OFFICES OF
DAVID C. HARRISON
505 Marquette NW, Suite 1
Albuquerque, New Mexico 87102
(505) 843-8698
Fax (505) 843-8694 or
(505) 842-5760

Mary M. Zuni
Office Manager

October 30, 1996

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
DOCUMENT PROCESSING SECTION
OCT 31 1996
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Mr. David S. Guzy, Chief
Rules & Procedures Staff
Minerals Management Service
Royalty Management Program
P. O. Box 25165
MS 3101
Denver, Colorado 80255

Dear Mr. Guzy:

Please find attached comments of the Council of Energy Resource Tribes (CERT) on the proposed amendments to Transportation Allowance Regulations for Federal and Indian Leases to Specify Allowable Costs and Related Amendments to Gas Valuation Regulations.

Sincerely,

Mary M. Zuni
Office Manager

COMMENTS OF THE COUNCIL OF ENERGY RESOURCE TRIBES

Re: PROPOSED AMENDMENTS TO TRANSPORTATION ALLOWANCE REGULATIONS FOR FEDERAL AND INDIAN LEASES AND RELATED AMENDMENTS TO NATURAL GAS VALUATION REGULATIONS

GENERAL

The introductory language of the preamble should specify that the present regulations not only are limited to "reasonable actual costs of transportation," but are also limited to no more than 50% of the value of the production. This language should further specify that these limitations are continued in the proposed regulations.

It may be a bit much to suggest, as you do, that "FERC remedied the inequities in the gas market," with Order 636. That Order certainly changed things, and it is in light of those changes as they are presently appreciated that the present proposal is put forth.

Given that the Indian RegNeg rules state that the Department's duty in the case of Indian production is to maximize revenues to the Indian mineral owners in accordance with lease terms and the Secretary's trust responsibility, and separate rules are to be proposed, we suggest that the Department should solicit specific comments on the question of whether or not separate transportation regulations should be proposed for Indian leases as well. This suggestion is made in light of the observation that Indian leases themselves do not mention transportation allowances at all, but do mention processing allowances. The doctrine of *inclusio unius est exclusio alterius* could be invoked to support the proposition that the Secretary's duty to maximize revenues and his trust responsibility compel him to protect Indian royalties from being subjected to allowances that are not contemplated in the leases.

The possibility of different transportation regulations for Indian leases would hold open the possibility of splitting the baby differently for federal and Indian allowances. More on that later.

Section-by-Section Analysis

We find the discussion on **Firm demand charges** unclear. If we understand this discussion, it is not true as stated that, "MMS proposes allowing firm demand charges." The succeeding limiting language attempts to clarify the point, but seems to us to result in inconsistent sentences. As we understand it, MMS proposes to allow <u>that portion</u> of firm demand charges on a pro rated per MMBTU basis that pay for gas actually shipped.

We do not share the MMS stated economic assumptions in this section that both the demand charges and the commodity charges permit pipelines only to recover their fixed and variable costs, respectively. It is clear from the following discussion that MMS recognizes profit margins built into both these components, i.e., "return on equity." We think we understand what is proposed here, namely, that MMS proposes to permit allowances for those portions of both demand and commodity charges that reflect the costs paid for gas actually shipped, but not to saddle royalty owners with the potential business costs that may be associated with purchases of surplus or unused capacity. If we understand this correctly, it should be stated more clearly. If MMS does not intend what we understand, then this proposal should be modified to say what we think it says.

<u>Capacity Release</u>

We believe this discussion is merely intended to further clarify what we indicate we understand from the discussion on firm demand charges, and this discussion could be significantly truncated if the preceding discussion were clarified as we have suggested above.

<u>Rate adjustments</u>

We agree that any allowances taken that are later rebated should certainly be adjusted and appropriate additional royalties paid. Monitoring this feature, however, will be even further complicated if the refund or rebate takes the form of a credit against future charges.

<u>Gas Supply Realignment Costs</u>

It is not entirely clear to us what is proposed here. If payors may take allowances for only <u>that portion</u> of their firm demand charges that are actually used, but are allowed to recover all of any GSR costs they may repay through this component of their bills from the pipeline, then the initial objective of limiting the firm demand charge that can be taken may well be lost, or so it seems to us. This proposal has the effect of "carrying" the royalty owner along on the myriad of business decisions of pipelines and producers that have nothing to do with actually transporting gas. This proposal also carries with it the potential of vitiating the careful attempt to limit that portion of a firm demand charge that can be taken as an allowance by permitting a producer to recover the entire portion of a GSR cost allocated to him, regardless of his actual volumes shipped.

