Mobil Exploration & Producing U.S. Inc.

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January 29, 1996

Mr. David S. Guzy **VIA FEDERAL EXPRESS**
Chief, Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
Denver Federal Center, Mail Stop ~~3901~~ 3101
Building 85, Room A-212
6th and Kipling Street
Denver, CO 80225

Re: Mobil Exploration & Producing U.S. Inc.;
Comments on Notice of Proposed Rulemaking;
Amendments to Gas Valuation Regulations
for Federal Leases;
60 Fed. Reg. 56007 (Nov. 6, 1995)

Dear Mr. Guzy:

Transmitted herein are the comments of Mobil Exploration & Producing U.S. Inc. ("Mobil") on the proposed regulations published by the Minerals Management Service ("MMS"), United States Department of the Interior ("DOI"), on November 6, 1995, entitled "Amendments to Gas Valuation Regulations for Federal Leases."

These comments are intended to complement comments submitted by the American Petroleum Institute and other organizations of which Mobil is a member. They therefore are not intended to be exhaustive, but rather are designed to focus on certain areas of interest to Mobil that may not be addressed elsewhere.

PRELIMINARY OBSERVATIONS

Mobil applauds the efforts of all of the participants in the negotiated rulemaking, particularly including the efforts of the agency itself. Among the many benefits of the process was the educational opportunity presented to the participants. Mobil believes that everyone has, and will continue to benefit from the increased knowledge and understanding that they have obtained regarding other interested parties' concerns.

Mobil not only applauds the process, it is supportive of the result. Many difficult issues were addressed on which there were substantial differences of opinion; and, to the great credit of everyone involved, the participants were willing to make compromises on individual issues in order to reach agreement on a consensus proposal. Thus, although Mobil believes that certain issues could, and perhaps should, have been handled differently, it supports the consensus proposal.

These comments are intended merely to identify certain areas that could benefit from further clarification, to identify what Mobil believes are two unintended gaps in the proposal and, in one instance, to identify a deviation from the consensus recommendation -- with one additional caveat. The proposed regulations note that the rulemaking process necessitated that the committee's consensus be incorporated into the MMS' existing regulations, as well as in new regulations. They further note that:

> In some instances, various participants on the Committee may have long-standing differences of opinion with MMS on the meaning and interpretation of existing regulations, some of which may be under administrative or judicial appeal. The incorporation of the Committee's consensus as expressed in the report into the existing regulatory framework should not be interpreted or infer that consensus was also reached on these differences or that they have been waived or withdrawn.

60 Fed. Reg. at 56008. Mobil is one of those who have long-standing differences of opinion with MMS on the meaning and interpretation of the agency's existing regulations, and it currently is a party to numerous administrative and judicial appeals challenging certain aspects of those existing regulations and MMS' interpretation and application of the regulations. Mobil's support of the consensus proposal of the negotiated rulemaking committee, therefore, is not, and should not be deemed

to be a waiver or withdrawal of its objections to the agency's existing regulations. Moreover, to the extent that the proposed regulations recodify the existing regulations, Mobil has the same objections to the proposed rulemaking.

COMMENTS

1. An express exception should be added to allow volumes and values to be reported and paid on a takes method for stand-alone leases and 100 percent Federal Agreements to be consistent with the Final Report of the Federal Gas Valuation Negotiated Rulemaking Committee, dated March 1995. The Final Report states, on page 3, that:

> The committee concurred with MMS' proposal that for gas produced from Agreements which contain only Federal leases with the same royalty rate and funds distribution, and from leases not in an Agreement (stand alone leases), volume and value must be reported and paid on a takes method. The proposal provided for an exception for lessees to request approval to pay on entitlements.

This recommendation is discussed again beginning at page 63 of the Final Report. The Final Report, at page 64, states the following:

> The MMS asked the committee for their input on a takes method for stand alone leases and leases in 100 percent Federal Agreements. The committee agreed with the MMS proposal. Although MMS explained that the lessee could still be held liable for undertakes in these situations, industry favored a takes reporting method for stand-alone leases and leases in 100 percent Federal Agreements because of simplicity and the fact it eliminates out-of-pocket royalties. Industry did not agree with MMS' position that the lessee would be liable for undertakes in these situations; however, industry did not perceive the issue associated with liability in these situations as problematic because the parties are Federal lessees and are more likely familiar with Federal royalty payment requirements.

