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May 8, 2015

Gregory Gould
Director
Office of Natural Resources Revenue
U.S. Department of the Interior
1849 C Street NW, MS 4230
Washington, D.C. 20240

Re: Regulation Identifier Number 1012-AA13

Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform

Dear Director Gould:

I am submitting these comments on the above-described proposed regulations as an attorney who has represented oil and gas producers for over 30 years in connection with the gathering, transportation, processing, fractionation and marketing of natural gas, natural gas liquids and crude oil.¹ My practice includes assisting clients with federal royalty reporting and valuation including responding to data mining requests and assisting with compliance reviews, unbundling under the marketable condition rule, and audits. These comments include the oral comments expressed during the question and answer sessions at the recent PASO conference in Tulsa, Oklahoma.

These comments are limited to the federal oil and gas proposed regulations.

The stated goal of the rulemaking is to provide regulations that:

- (1) offer greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees and mineral revenue recipients;
- (2) are more understandable;
- (3) decrease industry's cost of compliance and ONRR's cost to ensure industry compliance; and
- (4) provide early certainty to industry and ONRR that companies have paid every dollar due of oil, gas, and coal produced from Federal leases and coal produced from Indian leases.

These are very important goals. My observation is that companies want to correctly pay their federal oil and gas royalties and they want to know, at the time they submit their reports and payments, that

¹ These comments are my own and are not attributable to any of my clients.

Office of Natural Resources Revenue
 Regulation Identifier Number 1012-AA13
 May 8, 2015
 Page 2

everything is correct. The goals of the rulemaking are consistent with and required by the due process clause of the United States Constitution in order for a regulation to be constitutional. The United States Supreme Court has held that the void for vagueness doctrine addresses at least two connected but discrete due process concerns: "first, regulated parties should know what is required of them so they may act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way." *Grayned v. City of Rockford*, 408 U.S. 104, 108–109 (1972).

I am concerned that there are unintended royalty-reporting consequences of the proposed regulations that would require costly accounting system changes. I am also concerned that in some respects the proposed regulations would not achieve the stated goals but would, instead, increase uncertainty and industry's cost of compliance.

1. Significant and Costly Accounting System Changes Will be Required if POP and Similar Contracts are Reclassified as Contracts for the Sale of Processed Gas

Perhaps one of the most costly provisions of the proposed regulations is a provision that is revenue neutral from a royalty standpoint; the cost is in the accounting system changes that would be required for reporting.

The proposed regulations would require a lessee to value as processed gas for royalty purposes, gas sold under contracts that provide payment terms based on (1) a percentage of the volume or value of residue gas, plant products, or any combination of the two actually recovered at the plant; (2) the full volume and value of residue gas and/or plant products recovered at the plant, less a flat fee per MMBtu of wet gas entering the plant; (3) a combination of (1) and (2); and (4) the value of a percentage of the theoretical volumes of residue gas and/or plant products contained in the wet gas stream (so-called casing head gas contracts). The stated purposes of this change are:

(i) Protection against excessive transportation and processing allowances (i.e., the transportation and processing allowance caps would apply, and

(ii) Prevents a lessee from structuring contracts to avoid the transportation and processing allowance caps.

The NOPR also states that, with the exception of POP contracts, this constitutes a departure from current practice. Actually, this proposal is a departure from current practice even for POP contracts and therein lies the accounting system problem.

Since November of 1991,² gas sold in arm's length percentage of proceeds contracts has been valued for federal royalty purposes as unprocessed gas. From a reporting standpoint, this means that a single line, using product code 04, can be used to report the sale based upon the net proceeds received by the lessee (subject to a minimum value equal to the value of 100% of the residue gas). The proposed regulations proposes to reclassify POP and the other similar types of contracts described above as processed gas contracts for federal royalty valuation purposes.

² 56 FR 46527, September 13, 1991.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 3

The effect of this proposed change would be that three lines of reporting would be required instead of one: product code 03 for residue gas and disallowed plant fuel,³ product code 07 for liquids, and product code 15 for fuel and lost & unaccounted for volumes between the BLM/BSEE approved point of measurement and the point of sale.⁴ Transportation and processing would have to be itemized. The total royalties owed should be the same as under product code 04 but the reporting burden would be significantly increased.

Because POP contracts have since November of 1991 been subject to the unprocessed gas valuation regulations, many companies do not have accounting systems set up to report anything other than a single product code 04 line. The proposed change would require a lessee to go from three reported data items (mcf, MMBtu, and value) to twelve reported data items (mcf/gallons, mmbtu, value, and transportation for three product codes plus a processing allowance). It might be possible for some accounting systems to be modified by purchasing upgraded software but other systems would have to be completely replaced in order to accommodate processed gas reporting. Either way, at this time of significantly depressed oil and gas prices, making accounting system upgrades or changes would be cost prohibitive. Additionally, as anyone who has been through an accounting system upgrade or change knows, that cannot be done overnight. Even if a company could afford to upgrade or replace its accounting system, the process could take a year or more to complete. The only other option for lessees would be to have to manually prepare the Form ONRR-2014 csv files outside of and not integrated into their general accounting system. (This is probably not an option for any publicly traded companies.) It is already very difficult for industry to meet reporting deadlines; introducing a manual process would add significant additional time and increase the potential for errors. For lessees with more than a small number of leases, a manual reporting process would be unworkable.

