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February 5, 1996

Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Service
P. O. Box 25165, MS-3101
Denver, Colorado 80225



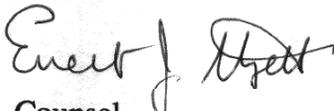
Re: Amendments to Gas Valuation Regulations,
60 Fed. Reg. 56,007 (November 6, 1995)

Dear Mr. Guzy:

Enclosed for your information and filing (via telecopy) is a copy of the comments of Conoco Inc. with respect to the above-referenced Notice of Proposed Rulemaking.

By separate cover you are being mailed, postage prepaid, an original and three copies of Conoco's comments. Should you have any questions or need additional information, please contact me at Tel.: (713) 293-1853.

Sincerely yours,


Counsel

/jg

Enclosure

cc: Mrs. Cynthia Quarterman, Director
Minerals Management Service
U. S. Department of the Interior
1849 C Street, N. W.
Washington, D. C. 20240

Frank B. Balke, Conoco, Houston

COMMENTS OF CONOCO INC.

MMS NOTICE OF PROPOSED RULEMAKING "AMENDMENTS TO GAS VALUATION REGULATIONS FOR FEDERAL LEASES", 60 FED. REG. 56,007 (NOVEMBER 6, 1995)

Conoco Inc. ("Conoco") welcomes this opportunity to submit these comments to the Minerals Management Service ("MMS") with respect to the above-referenced Notice of Proposed Rulemaking.

I. INTRODUCTION

Conoco is a wholly-owned subsidiary of E. I. du Pont de Nemours and Company. In 1994 its worldwide production of crude oil, condensate, and natural gas liquids averaged 436,000 barrels per day; and its worldwide natural gas production averaged 1,347 million cubic feet per day. During the five year period ending December 31, 1995 Conoco remitted royalty payments to the MMS in excess of \$383 Million.

Conoco and some of its employees are members of the American Petroleum Institute, Natural Gas Supply Association, Rocky Mountain Oil & Gas Association, and Council of Petroleum Accountants Societies -- all of which organizations are filing separate comments regarding this proposed MMS rulemaking. Except as otherwise stated herein, we adopt, and incorporate by reference, the comments as filed by these other organizations. We further note that such oil and gas industry organizations, like Conoco, are generally supportive of both the index-based gas valuation methodologies and the regulatory amendments as set forth in this proposed rulemaking.

The comments of Conoco which follow are intended to (i) address the specific questions as asked by the MMS in the preamble to its rulemaking proposals beginning at 60 Fed. Reg. 56,007; and (ii) make corrections and recommendations as to the suggested text to the proposed MMS gas valuations regulations which appear beginning at 60 Fed. Reg. 56,016. Further, these comments are limited to the proposed revisions to existing regulations and should not be construed as any endorsement of the existing "gross proceeds" gas valuation regulations.

II. GAS CONTRACT SETTLEMENTS

At 60 Fed. Reg. 56,011 the MMS asks for comments concerning whether gas contract settlement amounts entered into after the effective date of the rulemaking should be subject to royalty for lessees who use index-based or other gas valuation standards for royalty computation purposes. Conoco does not believe that gas contract settlements should be subject to royalty if a lessee uses the option of paying royalties based upon "index" prices.

Stated simply, the preamble as published in the Federal Register erroneously suggests that the Negotiated Rulemaking Committee "did not consider . . ." the gas contract settlement issue. 60 Fed. Reg. 56,011. This is not the case. In fact, the Negotiated Rulemaking Committee's March 1995 Final Report expressly states at page 35 that the "final safety net median value calculation will not include . . . pipeline buyout/buydown settlements." The efforts of the MMS to now require that gas contract settlement amounts received by royalty payors be treated as an add-on to "index" royalty payments violate the consensus which was reached and agreed within the Negotiated Rulemaking Committee with respect to lessees who elected to pay gas royalties upon an index-based value. Accordingly, the provisions of proposed § 206.454(a)(6) at 60 Fed.

Reg. 56.024 should be deleted from any final rule, and a new provision substituted which is fully consistent with the March 1995 Final Committee Report and consensus.

III. **FINAL SAFETY NET MEDIAN VALUE WITHIN 2 YEARS**

At 60 Fed. Reg. 56,012 comments are requested concerning the consequences which should occur in the event the MMS fails to publish "the final safety net median value within two years". Conoco believes that the consequences to occur should be that "no additional royalties" would be due from the lessee. This result should achieve the certainty in gas royalty payments to the Federal Government -- which certainty is at the very heart of the optional and streamlined index-based royalty payment methodology as recommended by the Negotiated Rulemaking Committee. The very essence of the Committee's recommendations and final report is, after all, that "gas produced from Federal leases be valued based on indices published in trade publications such as 'Inside FERC' and 'National Gas Intelligence'." MMS, News Release (March 16, 1995). The true-up calculations are purely secondary to the index-based royalty payments. Moreover, clearly providing that the MMS's failure to complete the final true-up calculations within two years should preclude it from seeking additional royalties.