As reported in the Final Report, the Solicitor advised the committee that MMS was considering publishing a proposed rule that would amend the requirement to report and pay royalties on production from, or attributable to, individual leases (leases not committed to Federal Agreements) or leases in 100 percent Federal Agreements to provide that volume and value should be reported and paid on a takes method. A notice of proposed rulemaking entitled "Liability for Royalty Due on Federal and Indian Leases; Paying and Reporting Royalty and Other Payments" was published at 60 Fed. Reg. 30492 (June 9, 1995). These proposed regulations, however, may or may not be finally promulgated. More important, the proposed rulemaking only proposes to amend 30 C.F.R. Part 211. It does not address 30 C.F.R. Part 202, Subpart D, which contains the current regulations regarding whether a takes method or an entitlements method of reporting and paying royalties is required.

The proposed rulemaking that is the subject of these comments, by contrast, do propose amending 30 C.F.R. Part 202. 60 Fed. Reg. at 56016-17. Accordingly, an express exception should be added here to allow volumes and values to be reported and paid on a takes method for stand-alone leases and 100 percent Federal Agreements, to be consistent with the consensus recommendation of the negotiated rulemaking committee.

2. An unintentional gap exists with respect to the use of index pricing for deepwater OCS production. The definition of an "active spot market" in proposed 30 C.F.R. § 206.451 comports with the consensus recommendation. It provides as follows:

> A. Active spot market means a market where one or more MMS-acceptable publications publish bidweek prices (or if bidweek prices are not available, first of the month prices) for at lease one index pricing point in the zone.

There are no index pricing points in OCS deepwater zones. Moreover, proposed 30 C.F.R. 206.454(g)(2) provides that deepwater leases in the OCS will not be included in a zone that includes non-deepwater leases. This means that index pricing can never be used for deepwater OCS leases, which is not what was intended by the committee. Mobil suggests that proposed 30 C.F.R. § 206.454(g)(2) be modified to add an additional sentence to provide that, for deepwater leases in the OCS for which there is no index pricing point physically located in the zone, the index pricing point recognized by existing gas markets as being appropriate for that zone be deemed to be the index pricing point in the zone.

3. MMS should consider reevaluating the need for the elaborate safety net provisions of the proposed regulations after a certain amount of time (perhaps three years) has passed. Consistent with the Clinton Administration's efforts to reinvent government by reducing regulatory burdens if they are not cost-justified, Mobil suggests that the proposed regulations be modified to include an express requirement that MMS reevaluate at an appropriate time the need for the safety net provision. This should be done after sufficient data has been accumulated to test the assumption that index prices are a reliable indicator of value, and that the safety net does not generate sufficient additional royalties to justify its cost.

Additionally, as gas markets mature and more payors utilize index pricing, the safety net provisions may become more difficult to apply. With the markets still in a state of flux, it would be appropriate for the agency to require that the regulations be reevaluated in light of changing conditions after the expiration of a specified time period.

4. The proposed regulations should be modified to expressly recognize that fair market value at the lease, which is the value on which royalties are owed, may be a range of values, and that use of the valuation methodologies provided for in the proposed regulation will not be rejected simply because use of some other valuation methodology might result in a higher wellhead value.

Mobil applauds the committee's recognition of the guiding principle, stated at page 2 of the Final Report, that "[v]alue should be based on the fair market value at the lease." The committee considered a variety of methods to determine that value at the lease should be based on index prices, less transportation costs arising from location differentials. The regulations should expressly recognize that valuation methods allowed under the regulations may not always result in the highest netted-back value at the lease. For example, where there are several possible index prices that can be used, the proposed regulations require the use of the second highest average index from the prior year, regardless of the transportation costs from the lease to that point. An index price at another location might be lower, but have a lower transportation cost associated with it. In this situation, the proposed regulations require a method that results in a lower value at the lease than would be arrived at by using the lower index price, because of the difference in transportation costs. Regulations should recognize this possibility and expressly state that the valuation methodology of the proposed regulation is acceptable notwithstanding the fact that it may not always result in the highest value at the lease.