Nothing has changed in terms of the nature of POP or other contracts that have pricing formulas tied to downstream residue gas or liquids values. The contracts are still for the sale of raw, unprocessed natural gas at the wellhead. Title passes at the wellhead and the purchasers are responsible for all nominations and scheduling of residue gas and liquids and for any imbalances they have between their scheduled quantities and actual production of residue gas and liquids. Lessees have as much incentive to minimize purchaser transportation and processing deductions under POP and similar types of contracts as they have to minimize transportation and processing costs under their own contracts.

If the goal is to subject the transportation and processing deductions taken by purchasers to the transportation and processing allowance caps, that can be accomplished by providing that purchaser deductions are subject to the same caps as transportation and processing allowances. It is not necessary to change how these types of contracts are reported. Given the significant accounting system costs and time that would be involved if the reporting is changed, it is submitted that POP and similar contracts should remain under the processed gas regulations.

³ See fn. 2 in the December 18, 2014, Dear Reporter Letter concerning gas used or lost along a pipeline prior to the point of sale.

⁴ December 18, 2014, Dear Reporter Letter concerning gas used or lost along a pipeline prior to the point of sale.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 4

Similarly, the proposed rules propose the elimination of transportation factors to facilitate data mining reviews. Again, for lessees with accounting systems not set up to report transportation allowances, they will be faced with the prospect of having to manually prepare the Form ONRR-2014 csv files – outside of and not integrated into their general accounting system – or purchase expensive upgrades or entirely change their accounting system. The benefit to data mining is not outweighed by this significant cost to industry; the reporting will remain subject to audit.

Moving POP and similar contracts to the processed gas regulations and eliminating transportation factors would impose a significant accounting system cost and delay in order for industry to be able to handle the reporting.

2. ONRR Determining Value and Allowances – the 10% Measure

The proposed regulations would allow ONRR to determine value or allowances if ONRR considers a sales price to be unreasonably low or considers transportation or processing costs to be unreasonably high.

Sales Prices.

Proposed 1206.104(c)(2) provides that “ONRR may decide your value if you have breached your duty to market the oil for the mutual benefit of yourself and the lessor by selling your oil at a value that is unreasonably low. ONRR may consider a sales price to be unreasonably low if it is 10 percent less than the lowest reasonable measures of market price, including but not limited to, index prices and prices reported to ONRR for like quality oil.”

Proposed 1206.143(c)(2) is an identical provision for gas, residue gas, and gas plant products. “ONRR may consider a sales price to be unreasonably low if it is 10 percent less than the lowest reasonable measures of market price, including but not limited to, index prices and prices reported to ONRR for like quality gas, residue gas, or gas plant products.”

The preamble to the NOPR states that an “unreasonably low” price “may reflect a failure of the lessee to perform its duty to market gas for the mutual benefit of the United States, as lessor, and the lessee. The preamble further states that ONRR’s authority to exercise this provision is discretionary and, in exercising this discretion, ONRR may consider any information that shows a price appears unreasonably low, and, thus, is not an accurate reflection of fair market value.

It does not follow that if a lessee has a price that is less than 10% below the lowest reasonable measures of market price, the lessee has breached its duty to market the oil or gas. The federal royalty interest is 1/8th or 1/6th; the lessee’s interest is much greater. There is no incentive for a lessee to sell its oil or gas at less than the price it is able to obtain under its circumstances. Sales prices vary for a wide variety of reasons including, but not limited to:

The quantity of oil or gas a lessee has available for sale in a particular market. (Lessees with more product to sell may be more attractive to buyers.)

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 5

The supply and demand relationships in a particular market at the time a sales contract is negotiated. (Contracts entered into during periods of oversupply may have lower prices than contracts entered into during periods of shortages.)⁵

The quality of the oil or gas a lessee has available for sale. (A lessee with gas rich in liquids may be able to command a better price than a lessee with lean gas during periods of favorable liquids prices.)

The type of sales contract – fixed price (price will not vary during the term and, therefore, could be higher or lower than the monthly spot prices) or index-based price.

Contract term – pricing can vary depending upon whether the contract is short term or long term

These are just some of the many factors that affect a particular sales price. The proposed change to the regulations, if adopted, would mean that no lessee could know at the time it submitted its royalty reports and paid its royalties that it had done so correctly. Whether the reporting and valuation is correct is left to the discretion of individual ONRR, state and tribal auditors. If a future auditor disagrees with the sales price a lessee was able to negotiate, the lessee will be required to reverse and rebook seven years of reporting and valuation or pursue a time consuming and costly appeal. The increased uncertainty associated with this proposed change will make the advisability of investment in federal oil and gas leases even more uncertain. This is not an improvement in the status quo.

