Roswell Workshop

Meeting held at BLM office, Roswell, NM, October 21, 1997.

Attendees:
Jennifer Hurst - Yates Petroleum
Neale Hickerson - Navajo Refining
Rhonda Nelson - Marbob Company
Dave Hubbard - MMS Royalty Valuation Division
Peter Christnacht - MMS Royalty Valuation Division
Todd McCutcheon - MMS Policy and Management Improvement
Dave Domagala - MMS Royalty Valuation Division
Johnny Knorr - Navajo Refining
Margie Oleson - Hayco
Kay Huffmon - Hayco
Will Waggoner - Independent Petroleum Association of New Mexico
Dan Girand - Mack Energy
Mark Murphy - Strata Producing Company

Meeting begins at 1:30 p.m. Dave Hubbard begins with an explanation of rule and goes through the handout.

Johnny Knorr - The terminology in using the trade month with NYMEX is different than what we use. October quits trading in September.

Dave Hubbard - The first of the production month is how you tie to the production month.

Peter Christnacht - We have had comments to revise the timing of using NYMEX.

Johnny Knorr - You might want to change that to the calender month.

Dave Hubbard - As of the first of any month, we would look at the near term trading month.

Johnny Knorr - What price will you use?

Dave Hubbard - The average of the daily close prices in the trading month.

Todd McCutcheon - How about using a calender to describe what we propose to do?

Johnny Knorr - No one does it the way you are describing it.

Comments Received about the MMS Proposed Federal Crude Oil Valuation Rule
Bakersfield, California Workshop Oct. 16, 1997

Attendees

Michael Sansing	Independent Oil Producers Agency, Bakersfield
Cathy Reheis	Western States Petroleum Association
Suzanne Noble	Western States Petroleum Association
John Vautrain	Purvin & Gertz
Harold Orndorff	Aera Energy
Greg Meisinger	Aera Energy
Jeff Braun	California State Controllers Office
Jeff Prude	Bureau of Land Management, Bakersfield Office.
Debbie Gibbs Tschudy	MMS
Todd McCutcheon	MMS
Peter Christnacht	MMS

Debbie Gibbs Tschudy opened the meeting by welcoming the participants and explaining that MMS was interested in holding a meeting in Bakersfield to allow producers to comment on the rule without the burden of traveling to Denver or Houston. Next, she gave a brief summary of the proposed rule and supplementary proposed rule. She then gave an overview of the Denver and Houston workshops. She also announced that the comment period would be extended to November 5th, and that an additional workshop would be held October 28th (later changed to Oct. 27th.) in Washington, D.C.

The floor was then opened to comments from the participants.

J. McCabe Let me begin by stating that the State of California has a problem with the modified provision in the July 3 supplementary proposal regarding calls. We will submit written comments asking for the change permitting value based on competitive crude oil calls to be withdrawn. We don't believe that it will be possible for auditors to verify whether lessees are in compliance. We also would like to see the two year purchase provision back in the rule. This would apply to all lessees except for true captive sellers. We don't believe that captive sellers represent a true market price, but we are sensitive to their having to pay royalties on phantom income.

The State also feels that the process is dragging on entirely too long. If MMS wants to tinker with this some more, let's have a separate rule for California. We have been at this issue for over 2 decades, and every day we delay is less money for school funding in our state. Let me also state that we do not hold MMS responsible for this. It is obvious that the integrated oil companies wish to delay the process as long as possible. It's been almost two years since we began this process and they have brought nothing to the table.

C. Reheis — We don't see where the supplemental rule gives our members any relief. We believe that posted prices are the market value.

J. McCabe — Our experience in the Long Beach litigation is that postings are not the market price. ANS is the swing crude on the West Coast. It has been acknowledged by the majors under testimony. The interagency taskforce documented that the companies compared their purchases of California crude against ANS and considered California postings to undervalue crude oil by $3-4 per barrel.

J. Vautrain — From an economist's point of view, this is not a real spot market. Only a limited number of tankers during any given month unload ANS. The state sells its production in a bidding process. This would be a better value.

