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 new organization within the department.

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

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

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

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

MR. STEWARD: I'm Jim Steward, program directer for asset management.

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

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

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

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

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

We feel it's important to obtain stakeholder input to see if further clarification of our rules is, in fact, worth pursuing. The issues we'll be talking about today will include, one, use of index prices to value oil and gas; two, examining possible alternatives to the requirement to track actual costs for determining transportation allowances; and, three, examining possible alternate methods for valuing wellhead gas volumes by eliminating the requirement to trace the value of liquids removed from processed gas.

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

PANEL MEMBER: Good morning. ONRR has over 23 years of experience valuing gas and current gas Federal gas regulation and has over 10 years experience on valuing oil under the current Federal oil valuation regulation which was substantially updated in 2000. Additionally, we have over 10 years experience valuing gas under the Indian gas valuation regulations. Indian gas valuation regulations provide early certainty and greatly simplify compliance.

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

We received comments from 19 parties representing a good cross-section of stakeholders. So, let's begin by looking at the valuation, for royalties purposes, of Federal oil. Generally commenters agreed that the current use of the spot prices and NYMEX prices for non-arm's-length sales of oil is working. So, the first question today we'd like feedback on is: Should the use of index pricing for non-arm's-length -- that's currently used for non-arm's-length be expanded or altered? Would anyone like to comment on that?

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

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

PANEL MEMBER: You want to add to that?

PANEL MEMBER: Well, the Rocky Mountain region is an area if you remember in the 2000 rule we had some issues. I believe we went -- we had few slight modifications to that with one of the benchmarks and went to instead we had three benchmarks for tendering which nobody seemed to use and I think now we slightly modified, I believe, it was the third benchmark; but, you know, side markets are evolving right now with the Bachman comment and we're looking to see if any of you have any thoughts on whether that dynamic is really changing the game. We'd love to hear any of your impressions on that.

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

PANEL MEMBER: Do I need to repeat it?

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

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

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

PANEL MEMBER: Other comments?

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

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

MR. REEMER: Dan Reemer. Yeah, I think as far as actual costs, lessees reasonable actual costs, when the 2000 oil rule was promulgated, there was no provision for what a lessee or an owner of the pipeline system -- for that transportation rate, whether it was a published tariff or contract rate if it's proprietary pipe, it was on a buy/sell agreement. There was no provision in the regulations for that rate to be used. The lessee had to default to actual costs calculation based on operation, maintenance costs, overhead and return on unappreciated capital. That's burdensome on industry and it's burdensome on minority interest owners in pipelines that don't have the financial data necessarily that they need to be able to go through the calculation.

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

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

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

MR. MORBY: Greg Morby with Chevron.

Repeat the question.

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

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

PANEL MEMBER: I'm glad that Debbie made that last comment because I was going to comment on that also. We do appreciate, you know, any positive insights or, you know, if things are working also because that helps us, you know, frame whatever we're going to further analyze going forward for either oil or gas and from the comments that we received or the advance notice of proposed rulemaking. Again, we kind of got that impression that it's -- you know, things could always be tweaked a little bit but oil was probably going to be less controversial than gas, and I think one of the reasons for that is we did make some major changes to oil in the valuation arena in 2000 and then again in 2004. So, we wanted to start off with the easy stuff first.

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

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

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

So, therein lie the conundrum. ONRR invites more specific comments as to whether index pricing could possibly replace gross proceeds in valuing Federal gas production. So, our first question: We want to hear from those that support index pricing as an option and how that would meet the intent of any changes to regulations to add simplicity and clarity. How would that option be applied?

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

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

PANEL MEMBER: Yes, exactly.

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

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

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

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

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

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

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

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

The next question kind of follows up to the first. Again we stated that comments were varied on the issue of going to index pricing to possibly replace gross proceeds, and some people expressed the opinion that they're opposed to that. We'd like to know from that side of the house what their concerns were from anybody that, you know, wouldn't be in favor of going to just an index pricing methodology and getting away from gross proceeds?

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

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

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

PANEL MEMBER: We appreciate that, thank you.

Next question and again we're trying to as we go along delve more deeply into the difficult concepts involved in changing valuation methodologies. We mentioned in the advance notice of proposed rulemaking that in making these changes conceptually we'd like to strive for revenue neutrality; but, you know, revenue neutrality has a lot of meanings; and we could start out looking at it at a high level. And, so, the next question would be: Is there anyone that would support going to index pricing methodology that would replace the gross proceeds calculation if it was not revenue neutral for every transaction? Would the economic benefits of simplicity, certainty and consistency offset any potential increase in royalty revenues paid?

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

MR. MORBY: Greg Morby with Chevron. If I'm understanding your question, the answer would be, yes, it's a compelling thought. Overall in Chevron's Federal gas royalties we come out revenue neutral because we're not spending a lot of time, money and effort on the deductions. You've asked several questions about what did you mean in your comments when you said you want an option. Well, we wanted an option. It's the unknown, it's like, okay, here are your new regulations, under our calculation they're revenue neutral based on the fact that C would pay X and it would cost you Y to administer. That's just a big gray number.