The preamble to the final 1988 gas valuation regulations explains quite well why the gross proceeds accruing to the lessee is a proper measure of value:

The MMS believes that the gross proceeds standard should be applied to arm's-length sales for several reasons. The MMS typically accepts this value because it is well grounded in the realities of the marketplace where, in most cases, the 7/8ths or 5/6ths owner will be striving to obtain the highest attainable price for the gas production for the benefit of itself. The royalty owner benefits from this incentive.

It also adds more certainty to the valuation process for payors and provides them with a clear and logical value on which to base royalties. Under the final regulations, in most instances the lessee will not have to be concerned that several years after the production has been sold MMS will establish royalty value in excess of the arm's-length contract proceeds, thereby imposing a potential hardship on the lessee. This is particularly a concern for lessees who have long-term arm's-length contracts where sales prices under newer contracts may be higher. If MMS were to establish royalty value based on prices under those newer contracts, (i.e., prices which the lessee cannot obtain under its contract), the resulting royalty obligation could, in some instances, consume the lessee's entire proceeds.

⁵ A 10% measure of reasonableness in a \$100 oil market is very different than a 10% measure in a \$45 oil market.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 6

The oil and gas markets are known for price volatility. As lessees struggle to survive in this market, one option might be to return to the pre-index price era when oil and gas were sold for fixed prices. This could provide a predictable and sufficient cash flow to continue producing, something reliance on index-based prices cannot do. The proposed change creates a significant disincentive to consider fixed priced contracts or any other pricing alternatives other than index-based pricing (because the index prices reflect the current month market price). Pricing creativity should be encouraged, not discouraged, because it can lead to consistent revenues despite volatility in oil and gas spot markets.

Furthermore, the proposed change does not have sufficient standards to prevent the exercise of discretion from being arbitrary, capricious and an abuse of discretion. What index prices would be relevant to a particular lessee's production? How would an auditor determine which values reported to ONRR are relevant to a particular lessee's production? Would product code 04 sales values (which are required to be increased to reflect the cost of services provided by purchasers to place gas into marketable condition rule) be included with product code 03 sales values (which are not adjusted for the marketable condition rule because the adjustments are in the transportation and processing allowances, not in the sales value). Just based on the marketable condition rule alone, a product code 04 reported sales price (with marketable condition adjustments) could easily be 10% or more higher than a product code 03 reported sales price, particularly in today's low price environment.

Finally, the proposed changes include an index-based valuation option for lessees that do not sell under an arm's-length contract. The proposed index-based valuation offers the prospect of certainty in exchange for paying royalties on higher values and lower allowances (10%, minimum of 10 cents and maximum of 30 cents). If some lessees elect this option, that will increase the reported sales values to ONRR further increasing the chances that other lessees' sales prices will be 10% or more below the non-arm's length index-based prices. Just because some lessees who do not sell under an arm's length contract elect the index-based valuation option does not indicate other lessees have breached their duty to market.

Absent evidence that a lessee actually failed to market gas for the mutual benefit of the United States, as lessor, and the lessee, the gross proceeds standard should continue to apply.

Transportation and processing allowances

Proposed 1206.152(g)(2) provides that "ONRR may determine your transportation allowance for residue gas, gas plant products, or unprocessed gas if ONRR determines that the consideration you or your affiliate paid under an arm's-length transportation contract does not reflect the reasonable cost of the transportation because you breached your duty to market the gas, residue gas, or gas plant products for the mutual benefit of yourself and the lessor by transporting your gas, residue gas, or gas plant products at a cost that is unreasonably high. ONRR may consider a transportation allowance unreasonably high if it is 10-percent higher than the highest reasonable measures of transportation costs including, but not limited to, transportation allowances reported to ONRR and tariffs for gas, residue gas, or gas plant

Office of Natural Resources Revenue
 Regulation Identifier Number 1012-AA13
 May 8, 2015
 Page 7

products transported through the same system.” There is a similar provision as to oil transportation in proposed 1206.110(f)(2).⁶

Proposed 1206.160(a)(3)(ii) similarly provides that “ONRR may determine your processing allowance if ONRR determines that the consideration you or your affiliate paid under an arm’s-length processing contract does not reflect the reasonable cost of the processing because you breached your duty to market the gas for the mutual benefit of yourself and the lessor by processing your gas at a cost that is unreasonably high. ONRR may consider a processing allowance unreasonably high if it is 10-percent higher than the highest reasonable measures of processing costs including, but not limited to, processing allowances reported to ONRR for gas processed in the same plant or area.”

