil and also separate regulations for Federal and
16 Indian gas. So, just to throw out this concept of
17 maybe making some technical changes, if nothing else
18 is possible, is there any consideration for going to
19 a definition section that we would take similar
20 terms such as "arm's-length," you know, "gathering,"
21 "transportation" that are contained in each one of
22 those different areas of regulation and just putting
23 them up front to apply to all the regulations, again
24 in terms that are similar to all four of those
25 separate regulations to try and, you know, just

1 simplify, that way make it a little more clear?

2 PANEL MEMBER: I'd like to add to that, too,
3 and actually since we're at the very end, it seems;
4 just in terms of regulation, in general, I think what
5 you're seeing with the administration is the
6 administration is looking at all regulations right now
7 to see if we can simplify the regulations. So, from
8 the high level general look at the regulations, that's
9 what Richard is getting at, not only definitions, but
10 wherever we can get the definition easier to read and
11 understandable overall. That's something we'd like
12 some feedback on as well as part of the larger
13 perspective of looking at the regulations across the
14 spectrum. So, just not our regulation, that is being
15 done throughout government right now. So, if there's
16 any suggestions for simplification of how the
17 regulation itself is presented, that's something we'd
18 be interested in hearing as well. I'm not sure the
19 book is as easy to read as we'd like it to be.

20 MR. MORBY: It's not on point, but I sense
21 things are winding down, so I wanted to mention one
22 other thing. You have index pricing for crude oil,
23 you're investigating it for natural gas. At the end
24 of the day if something else spins out of this and we
25 still have natural gas, liquid gas plant products, I

1 would ask that you consider making an option to use
2 index pricing for NGLs if they survive this process.
3 Mt. Belvieu and other places provide pretty dynamic
4 and fluid trade points; and I think a lot of deals are
5 done closely high, low, daily average as relative to
6 the index. So, that's it.

7 MR. MASSEY: I'd like to just make one
8 comment, Dan Massy, Argus Media. There are robust
9 markets of NGLs at Mt. Belvieu and Gulf Coast and also
10 that reflects PAT 2 pricing. A little more difficult
11 on the West Coast and perhaps East Coast, but there
12 are robust markets that are, by our measures, as
13 robust as the crude oil indices that you're currently
14 using.

15 PANEL MEMBER: That pretty much concludes
16 all the formal questions that we had. Again what we
17 were trying to accomplish with these public workshops
18 is to get, you know, any other comments from our
19 stakeholders out there, some people. Again, we
20 appreciate the comments that we received, the written
21 comments for the advanced notice of proposed
22 rulemaking, not everybody may have had an opportunity
23 to send in written comments so that we are having
24 these forums to, you know, to get comments from those
25 individuals and also it gives people a chance to fill

1 in maybe more specific comments that we did not
2 receive initially.

3 We will be headed to Washington D.C. this
4 Thursday for another public workshop and then also
5 our final public workshop will be in Denver next,
6 Tuesday, October 4th. So, if someone was not able
7 to make it here, maybe they could make it at one of
8 those other sessions. If we'll take another minute,
9 if there's any other comments, if not we really
10 appreciate your participation and thoughts. Again,
11 it helps us tremendously to get your perspective on
12 things. As Richard pointed out we are going to be
13 in DC on Thursday. So, if there are thoughts that
14 you have after you leave here and have people
15 representing your programs or your companies in DC,
16 please pass those comments along to them.

17 MR. REEMER: Again to follow-up on a comment
18 that was made by Chevron, we get transporting invoices
19 and we get processing plant statements and to the
20 extent that what we get -- and then our revenue
21 accountants track what's in our system through our
22 system, to the extent that can represent our actual
23 cost, that simplifies and streamlines, provides
24 certainty.

25 So, I know that's what the unbundling

1 project is all about, getting to that point where --
2 this is kind of going back to other alternatives and
3 addressing the unbundling concept is clear
4 definitions, distinctions of what's marketing and
5 what's transportation and what's allowable and
6 what's not so that we can ultimately get to that
7 point or strive to get to that point where our
8 actual costs is what's reflected on our transporting
9 invoices and our processing statements because then
10 it's -- then it's an automated process and it flows
11 through the system and your auditors or your data
12 mining request copies of the contract, we give the
13 contract and we give you invoice and statements and
14 everything matches up and everybody is happy. Again
15 the devil's in the details in how we get to that
16 point.

17 PANEL MEMBER: Thank you-all for attending
18 today, and as we said we're going to be receiving
19 comments for some time and then at some point we're
20 going to be making a decision and issue a proposed
21 rule and at that point we'll also have comments period
22 associated with that part of the process. Thank you
23 for attending today.

24
25

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