5. The reference in the proposed regulations to royalties being owed on contract settlement proceeds should be deleted. It is Mobil's position, which is currently being asserted in numerous administrative and judicial appeals, that contract settlement proceeds are not proceeds from the sale of lease production and, therefore, are not royalty bearing. In addition, the Committee did not agree to this section of the proposed rule.

6. An unintentional gap exists with respect to non-arm's-length transportation. Proposed 30 C.F.R. § 206.457(c) contains the provisions for determining transportation allowances for non-arm's-length transportation through non-jurisdictional pipelines. Especially in light of the FERC's recent Notice of Inquiry regarding deregulating OCS gas pipelines, it is important to ensure that this provision operates in the manner in which it was intended to operate. Mobil believes that there may be an unintentional problem with the provision, as the following hypothetical illustrates.

Assume that Mobil sells OCS production in an arm's-length sale to Company X, which then transports the gas through a pipeline owned by an affiliate of Company X to the index pricing point. If the pipeline is non-jurisdictional, the transportation is pursuant to a non-arm's-length transportation contract. Accordingly, 30 C.F.R. § 206.457(c) applies. Mobil will not be able to utilize the index pricing valuation methodology, however, because it has no way to obtain information regarding Company X's affiliate's transportation costs. Mobil therefore suggests that a provision be added to this section to state that, where the lessee and the transporter are not affiliated, the transportation allowance should be determined under proposed 30 C.F.R. § 206.457(c)(5)(ii).

CONCLUSION

The changes proposed by these comments are merely intended to clarify and fill unintentional gaps in the proposed regulations. Again, Mobil supports the consensus proposal of the negotiated rulemaking committee, and it urges that the proposed regulations be promulgated.

Very truly yours,

Dawlauser for

R. R. Bates, Manager
Royalty Compliance

DBH/pdm

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February 6, 1996

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Re: Mobil Exploration & Producing U.S., Inc.; Supplemental Comments on Notice of Proposed Rulemaking; Amendments to Gas Valuation Regulations for Federal Leases; 60 Fed. Reg. 56007 (Nov. 6, 1995)

Dear Mr. Guzy:

By letter dated January 29, 1996 Mobil Exploration & Producing U.S. Inc. ("Mobil") transmitted its comments on the proposed regulations published by the Minerals Management Service ("MMS"), United States Department of the Interior ("DOI"), on November 6, 1995, entitled "Amendments to Gas Valuation Regulations for Federal Leases." This letter supplements those comments.

Mobil reiterates it's support for the consensus proposal. It wishes to reemphasize, however, that many difficult issues were addressed in the negotiated rulemaking process, and that there were substantial differences of opinion on which compromises were made by the various interested parties in order to achieve consensus.

One such issue for Mobil was the committee's decision to use the highest average index price, or in some cases the second highest average index price, in the valuation methodology set forth in proposed 30 C.F.R. § 206.454 (b) (ii). There are many reasons why, in a particular case, a lessee may not be able to sell its gas into the market for which the highest, or even the second highest, index price is published. For example, pipeline capacity restrictions may make it impossible for a lessee to sell its gas into that particular market.

Mobil is willing to support proposed 30 C.F.R. § 206.454 (b) (ii) only because it is part of the compromise proposal. If any part of the compromise proposal is rejected, Mobil reurges its objection to proposed 30 C.F.R. § 206.454 (b) (ii).

Again, Mobil supports the consensus proposal of the negotiated rulemaking committee, and it urges that the proposed regulations be promulgated, but only if the consensus proposal is adopted in toto.

Very truly yours,

Deborah B. Hagglund for

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R. R. Bates, Manager
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