It does not follow that if a lessee has a transportation or processing cost that is more than 10% above what other lessees have reported or been charged under a tariff,⁷ the lessee has breached its duty to market the oil or gas. Again, the federal royalty interest is 1/8th or 1/6th; the lessee’s interest is much greater. There is no incentive for a lessee to pay more for transportation or processing than it has to. Transportation rates vary for a wide variety of reasons including, but not limited to:

The lessee’s gas may be subject to a long-term or life of the lease transportation and/or processing agreement that was necessary in order to be able to market production at all. For example, some lessees are subject to life of the lease transportation and/or processing agreements that were offered right after FERC Order 636⁸ when the former interstate pipeline purchasers decided to spin down or spin off their gathering and processing assets and producers objected at FERC. FERC required the pipelines to offer default contracts as a condition for obtaining approval of the spin down or spin off. The rates under these life of the lease agreements are not going to be the same as rates negotiated at other points in time.

The available capacity in a transportation system or gas plant. If capacity has to be expanded to accommodate a new producer, the rates are going to be higher than if there is existing excess capacity. For example, gas plants are known to run more efficiently (i.e., recover more liquids) if they are operated close to capacity and that may provide an incentive for a gas plant owner to provide a discount to a producer to fill up a plant if the plant is not running at near capacity.

⁶ There appears to be a drafting error in 1206.110(f)(2) which ends with a reference to gas, residue gas, or gas plant product tariffs. The reference should be to oil transportation tariffs.

⁷ Some tariffs allow rates to be discounted in certain circumstances. For example, interstate gas pipeline tariffs may provide for discount authority between a maximum and a minimum. Crude oil and liquids transportation tariffs may provide discounted rates to anchor or incentive shippers in exchange for long-term volume dedications under throughput and deficiency agreements. These discounts have been approved by FERC as necessary to fund new infrastructure development. See, for example, MAPL, July 1, 2006. 116 FERC P 61040, 2006 WL 2007551 (F.E.R.C.).

⁸ FERC Order No. 636, Restructuring of Interstate Natural Gas Pipeline Services (Final Rule), Order No. 636, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission’s Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, III F.E.R.C. Stats. & Regs. [Regs. Preambles] ¶ 30, 939, April 9, 1992.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 8

Certain shippers on intrastate pipelines and local distribution company systems may be given a discounted rate to keep the shipper from bypassing the system and connecting to an interstate provider.⁹

Transportation rates upstream of gas processing plants may vary based upon distance to the plant. Transportation allowances reported to ONRR cannot distinguish distance-related differences. Some transportation tariffs also have zone rates and not postage stamp rates. These differences cannot be distinguished in the transportation allowances reported to ONRR.

Processing costs vary depending upon the type of processing contract – fixed fee, keepwhole, and percentage of proceeds contracts are only three of the types of processing contracts that may be negotiated. Under keepwhole agreements and POP agreements, processing fees are based upon the value of products retained by the plant. Keepwhole and POP processing fees will be as volatile as gas and liquids prices. Processing allowances reported to ONRR cannot distinguish between processing fees under different types of contracts. Additionally, using index-based measures to evaluate the reasonableness of a particular lessee's processing fee may unfairly penalize a lessee who negotiated a fixed fee processing fee even though a fixed fee avoids the price volatility inherent in index-based fees and may be the more reasonable fee over time.¹⁰

Different lessees have different negotiating leverage based upon their size, the quantity of production they have, the quality of the production (rich in liquids for example), and other factors.

These are just some of the many factors that affect a particular transportation or processing cost. The proposed change to the regulations, if adopted, would mean that no lessee could know at the time it submitted its royalty reports and paid its royalties that it had done so correctly. Whether the allowances are deemed to be reasonable is left to the discretion of individual ONRR, state and tribal auditors. If a future auditor disagrees with a lessee that the lessee's transportation or processing costs were reasonable, the lessee will be required to reverse and rebook seven years of reporting and valuation or pursue a time consuming and costly appeal. The increased uncertainty associated with this proposed change will make the advisability of investment in federal oil and gas leases even more uncertain. This is not an improvement in the status quo.

⁹ See, for example, C.R.S. §40-3-104.3. The discount is given to keep the shipper on the system contributing something towards the cost of service; if the shipper is lost the remaining customers will have to cover the lost revenues.

¹⁰ In July of 2008, gas prices exceeded \$11.00 per MMBtu. A producer with a fixed fee transportation or processing agreement had lower transportation and processing fees than producers who had keepwhole or POP contracts. In contrast, during periods of low gas and liquids prices, the fixed fee producer may have higher transportation and processing fees than producers who have keepwhole or POP contracts. Over the life of the contract, all three types of contracts could have comparable transportation and processing fees but they will not be comparable on a short term basis.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 9

