# Committee on Resources

## Witness Testimony

Testimony of

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Good afternoon Mr. Chairman, I am Andy Hoyle, Vice President, Marketing, Enron Oil & Gas Company (EOG). Enron Oil & Gas Company is owned approximately 60 percent by Enron Corp. and is one of the largest independent (non-integrated) oil and gas companies in the United States in terms of domestic proved reserves. In addition, it is the operator of substantial reserves in Canada, India and Trinidad. The company s year-end 1995 reserve base was 88 percent in North America and 92 percent natural gas.

I thank you for the opportunity to testify on the role of EOG as a participant in the royalty-in-kind (RIK) pilot program conducted by the Minerals Management Service (MMS) in 1995. I will discuss the program from the point of view of EOG as a producer of natural gas from MMS leases. I will also include comments on behalf of Enron Oil & Gas Marketing, Inc. (EOGM), a marketer which buys and resells natural gas and was the winning bidder for the MMS s royalty gas from EOG s leases.

### DESCRIPTION OF LEASES

The leases that EOG volunteered for the RIK pilot program are located offshore the Gulf Coast of Texas in the Matagorda Island Area. The following briefly describes EOG s leases:

| | MATAGORDA | EOG |
|---|---|---|
| | BLOCK | OWNERSHIP |
| LEASE | NUMBER | (PERCENT) |
| G03932 | 527P | 61 |
| G03079 | 555 | 63 |

| | | |
|---|---|---|
| G03080 | 556 | 61 |
| G03087 | 620 | 89 |
| G06044 | 638 | 85 |

Additionally, EOG is the operator of the producing facilities serving these blocks.

**VOLUME PRODUCED AND MARKETED**

For simplicity, I have combined the volumes into two groups from the above discussed blocks which also correspond to the bid groups as designated by the MMS under the bidding procedures. To summarize, the approximate volumes of gas owned by EOG and the MMS that were marketed on an average, daily MMBtu basis during 1995 were:

| MATAGORDA | EOG | MMS | TOTAL |
|---|---|---|---|
| **BLOCKS** | **MMBtu/Day** | **MMBtu/Day** | **MMBtu/Day** |
| 527, 555, 556 | 21,920 | 4,380 | 26,300 |
| 620, 638 | 37,250 | 7,450 | 44,700 |
| **Total:** | 59,170 | 11,830 | 71,000 |

**RIK PROGRAM BENEFITS ?**

We believe the major administrative benefit of the RIK pilot program should be to reduce the MMS audit requirements, mainly involving valuation issues. Another potential benefit of the program we identified was the MMS s waiver of the onerous requirements of Section 10 of the Outer Continental Shelf Lands Act for refunding overpayments by the producer to the MMS.

The program would seem to provide yet another benefit to the producer because the administrative responsibility for filing MMS 2014 forms was, on paper, shifted from the producer to the marketer. Unfortunately, currently, marketers are typically unfamiliar with these forms and the reporting requirements. Thus, the producer was still involved in the process and required to provide the marketer with information involving detailed volume allocations. These information requests had to be handled in a very tight time frame in order for the marketer to comply with reporting deadlines. This negated the producer s benefit of not filing MMS 2014 forms; but, perhaps over time, the marketers familiarity with these forms could ease the producers input into the overall process.

Unfortunately, the RIK pilot program also required additional reports from the producer that would offset some, if not all, of the administrative benefits previously discussed. For example, the MMS required the producer to complete a Royalty Gas Imbalance Account which was required to be submitted to the MMS and the marketer/purchaser within 45 days following the month of production. The producer was further required to provide the MMS a monthly report which included detailed volume and pricing information so that the MMS could evaluate the revenue neutrality of the program.

**MARKETING CONTRACT**

The marketing contract was unlike most industry contracts in that certain provisions were very one-sided in favor of the MMS. The majority of the industry agreements between EOG and the marketers/purchasers have provisions that are reciprocal in nature, meaning penalties will affect either party if non-performance occurs. If the marketing contract offered under this program had been submitted by an industry entity instead of the MMS, neither EOG nor EOGM would have executed the agreement because of its strong bias in favor of the other party. Generally, the provisions where this bias was most prevalent involved penalties for the marketer s failure to take 100% of the gas volume, indemnification of the MMS for any penalties due to gas pipeline imbalances and the right of the MMS to terminate the contract at any time without liability.

