

MINUTES
Meeting Between Senate Staff and
the Department of the Interior (DOI) on
Oil Valuation Proposed Rules
July 28, 1998

Participants included:

Staff

Karen Knutson (Sen. Hutchison, R-TX)
McLane Layton (Sen. Nickles, R-OK)
Bob Simon (Sen. Bingaman, D-NM)
Mike Poling (Energy and Nat. Res. Com.)
Hank Kashdan (Interior Approps. Com.)

DOI

John Northington
Tom Kitsos
Lucy Querques Denett
Peter Schaumberg
Debbie Gibbs Tschudy (via telecon)
Dave Hubbard (via telecon)

The purpose of the meeting was to discuss MMS's July 24, 1998, responses to industry's comments on five major issues arising from MMS' proposed oil valuation rule.

Arm's-Length Contracts

Breach of Duty to Market

The issue here is what MMS expects of a lessee in its duty to market. Staff suggested removing certain parts of the July 16, 1998, regulatory language to eliminate confusion and distrust of MMS' intentions to come back later and question a lessee's marketing decisions. DOI stated it understands the producers' concerns.

Multiple Exchange Agreements

There was general agreement that different companies favor different methods to value oil that is exchanged several times before it is sold at arm's-length. Staff suggested that MMS provide options to accommodate different situations.

A specific suggestion was that MMS adopt an intermediary benchmark that companies could elect to use before trading exchanged oil or using an index. The benchmark would be based on either tendering or a representative sample of arm's-length transactions in the field or area and would apply in all three marketing regions of the country. DOI reiterated its concerns with lease-based benchmarks, but said that it would take this suggestion under advisement.

Non-Arm's-Length

Menu

DOI stated that it has concerns about allowing lessees to select from a menu of options. Staff thought industry supported a menu with an election for a fixed period of time.

Tendering

No agreement was reached regarding tendering. However, the bigger issue centered around finding viable methods for establishing value at the lease using arm's-length transactions. Staff suggested that MMS create a reporting service, similar to those at the market centers, that would collect and publish arm's-length sales values at the lease.

DOI stated its concerns that simply looking at prices under arm's-length contracts would not achieve certainty and would be administratively costly. Recounting the experience under the 1988 benchmarks, DOI stressed that comparability must be factored in and that involves many more components than price.

Duty to Market

Staff asked if industry had shown where its incremental costs of marketing are derived and what its arguments had been on this issue. MMS responded that industry's arguments were primarily legal and did not include much detail describing what costs of marketing incurred downstream would not also be incurred by marketing at the lease.

Staff asked DOI if it thought that the gas litigation would completely resolve the marketing issue. DOI replied that it probably wouldn't because for gas the issue is which components of an unbundled tariff are transportation and which are marketing.

Transportation

Tariffs

Staff asked whether MMS is willing to accept tariffs for onshore transportation where FERC has jurisdiction, and whether MMS would accept tariffs for offshore transportation if Congress granted FERC jurisdiction that it does not currently have. DOI explained that, because tariffs significantly overstate a producer-pipeline's actual costs, its proposal is to not accept tariffs for onshore or OCS transportation. However, it was apparent that DOI needed to further clarify its position on FERC tariffs. Although not specifically mentioned at the meeting, DOI is including a clarification in a revision to its July 24, 1998, response to industry comments. This clarification will state that, "Congress could fix this problem by passing legislation giving FERC jurisdiction over movement of oil from the OCS to an adjacent State and requiring FERC to review all tariff

rates to assure that they reflect a pipeline's reasonable and actual costs of transportation." This revision will be dated July 29, 1998 and will be posted at the same website.

Non-binding Guidance

DOI reiterated that the Assistant Secretary can provide binding guidance, while elaborating on why lower level officials cannot bind the Department. Staff asked whether that authority could be delegated down from the Assistant Secretary. DOI responded yes, but also pointed out that issuing a final agency determination would circumvent the administrative appeals process and lessees would have to seek direct judicial remedies. Furthermore, because States and Tribes can appeal MMS decisions, issuing binding decisions would infringe on that right.

Staff related that industry's foremost desire on this issue was to simplify and expedite the process. Providing finality would solve many problems. DOI pointed out that in the vast majority of cases, MMS provides a quick response that is never subject to further dispute. However, there may be cases where an auditor finds external factors that may influence how royalties should have been paid. There was general agreement among all that DOI cannot offer binding guidance instantaneously.

Closing Comments

Staff asked DOI if it would consider proposing another rule based on progress and suggestions made to date. DOI replied that proposing another rule would further delay publication of a final rule. However, DOI indicated that it would take such a proposal under consideration.