3. ONRR Default Methodology If a Lessee Does Not Have Requested Documents

The proposed regulations provide that ONRR may determine the value of oil or gas for royalty purposes if ONRR cannot determine whether the valuation or allowances are proper “for any reason, including but not limited to, you or your affiliate’s failure to provide documents ONRR requests under 30 CFR part 1212, subpart B.” See 1206.104(c)(3); 1206.110(f)(3); 1206.143(c)(3); and 1206.152(g)(3). The concern with this provision is the very broad “for any reason” language. Auditors sometimes request documents that are not the lessee’s documents and that a lessee does not have any legal right to obtain.¹¹ This includes, but is not limited to, itemized capital costs, operating expenses, maintenance expenses and overhead expenses from owners of transportation systems and gas plants or the downstream contracts of the purchasers of oil, gas, residue gas or liquids; a list of producers (shippers) who shipped gas through each transportation/gathering system or through a particular plant, transportation/gathering agreements for large and small customers of a particular system and associated sample statements; processing agreements with large and volume customers of a particular processing plant and associated sample statements; etc.¹²

The scope of the proposed regulation regarding when ONRR may determine value for failure to provide documents should be clearly limited to the failure of a lessee to provide its contracts and associated statements and invoices.

4. ONRR Default Methodology to Value Field Fuel and Disallowed Plant Fuel

The proposed regulations propose that if a payor has no contract for the sale of gas or no sale of gas and there is an index pricing point for the gas, then you must value your gas under subparagraph (c) (the index-based pricing option for lessee’s making non-arm’s length sales). If there is not an index pricing point for the gas, then ONRR will decide the value under 1206.144 but the lessee must propose a method and submit it to ONRR. After ONRR issues its determination, the lessee may have to make retroactive adjustments to the proposed method.

Lessees do not sell fuel and lost and unaccounted for volumes or the disallowed portion of plant fuel. Currently, lessees may value field fuel and lost and unaccounted for volumes and the disallowed portion of plant fuel (reported as part of product code 03) under the benchmark valuation regulations. Benchmark two would be satisfied by using the price the lessee received for the gas or residue gas it sold. This is a much more certain method of valuing fuel and lost and unaccounted for volumes and disallowed plant fuel than requiring every lessee to submit a proposed method and be subject to having to reverse and rebook if ONRR does not accept the proposed method. It also seems unfair to require lessees who cannot otherwise use the index-based option (those making arm’s length sales) to have to use the index based pricing to value FL&U and disallowed plant fuel. This is just unnecessary added complexity.

¹¹ In some cases, there could also be antitrust issues associated with some of the documents a lessee might be asked to provide.

¹² See lists at <http://www.onrr.gov/Unbundling/methodology.htm>

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 10

5. Index Pricing For Arm's-Length Transactions

The proposed regulations provide for an option to value production on an index price basis but this option is only available for lessees who do not sell their production in an arm's length transaction. The preamble to the NOPR explains the benefit of the proposed index-based valuation:

We believe this index price option simplifies the current valuation methodology and provides early certainty. Many pipelines and services providers now charge producers "bundled" fees that include both deductible costs of transportation and non-deductible costs to place production into marketable condition. Both ONRR and lessees with arm's-length transportation contracts have found allocating the costs between placing the gas in marketable condition and transportation is administratively burdensome and time consuming. Similarly, when processing plants charge bundled fees that include non-deductible costs, the cost allocation is administratively burdensome and time consuming.

Litigation also has complicated the application of ONRR's gas valuation regulations. Although litigation has clarified what constitutes marketable condition, its application is fact specific and time consuming. See *Devon* and cases cited therein.

The proposed index-based option provides a lessee with an alternative that is simple, certain, and avoids the requirements to "trace" production when there are numerous non-arm's-length sales prior to an arm's-length sale and unbundled fees.

Lessees who make arm's length sales are as much in need of an option to provide early certainty and relief from the complexities of unbundling as are lessees who make non-arm's length sales. The complexities of unbundling were not well known at the time comments opposing index pricing were made in response to the 2011 advanced notice of proposed rulemaking. Those commenters that were opposed to index-based pricing might have a different viewpoint today. Furthermore, ONRR only received comments from 19 State, industry, industry trade association, and general public commenters. That is not a sufficient number to not propose an index-based pricing option for lessees who make arm's-length sales.

Given the existing complexity of valuation and reporting and the even further complexity that the proposed changes would bring, an index pricing option for lessees who make arm's length sales should be proposed. There is no reason why lessees who engage in arm's length transactions should be at a disadvantage as compared to lessees who do not engage in arm's length transactions.

There are some unanswered questions regarding the index pricing option including:

(1) For processed gas, what does the phrase "if you can transport to more than one index pricing point" mean in 1206.141(c)(ii)? Gas production is connected to a single transportation system. Wells are seldom dual connected. Once a connection is made, the gas cannot physically be transported to other index pricing points even if there are other index pricing points in a particular region.

Office of Natural Resources Revenue
Regulation Identifier Number 1012-AA13
May 8, 2015
Page 11

(2) For processed gas, what does the phrase “if you can only transport residue gas to one index pricing point” mean in 1206.142(d)(1)(i)? Is this phrase limited to the pipelines at the outlet of the gas plant at which the gas is processed? Once a processing contract is executed, there is not an option to go to other gas plants.