We also suggest that MMS should be more direct and straightforward in this discussion regarding what royalties are due on pipeline settlements of various kinds. Many tribes and individual Indian mineral owners are still unclear on exactly how the MMS actually regards these payments received by a producer.

Wheeling costs

We are not sure we see any principled basis for treating costs incurred at a hub so differently as we propose to treat wheeling costs and parking costs. Actual transportation costs should not be allowed or disallowed as if we think the difference is whether or not molecules are in motion (which, of course, they always are), or as if we think they can even be tracked (which, of course, they cannot). The cost for wheeling gas through a hub is as much an incidental cost of marketing as is any cost associated with (theoretically) shunting it to a siding and back into the transportation system. These costs should be treated the same as it is proposed to treat the banking or parking fees incurred at a hub.

If the MMS does proposes to allow wheeling costs, this proposal should also be limited to "actual reasonable" costs incurred for wheeling.

GRI and ACA fees

We se no reason whatsoever why these fees should be allowed as transportation allowances. The MMS does not make any representation that these fees have anything at all to do with the transportation of gas. We see no principled basis for distinguishing these fees from any other government-imposed costs, such as *ad valorem* or income taxes that are solely the responsibility of the taxpayer. He has already factored these costs of doing business into his charges for his services, or the government agency imposing them has already allocated them to the party responsible for paying them. There is no basis whatsoever for the government agency charged with maximizing revenues from Indian production to volunteer this cost-sharing scheme which has the effect of directly diminishing those revenues.

Actual or Theoretical losses

There has to be some limit to any allowance under this provision, and some mechanism for monitoring such allowances against the 50% limit. In the field, we make a distinction between avoidable and unavoidable losses. In the pipeline, it appears we do not intend even to attempt to make this distinction, and are willing to permit payors to take unlimited allowances for unlimited *theoretical* losses. This cannot be the case. And if it is, it is totally unacceptable for Indian production.

Supplemental services necessary for transportation

This discussion is entirely inconsistent with the underlying purposes of the new Indian gas valuation regulations. The discussion regarding the producer's duty to put the production into marketable condition at no cost to the lessor is well stated and well taken. The remainder of this provision is totally inconsistent with that discussion of the producer's duty.

The entire economic rationale for permitting transportation allowances at all is that economic value is added to the production (at some cost), and that cost is allowed to be deducted from the enhanced value to arrive back at a wellhead or lease boundary value for royalty purposes. There is no suggestion whatsoever in this discussion that any value is added to the production by these "supplemental services." By the terms of this discussion, no deduction is permitted for "any costs necessary to bring production up to the required pipeline system standards." If the production meets pipeline standards, no deduction should be allowed for superfluous activities or processes the pipeline might elect to require as part of its own revenue-maximizing activities. We have seen situations in which contracts have been rewritten with no apparent purpose in mind at all, except to take advantage of the additional allowances which would be permitted by this proposal. This legalistic legerdemain emphatically should not be rewarded.

Non-allowable costs in determining transportation allowances

marketing costs and fees

We emphatically agree that the costs of marketing production are solely the province and duty of the producer, and that no deductions against royalties, whether denominated transportation or any other form of allowance, should be permitted.

Storage fees

We agree that storage fees should not be permitted as a deduction against royalties. We fail to see the principled basis for treating "banking" or "parking" fees at a hub differently than the "wheeling" fee. It seems to us that all of these are incidental to marketing and should not be allowed.

We think the MMS has been too cute by far, however, in its attempt to treat sales remote in both time and distance as somehow an inevitable exception to the gross proceeds rule. It is often the case that a producer does not know exactly what production he has sold, or what he has sold that production for, by the end of the month following the month of production. That is why estimated payments are made. If he stores gas for later sale, he should pay an estimated royalty, and when he actually sells the gas, he should pay any additional royalties that may be due based on his gross proceeds. So long as the MMS permits subsequent adjustments to reduce royalties, the agency cannot pretend that subsequent adjustments upwards are not required, if the gross proceeds actually exceed the basis upon which estimated payments were made.

Penalties

We agree that penalties that a producer may incur from pipelines are not associated with the reasonable actual costs of transportation that, arguably, add value to the production and should be entitled to an allowance. Penalties for over-delivery, under-delivery, failure to nominate and deliver in an accurate and timely fashion, failure to correct imbalances, or for failure to comply with other contract provisions and conditions are no responsibility of the lessor; these costs reflect no value-added activity; and to permit them as allowances would render the lessor's royalty more subject to the operational competence of the producer than to the "value" of the production, as required by the lease terms and the Secretary's trust responsibility.