Through various provisions, the contract imposed on the marketer the obligation to take 100% of the gas made available for sales, regardless of market and operating (producing and pipeline) conditions. Failure by the marketer to take 100% of the volume allowed the MMS to terminate the contract. Other reasons for allowing the MMS to terminate the contract included 1) not properly nominating the gas, 2) transporter s failure to accept the gas and 3) the "appearance" that the marketer was "swinging" gas takes. On the other hand, if the MMS failed to deliver gas to the marketer, the MMS s liability for damages was limited.

The contract required the marketer to indemnify the MMS from any pipeline imbalance penalties, even if the penalties were caused by either the MMS or the operator of the producing facilities. Due to the nature and complexity of producing operations, the actual daily flow rates from the wells differ from the nominated or scheduled volumes, resulting in pipeline imbalances. Over the course of a month, the producer, marketer and pipeline work together to manage the imbalances within certain tolerances. However, under certain operating conditions, the pipeline(s) receiving the gas may impose operational flow orders which may dramatically vary the volume of gas the pipeline(s) will take. If any pipeline penalties are incurred because the volumes delivered are outside the tolerances, then, under the MMS contract, the marketer was required to bear all cost exposure, even if the MMS was the sole party at fault. Pipeline imbalance penalties could also occur if a pipeline that receives this gas at subsequent downstream delivery points reallocates its capacity, thereby reducing the volume of gas it can accept from the marketer. This situation would also have a negative impact on the marketer s obligation to take 100% of the gas made available for sales.

Finally, the provision that allowed the MMS to terminate this contract for convenience at any time and without liability is unlike any clause existing in the gas industry today and is, in my view, unreasonable.

## SUGGESTIONS FOR IMPROVING THE 1995 PILOT PROGRAM

A key suggestion for improving the 1995 pilot program would be to require 100% participation of all owners in the lease or block. This would enable the operator to simplify the monthly availability reporting process by including the MMS ownership interest in the primary calculation. Also, reporting requirements for gas imbalances would be minimized because the MMS volumes would be handled similarly to the volumes of the other owners.

The provisions for the pricing formula need additional flexibility to provide for changes in pipeline transportation rates. Under the pilot program, the marketers were instructed to bid a price for the one-year term based upon an MMS-designated index price less a fixed differential to be determined by the marketer. In today s post-Order 636 environment, transportation rates are subject to change for various reasons including sale(s) of pipeline system(s) to another party or the spin-down of a jurisdictional pipeline system to a non-jurisdictional entity. A change in the transportation rates after the bid was accepted would affect the value of the contract to both parties. Therefore, either party should have the right to renegotiate the contract due to a change in the pipeline transportation rate.

## EXPANSION OF RIK PROGRAM

As a producer and gas marketer, I can only support expansion of the RIK pilot program if such expansion includes elimination of the administrative burdens imposed by MMS during the pilot program. I fully support the idea of reduced MMS audit requirements which could virtually eliminate valuation issues. However, if the MMS continues to require the producers and marketers to prepare the reports outlined in this presentation, I fear that both the gas industry and the MMS would incur significantly higher costs. If the RIK pilot program is expanded, the MMS would need to increase its gas marketing expertise. In today's unregulated environment, the MMS needs to develop competent expertise in all producing and marketing issues from the wellhead through the pipeline delivery point. As we all know, additional costs would be involved in gaining more expertise. If the MMS does not want to invest in gaining more expertise, but would prefer to establish an expanded program utilizing basically the same concepts and agreements as the pilot program, I believe the current program would be difficult for both producers and marketers to accept. Not only would it increase the producers' and marketers' costs of operations, but it would be grossly unfair for the MMS to mandate such requirements in order to shield the agency from the realities of a pipeline and marketing environment largely created by its sister agency, the Federal Energy Regulatory Commission.