(3) For NGLs, ONRR will periodically post on its website the amounts that must be used to reduce the published prices for transportation and fractionation of liquids. The proposed language of the rule is that the methodology ONRR will use is set forth in the preamble to this regulation. It is not certain that language in a preamble to a regulation is a binding regulation. What remedy would a lessee have if ONRR did not follow the methodology set forth in the preamble? Additionally, the proposed regulation provides that an election to use index-based pricing cannot be changed more often than once every 2 years. It is hard to make an election when the basis for making the election – including ONRR’s posting of the amounts that can be deducted – can be changed during the 2 year period for which the election was made.

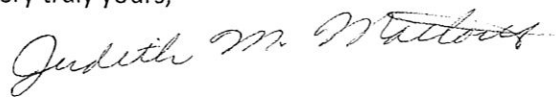
(4) For NGLs, there is no adjustment to the index price for transportation of the NGL component of the gas stream from the wellhead to the gas plant. The only adjustment is for T&F of the liquids. One option would be to allow a lessee to use the same adjustment amount (10% but not less than 10 cents per MMBtu or more than 30 cents per MMBtu) as can be used for the index-based value of residue gas and apply that amount to the liquids shrink MMBtus.

Workshops and Consensus Rulemaking

It appears from extension of time requests previously filed in this rulemaking that there will be significant anti-coal comments filed as to the coal proposed regulations. Please consider “unbundling” the oil and gas rulemaking from the coal rulemaking so that the oil and gas rulemaking can move forward more quickly. Also, it would be very helpful to be able to have some workshops to try to work through the proposed rules and all of the comments on the proposed rules, including examples of application of the proposed rules which would aid in everyone’s understanding. It might also be possible to reach a consensus on some or all of the proposed changes.

Thank you for considering these comments.

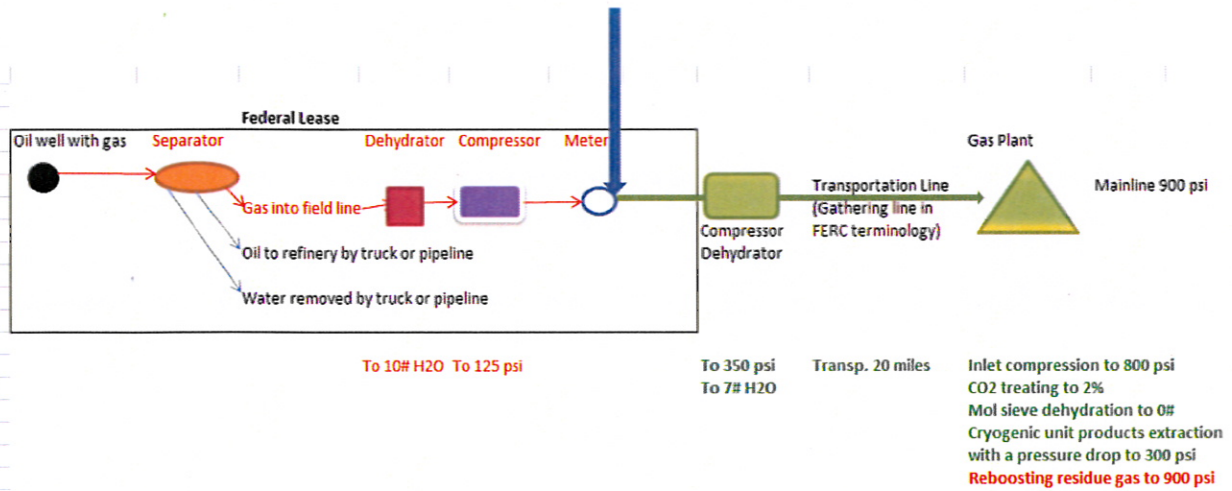
Very truly yours,

A handwritten signature in cursive script, appearing to read "Judith M. Matlock".

Judith M. Matlock

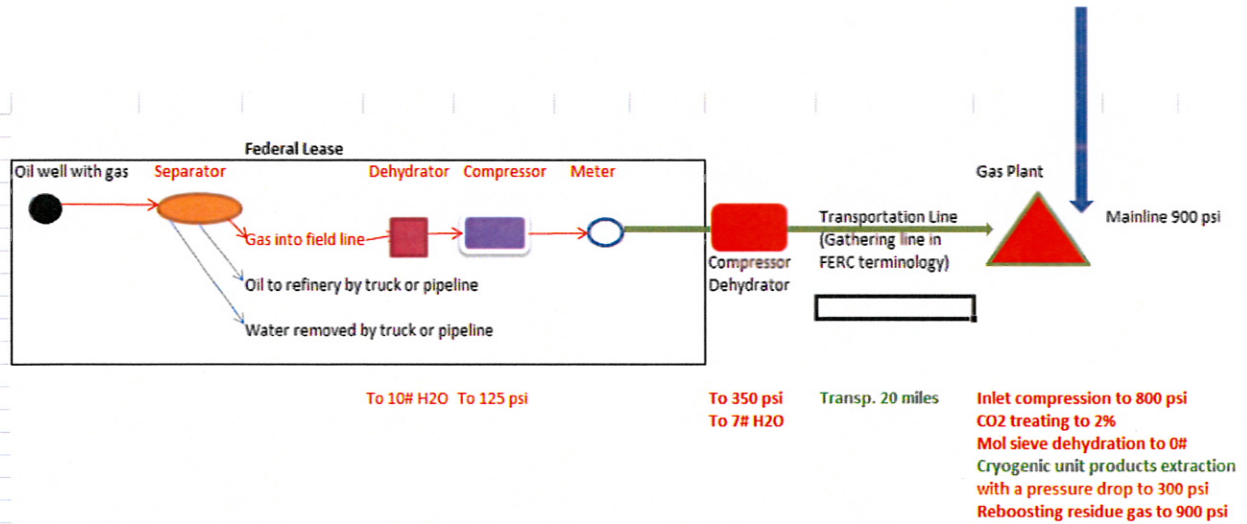
Attachment Two to Testimony of Judith M. Matlock

