



Taking Royalties in Kind: The Federal Perspective

Presentation to the American Association of Professional Landmen

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RIK Authorities

- The Secretary reserves the right to take royalties in kind
 - ready to do so when it makes sense for the Treasury
 - and rarely has made sense in recent decades for value purposes
- Lessees agreed to that right in the Lease
- RIK is explicitly permitted at the Secretary's discretion in:
 - The Mineral Leasing Act
 - The Outer Continental Shelf Lands Act

RIK Authorities

- There has been renewed interest in RIK over last 4 -5 years
- MMS, the Administration, the Congress and Industry all believe it is worth looking into
- MMS started its study of RIK 4 years ago to find out:
 - is it economically efficient to take royalties in kind?
 - Is it accurate, simple and certain?- lowers admin cost
 - Is it revenue neutral?
 - Can we effectively market our production and enhance value?
- Consistent with main objective of Federal resource management to maximize value to the taxpayer

MMS RIK Pilot Progress

- MMS continues to prudently and conscientiously proceed with RIK development
- Over the last 4 years our work has shown:
 - there is a potential to lose money -
 - the 1995 Gas Pilot showed us that
 - there is the potential to earn money -
 - the 1997 Feasibility Study showed us that
 - we've seen the pitfalls and the opportunities and better understand the factors that dictate RIK success

MMS RIK Pilots - the Next Step

- The logical next step for MMS was to proceed with a larger, broader, more comprehensive test
- 1997 Feasibility Study recommended three pilots be implemented.
 - Onshore Oil pilot in Wyoming
 - small offshore gas pilot in 8(g) waters off Texas
 - Offshore Gulf of Mexico gas pilot
- Pilots chosen in areas when there was some potential for success, State interest

MMS RIK Pilots - Today

- MMS has put together a team of 15 people
 - representing a broad cross-section of MMS skills and experience
- Plus participation from BLM, other agencies, and Wyoming and Texas
- Extensive discussion with regional industry in our planning process
 - met with producers, marketers, refiners
- Working overtime to produce timely, efficient and effective pilots
 - the Texas 8(g) gas pilot by Oct. 1, 1998
 - the Wyoming Oil pilot by Oct. 1, 1998
 - the offshore GOM gas pilot by Oct. 1, 1999

MMS Wyoming Oil RIK Pilot

- Developing the pilot to examine the many factors that control RIK success
- Will test RIK in the two main producing basins of Wyoming:
 - the Powder River basin and Big Horn Basin
- Will take Sweet crudes and sour asphaltic crudes
- Will take crude transported by Pipeline and truck
- Will take crude from higher productivity wells and well as stripper wells
- Will market crude by competitive bidding/public auction and by marketing direct to refiners and other marketers

MMS Wyoming Oil RIK Pilot

- Royalty Production
 - 4445 bbls/day in Powder River Basin
 - 4420 bbls/day in Big Horn Basin
- Pilot may take in-kind as much as half of that
- Size of Wyoming pilot: up to 4000 bbls/day
 - necessary for adequate test
 - marketing intelligence suggest minimum feasible contract size of 500 bbls/day
- Other half of Royalty Production will remain in-value
 - provides a benchmark to test program success
- Pilot will run a minimum of two years

MMS Texas 8(g) Gas RIK Pilot

- Volumes in the 8(g) area are small
 - royalty oil production only 402 bbls/day
 - royalty gas production 72,000 mcf/day
- Oil is mostly condensate produced with the gas
- Pilot focussed on gas royalty production will take much of the oil production with it
 - condensate commingled with oil and separated onshore
- Considerable potential to supply Federal facilities in Texas and region with royalty natural gas
 - GSA, VA, Federal prisons, NASA, Defense all users in the State

MMS Texas 8(g) Gas RIK Pilot

- Will work in close collaboration with Texas
 - a cooperative agreement will be finalized shortly
 - they will advise us and market production jointly with us
- Texas GLO RIK program from State Leases is a Good fit
 - successful and established: we can learn from them
 - scale economies, efficiencies from working together
 - benefits of further aggregation for smaller volumes
 - State leases adjacent to Federal leases
 - same pipelines, markets, information
 - same opportunities

MMS GOM Gas RIK Pilot

- Potential Size of GOM pilot dwarfs the other two
- Huge, complex undertaking
- Royalty Gas production from GOM is 2.3bcf/day
 - makes MMS the largest supplier of gas from the Gulf
 - Size and effect on the market becomes a consideration in planning the pilot
- Intricate transportation network and highly evolved, complex market structures
 - much to understand before we jump into it

MMS GOM Gas RIK Pilot

- Size and complexity dictate that it will take another year before we can confidently have a pilot that we can implement -- Oct 1, 1999 start
- Work has begun
 - analyzing lease data, pipeline infrastructure, processing facilities, assessing which fields to take in kind
 - Like Wyoming, hope to structure a program that helps us understand the key success factors better, and comprehensively and broadly tests RIK potential in the Gulf of Mexico
 - Working on the Legal issues, contractual/procurement issues, and developing a marketing strategy
 - finding Federal markets for the gas

MMS RIK Pilot Progress

- We don't have all the answers yet, a lot of work remains
- We're committed to producing the successful pilots
- Continued collaboration with Industry essential to Pilot success
- Outreach is a key part of our effort
- Wyoming and Texas 8(g) pilots structures will be ready shortly
 - need sufficient time through spring and summer for contracting, notification, systems and specific details,
- Mid-Winter target for GOM pilot structure

RIK Value Creation

- Under RIK the MMS might have to cover costs currently paid by lessees
 - need to *create value* to overcome these costs
- A competitive market is a zero sum game
 - changing the seller does not increase value
 - competition means you can not simply raise the price of a product
- We have to do something better than the industry to create value - that's not easy.

RIK Value Creation

- Need to provide services with the basic oil or gas commodity to add value - why buy from MMS?
 - Aggregation is one potential service MMS could supply
 - adds value because it reduces costs for the purchaser
 - eliminates a service currently provided by someone else in the industry value chain - who are the losers?
 - Do we have a competitive advantage to provide these services?
- Value in less-competitive markets is created by overcoming barriers to competition

RIK Summary

- MMS has authority to take royalties in kind and is doing it
 - *no legislation is necessary*
- Work on RIK pilots to learn where when and how to implement in the taxpayer's interest
- Optimistic about the opportunities that RIK presents and will elect to do so where it makes sense