IV. **ELIMINATION OF FORMS**

At 60 Fed. Reg. 56,014 the MMS notes that both the Committee's Final Report and proposed regulations as to index-based gas royalty payments state that "all gas transportation allowance forms . . . [and] all processing allowance forms" are eliminated. Conoco fully supports these proposals -- and again emphasizes the simplicity, certainty, revenue neutrality, and cost savings which will result for both the Government and industry due to the elimination of these

unnecessary forms. See in this regard the Final Report, Negotiated Rulemaking Committee at p. 73 (March 1995). In fact, it is Conoco's belief that the cost savings to the Government from the elimination of these unnecessary forms may be more than adequate to insure that sufficient resources are available within the MMS to timely complete the final "true-up" calculations previously discussed.

V.
SEPARATE ZONE DETERMINATION
AS TO SAN JUAN COALBED METHANE

Both the MMS published rulemaking and the Committee's Final Report fail to adequately address the unique and unconventional characteristics of coalbed methane gas production from the San Juan Basin. See, § 202.454(g) at 60 Fed. Reg. 56,027 as well as the discussion in the Committee's Final Report at 51-52. Further consideration should be given by the MMS to the establishment of a separate index-based zone for San Juan Basin coalbed methane production because of its unique characteristics. The Committee's Final Report at page 52, in fact, requires that "this list of factors and conditions is not necessarily all inclusive when determining zones" In short, Conoco suggests that the following language be added to proposed § 206,454(g)(3) at 60 Fed. Reg. 56,027:

"(3) unique and unconventional characteristics";

and that the existing proposed § 206.454(g)(3) be changed to § 206.454(g)(4).

We believe, moreover, that it is inequitable for both the MMS and coalbed gas producers for the San Juan Basin to be treated under one index zone. From the producer standpoint, if they were to pay on index, they would be faced with the possibility of paying additional royalty because the final safety net median value includes NGL values. Coalbed methane produced in the San Juan Basin contains only trace amounts of nonrecoverable NGLs.

If the coalbed producers were to pay royalties on a gross proceeds basis, then MMS could never be assured of receiving market value on conventional gas. This situation would be due to the final safety net median value containing no NGL value because coalbed gas accounts for more than 50 percent of the San Juan Basin production. These factors need to be considered in the technical conference prior to MMS issuing the final zone determinations.

VI. SUPPLEMENTARY REPORTING

At 60 Fed. Reg. 56,015 the MMS asks for comments concerning how to facilitate additional reporting on the Form MMS-2014 in order to accommodate many of the proposals as contained in this rulemaking. Conoco recommends that these important issues be given to the Production and Royalty Reporting Subcommittee of the Royalty Policy Committee for prompt resolution. In this fashion, we believe the needs of both industry, MMS, and the States for a more streamlined and cost efficient gas royalty reporting process will be achieved and improved.

VII. SUGGESTED REVISIONS TO THE PROPOSED REGULATIONS

In addition to those matters addressed above, Conoco comments upon the proposed regulations which appears at 60, Fed. Reg. 56,016 as follows:

Proposed § 202.450(d)(iv)(3) at 60 Fed. Reg. 56,017. This provision (weighted average of operators' gross proceeds under arm's-length contracts for that month in field or area) should be moved to (c)(1) and the remaining valuation benchmarks renumbered accordingly. We believe that the most appropriate

value for production not taken is the value received in the current month in the field or area. A current month value is, after all, the best indicator of "market value" in most circumstances.

Proposed § 206.454(e)(7) at 60 Fed. Reg. 56,026. The terms "technical procedural review from the Associate Director . . ." need additional clarification. The technical review procedure should afford all affected lessees with reasonable access to all studies, accounting reports, and computer generated information, and other data which is relied upon by the MMS with respect to its "final safety net median value . . ." Such access to MMS records is fully consistent with MMS's broad access to similar accounting records of royalty payors/lessees. The fundamental purpose of the "safety net" or "true-up" calculations, after all, is merely to validate whether or not the alternative index-based gas royalty payments represent an appropriate "market value" for the gas production at issue.

Proposed § 206.454(e)(8)(9) and (10) at 60 Fed. Reg. 56,026. Each of these subsections--i.e., (8), (9), and (10)--state that the lessee must determine the weighted average value. We note that the Committee's Final Report at page 35 expressly states that the "MMS will calculate the weighted average price . . ." Conoco, however, agrees with the requirement as revised in the proposed

regulations. This revision will to some extent lessen the administrative burden upon the MMS in calculating the "safety net". Presumably, this will also assist the MMS in complying with the 2-year deadline for computing the "final" safety net calculations.

With respect to the "50%" percentage as set forth in proposed § 206,454(e)(9)(ii)(B) the percentage should be "65%". Similarly, as to the "50%" percentage as set forth in proposed § 206,454(e)(10)(ii)(B) the percentage should be "30%". Both of these percentages are correctly stated in the Committee's Final Report at pages 36 and 37.

Proposed § 206.457(c)(1)(ii)(B) at 60 Fed. Reg. 56,029. Conoco support the MMS recommendation concerning situations where more than 30 percent of the gas is under arm's-length transportation contracts. We would encourage the MMS to include this concept in the oil transportation allowance final rules now being considered within the agency.

VIII. CONCLUSION

For the foregoing reasons Conoco asks that the MMS adopt its proposed gas valuation regulations with the revisions indicated. Should the MMS have any questions of Conoco

concerning these comments, please address them to the undersigned or John E. Clark (tel.: 405-767-5044).

Dated: February 5, 1996

Respectfully submitted,

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