Gas in marketable condition here under the 1996 Guidance



Attachment Three to Testimony of Judith Matlock

Gas destined for interstate market is in marketable condition here under the Devon Decision



**WILLIAMS TORRE ALTA TRANSPORTATION SYSTEM - KUTZ PLANT
COST ALLOCATION**

SYSTEM-TO-PLANT ALLOCATION				
YEAR	2003	2004	2005	2006
System	75.17%	74.59%	73.79%	77.64%
Plant	24.83%	25.41%	26.21%	22.36%
	100.00%	100.00%	100.00%	100.00%

The following percentages apply after allocating the fee between system and plant.

TORRE ALTA TRANSPORTATION SYSTEM COST ALLOCATION				
YEAR	2003	2004	2005	2006
Allowed Costs	62.65%	65.37%	67.25%	70.71%
Disallowed Costs	37.35%	34.63%	32.75%	29.29%
	100.00%	100.00%	100.00%	100.00%
Fuel Allowed	6.77%	6.77%	6.77%	6.77%
Fuel Disallowed	93.23%	93.23%	93.23%	93.23%
	100.00%	100.00%	100.00%	100.00%

KUTZ PLANT COST ALLOCATION				
YEAR	2003	2004	2005	2006
Allowed Costs	72.20%	72.09%	71.98%	72.09%
Disallowed Costs	27.80%	27.91%	28.02%	27.91%
	100.00%	100.00%	100.00%	100.00%
Fuel Allowed	72.20%	72.09%	71.98%	72.09%
Fuel Disallowed	27.80%	27.91%	28.02%	27.91%
	100.00%	100.00%	100.00%	100.00%

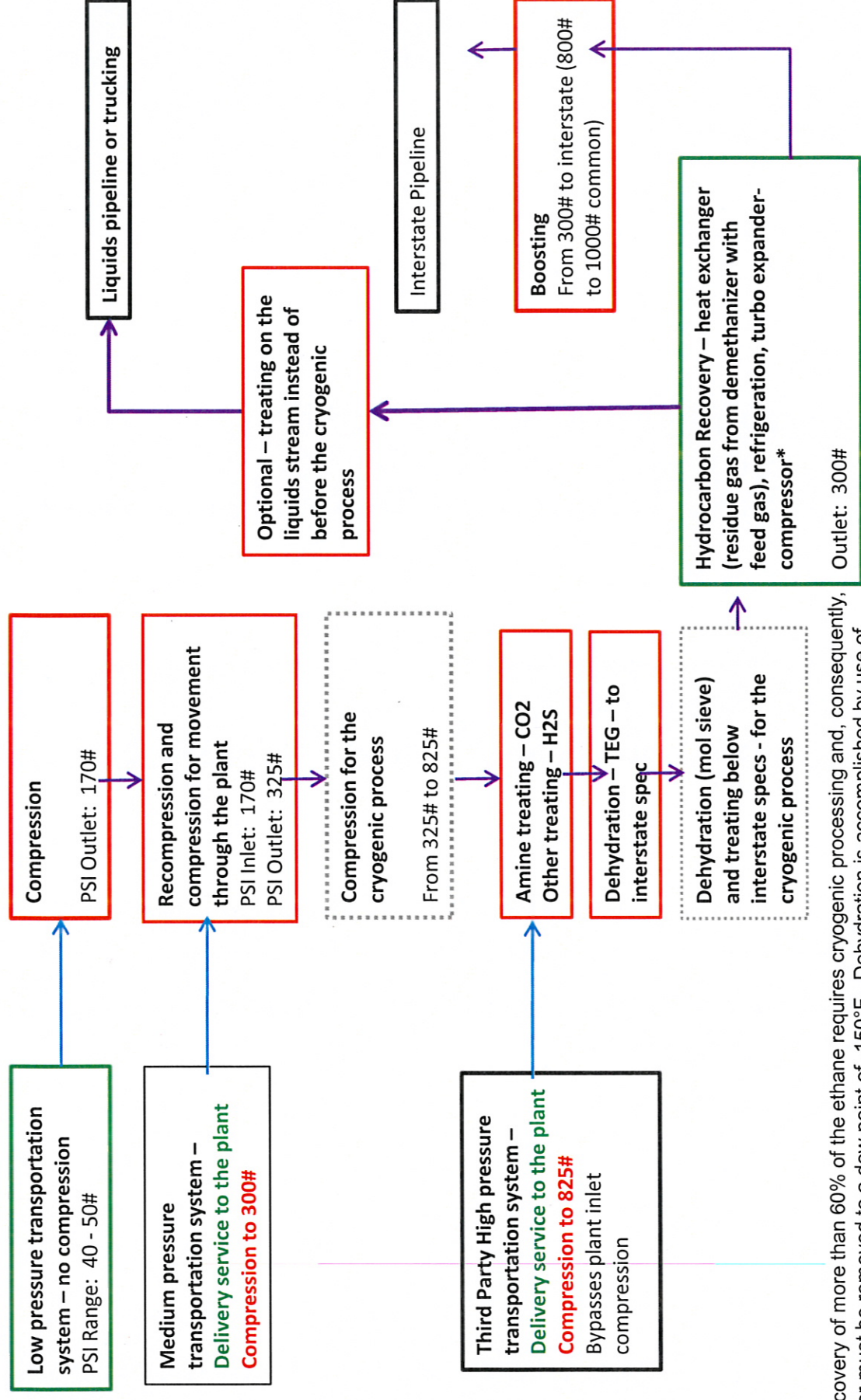
Sample Case - 2006		<i>The data in the highlighted fields may be changed to reflect reporter's actual contract data</i>	
Bundled Fee :	\$210.00	Processing Fuel:	40 MMBtu
Wellhead Volume:	1000 Mcf	Residue Price:	\$4.00 MMBtu
Btu Content	1050	Residue Volume:	770 MMBtu
Transportation Fuel:	40 MMBtu	Plant Shrink Volume:	200 MMBtu

