Committee on Resources

Witness Testimony

Testimony of
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BACKGROUND

In June 1994 MMS approached Amerada Hess, among others, to participate in a Royalty Gas Marketing Pilot in the Gulf of Mexico. In the Pilot, gas royalties were to be taken in kind by MMS and sold/transferred directly to gas marketing companies.

Amerada Hess participated by providing comments on the original Marketing/Agent Contract and the MMS/Lessee Agreement. Amerada Hess offered three offshore leases for the Pilot two of which were accepted. As a marketer, Amerada Hess bid on 23 groups of leases, wining one.

OBSERVATIONS

MMS did an excellent job designing and implementing the Pilot Project. By seeking input from industry participants early in the Project's formative stage they avoided many problems. The Pilot got off to a good start and should have provided a good test of the Royalty-In-Kind concept. We have not seen any post Pilot results to form an opinion otherwise.

ACTUAL ECONOMIC IMPACT

With respect to the two leases Amerada Hess had in the Pilot, the economic results were not favorable; the MMS lost approximately $.14/MCF on the gas that was provided in kind versus the revenue they would have received under the conventional method. We have no idea what the offsetting administrative savings were from the MMS' perspective.

LATERAL PIPELINES

During the bidding process, we observed that several marketers lacked sufficient information to make proper decisions as to how to calculate their bids. It took some behind the scenes activity to avoid serious problems. More effort needs to be put into identifying all lateral situations and fees.

Various interstate pipelines have filed with the FERC to spin down certain offshore pipeline assets. Should this be allowed it could alter the economics of any marketers' bid significantly by increasing the gathering/transportation fees. Allowances must be made to alleviate potential after the fact fee increases which may be prevalent after spindowns occur. Marketers could be forced into breach situations with their MMS/Agent contracts if fees go up.

If this uncertainty prevails and the MMS requests bids for all of its volume, it could find itself in the untenable position of having several leases with no bids and therefore having to administer a dual system which is unlikely to produce the expected administrative savings.

EFFECT OF LARGE VOLUMES

Should MMS expand the Royalty-In-Kind concept to all offshore gas production, a potential for significant disruption exists. A volume in the 2/BCF range is possible if all MMS offshore royalty is taken in kind. Markets will need time to adjust to such a significant change. A phase-in period is essential to alleviate this problem.

Further, when a producer "loses" 1/6th of its volume over night, a scramble will occur to acquire sufficient gas to fulfill existing commitments. A significant price spike is also likely during such periods. Some Producers/Lessees have entered into long term sales arrangements, and in some cases, firm transportation agreements coupled with demand charges and related obligations, such that losing 1/6th of their volume from a particular property would cause financial hardship. Offshore Producers incurred significant risks in acquiring leases from MMS, drilling exploration wells and where successful, investing huge sums to build platforms and facilities to produce oil and gas. To lose the synergy of marketing 100% on the gas found is an additional risk not bargained for. A solution -- which would be revenue neutral to the MMS -- would be to give the Lessee the right to match the MMS' agents' offer.