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

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

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

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

PANEL MEMBER: My final question on index pricing or I guess pricing in general is the age old question of we seek input on how to best value gas for royalty purposes in situations where gas from Federal leases is produced in areas not covered by index prices or where limited reported spot market activity exists. Are there any thoughts on that, and I know this is a difficult area.

(No response.)

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

There was general consensus that a flat percentage of index value would likely not provide revenue neutrality and is not preferred. So, what we're seeking feedback on today, you know, appreciate any comment: In the interest of simplifying the determination and verification of the location adjustments ONRR requests any alternative methods to calculate actual transportation costs that would adjust for location differences between the lease or the unit and index pricing and publication point. So, is there any scheme out there that we could apply or formula so we don't have to, we and industry, does not have to trace their actual costs, deductions involving transportation?

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

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

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

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

PANEL MEMBER: That helps a lot. Thank you. We really do appreciate those comment and clarifications. Like Debbie mentioned that does help us kind of frame the discussion and analysis and, again, I think Federal gas is difficult because we are dealing with onshore situations and offshore situations which are, you know, a lot different in the way the market plays out. You know, we've had some experience in the past in the Gulf of Mexico, especially with our royalty-in-kind program. So, you know, we understand, we've played in the transportation costs, things like that also. Any other comments for either onshore or offshore gas transportation and what the specifics are of the difficulties?

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

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

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

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

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

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

PANEL MEMBER: The last big area for Federal gas that involves, you know, allowable and nonallowable deductions from royalty is processing. We've had experience with the Indian gas pool going to a "bump" type of method to the wellhead gas account for the liquids value in the gas stream and which provides, you know, some certainty and some simplicity in that calculation. So, conceptually we're thinking of something similar that might work for Federal gas.

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

Again, there was not a consensus that we saw from the commenters to the ANPR. Some commenters preferred actual costs and said that, you know, you track and calculate those anyway so that you're comfortable doing that. Other commenters believed that a proxy is workable and suggested that adjustments should be plant specific and frequently updated to reflect changing market conditions. So, again, we're just going to throw it out there that we're seeking suggestions regarding other methodologies that would simplify the reporting associated with gas processing allowances; or, if possible, eliminate the allowances by substituting a market-based proxy to reflect the variable of hydrocarbon contained in the gas stream.

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

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

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

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

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

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

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

So, administratively speaking for companies to even administer it obviously has to be prepared. It goes to back to the initial comments, of, well, tell us what your bump looks like, tell us what kind of deduct would be allowed with it and that helps us get our brain around it. But this, you know, checking the Web site once a week to see if there's any unbundled systems and then looking at it with one eye open just to see what those percentages are, is not efficient either. We all know that.

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

PANEL MEMBER: Again, we appreciate that comment and actually it's perfect sequel into the last question that we had that we specifically want to focus on the unbundling issue and unbundling is a -- occurs with both transportation and processing when we're involved in processing sometimes, but as Mr. Morgan said over the last five years or more, we've seen more and more costs to the lessee, the producer that you're just given a cost for processing or for transportation and that cost or fee is a bundled fee that could involve costs that are allowable deductions, such as for transportation or processing, you know, maybe some compression and things like that; but also some of those fees that are not allowed as deductions from the royalty value again maybe involve compression, dehydration sweetening, things to put the gas into marketable condition. So, on our side of the house we could not blanketedly accept a bundled charge without looking at it further to see what the components of that fee may be not allowable.

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

MR. REEMER: Dan Reemer, Marathon Oil. The

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

As one of the commenters said if you're going to go to the detail of looking at every price for every transportation or every processing so that you can try to be revenue neutral, because that's the objective at end of the day to be revenue neutral, and if you end up doing it at the property level, there are just so many variables that can change and the ranges are so wide, I just don't know how a simple percentage of price -- like with the Indian gas rule for transportation, 10 percent of price was sidewards not to exceed or even with the NGH bump.

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

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

PANEL MEMBER: Just a concept.

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

Can you share a little bit in terms of how that was determined, if you were to go down a path like that? So then, we determined that index alone with some type of percentage or a flat rate adjustment doesn't quite get us there, it doesn't get us to revenue neutral, it needs to be an index plus, how would a monitor go about, whether it's market assessment or expected value, to get to that index plus?

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

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

PANEL MEMBER: The final area that we'd like to talk about a little bit, everybody take a deep breath, we're into the final stretch here and talking about just any other alternatives, you know, that maybe somebody has thought of that we haven't; and, again, that's what we're here for and, you know, doing three public workshops in addition to written comments that we received.

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

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

MR. MORBY: It's not on point, but I sense things are winding down, so I wanted to mention one other thing. You have index pricing for crude oil, you're investigating it for natural gas. At the end of the day if something else spins out of this and we still have natural gas, liquid gas plant products, I would ask that you consider making an option to use index pricing for NGLs if they survive this process. Mt. Belvieu and other places provide pretty dynamic and fluid trade points; and I think a lot of deals are done closely high, low, daily average as relative to the index. So, that's it.

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

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

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

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

So, I know that's what the unbundling

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

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

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COUNTY OF HARRIS:

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