Step 1		Identify total cost of Bundled Fee.	
Total Cost of Fee	=		\$210.00

Step 2		Use the plant-to-system allocation percentages, if available, to determine the correct allocation of transportation and processing.			
		Total Cost of Fee		System %	
Transportation portion of fee	=	\$210.00	*	77.64%	= \$163.04
Processing portion of fee	=	\$210.00	*	22.36%	= \$46.96

Step 3		Determine the allowable portion of the total fee by multiplying the transportation and processing portions by the allowed percentage (Annual Factor).				
Allowed Transportation portion of fee	=	\$163.04	*	70.71%	=	\$115.29
Allowed Processing portion of fee	=	\$46.96	*	72.09%	=	\$33.85
Step 4		Fuel - Determine the allowable portion of fuel costs by multiplying each fuel volume by the residue price and then by the allowed percentage.				
		Fuel	(MMBtu)	Residue Price		
Transportation	=	40	*	\$4.00	=	\$160.00
Processing	=	40	*	\$4.00	=	\$160.00
				Allowed %		
Allowed Transportation fuel cost	=	\$160.00	*	6.77%	=	\$10.83
Allowed Processing fuel cost	=	\$160.00	*	72.09%	=	\$115.34
Step 5		Calculate Total Allowed Transportation and Processing Costs				
Total Allowed Transportation Costs	=	\$115.29	+	\$10.83	=	\$126.12
Total Allowed Processing Costs	=	\$33.85	+	\$115.34	=	\$149.20
Step 6		Calculate the Residue and NGL Transportation Allocation Percentage				
		Residue Volume				
Residue Transportation Percentage	=	770	/	(770+200)	=	79.38%
NGL Transportation Percentage	=	200	/	(770+200)	=	20.62%
Step 7		Calculate the Allowed Residue and NGL Transportation Costs				
Residue Transportation Costs	=	\$126.12	*	79.38%	=	\$100.11
NGL Transportation Costs	=	\$126.12	*	20.62%	=	\$26.00
Step 8		Calculate Final Transportation & Processing Allowances				
		Royalty Rate				
Residue Transportation Allowance	=	\$100.11	*	12.50%	=	\$12.51
NGL Transportation Allowance	=	\$26.00	*	12.50%	=	\$3.25
Processing Allowance	=	\$149.20	*	12.50%	=	\$18.65

Generic Transportation and Cryogenic Gas Plant Process Flow Diagram



*Recovery of more than 60% of the ethane requires cryogenic processing and, consequently, water must be removed to a dew point of -150°F . Dehydration is accomplished by use of molecular sieve adsorption beds. As is common practice for cryogenic gas plants propane refrigeration provides much of the initial cooling. Propane refrigeration supplies 64% of the plant cooling requirements. *Fundamentals of Gas Processing*, Sections 20.2.4 and 20.2.5.