H. Orndorff — B.P. is the only seller of ANS crude. Their price is not a good price indicator.

P. Christnacht — That is somewhat problematic.

J. McCabe — BP is not a take it or leave it price. Other producers sell and exchange ANS. In the contracts we have looked at, we have seen ANS prices track quite nicely with the ANS spot price. There are good incentives for ANS producers to get a competitive price. We don't see the same dynamics with California production.

J. Vautrain — It's difficult to get information on exchanges. There may be a way to get market information. One could correlate gasoline to residual fuel oil.

C. Reheis — It sounds like MMS would like our help in coming up with alternatives for differentials.

G. Meisinger — I am having some trouble grasping the essence of this issue. We have these alternatives but we need to see them fleshed out a bit more.

J. McCabe — We want a rule now. The majors have had nearly two years to get a proposal on the table.

J. Vautrain — Why are you getting less than market value for your State sell-off oil? Why don't we use the State sell offs to set a value for California crude oil?

J. McCabe — The market is not liquid enough to get the adjusted ANS price. The pipelines continue to be a reason for undervaluation of California crude. Access to our oil is

Casper Workshop:

Meeting at BLM office 1701 East "E" street, Casper, Wyoming
October 16th, 1997.

Meeting begins at 1:02 p.m.

Attendees:
Dave Hubbard - MMS - Royalty Valuation Division
Bob Kronebusch - MMS - Policy and Management Improvement
Dave Domagala - MMS - Royalty Valuation Division
Ron Redding - True Oil Company
Doug Richardson - Goldmark Engineering
Jack Blomstrom - True Oil Company
Bob McDougall - Phoenix Production Co.
Dwain Park - True Oil Company
Rich Huwaldt - Wyo. Dept. of Audit
Francine Schoen - Wyo. Dept. of Audit
Sharon Redding - True Oil Company
Jeff Cook - Mercury Exploration
Jerry Herz - Eighty Eight Oil
Michele McIntyre - Pet. Assoc. of Wyoming
Jack Bradley - Manx Oil

Dave Hubbard begins the meeting at 1:05, begins with going through the handout. Meeting opened for comment including MMS questions, at 1:31.

Jack Blomstrom - MMS is stuck looking at areas and zones. A lot of the things that are of concern in the rule do not fit here.

Bob Kronebusch - We recognize the problem. That's why we are here. Is there a way to value this oil?

Dave Hubbard - The rule probably will have a separate part for Rocky Mountain areas, we need some feedback on non-arm's-length sales, do you have ideas?

Jack Blomstrom - Gross proceeds will survive? Is there any limit on arm's-length sales?

Dave Hubbard - The 2-year limitation is gone now; true arm's-length sales will represent royalty value.

Jack Blomstrom - Lease sales will survive as an arm's-length Gross proceeds framework?

Dave Hubbard - Yes.

Houston - Second Workshop

CRUDE OIL VALUATION WORKSHOP (October 14, 1997)

ATTENDEES

NAME	COMPANY NAME	PHONE NUMBER
Ben Dillon	IPAA	(202) 857-4722
Amy Cebull	Nance Petroleum	(406) 245-6248
David Blackmon	Burlington	(817) 347-2356
Shirley Neff	Shell	(202) 466-1400
Sandra Hendrickson	Elf	(713) 739-2377
Bonn Macy	MMS	(202) 208-3827
Tom White	Walter Oil	(713) 659-1221
Jonathon Hunter	Liskow & Lewis	(504) 556-4131
Stevia Walther	Liskow & Lewis	(504) 556-4158
David Simpson	Total Minatome	(713) 739-3067
Michael Molberg	Total Minatome	(713) 739-3240
Sara Tays	Exxon	(713) 680-7730
Anita Gonzales-Evans	MMS	(202) 208-3821
Linda Allen	Pennzoil	(713) 546-4982
Wayne Pachall	Texaco	(713) 752-7412
Bob Kronebusch	MMS/PMI	(303) 275-7113
Mary Stonecipher	Amoco	(918) 581-4354
John Clark	Conoco	(405) 767-5044
John Haley	Conoco	(281) 293-1683
Ken Wells	Texaco	(504) 595-1213
Don Lynch	Texaco	(504) 595-1331
Ronnie Martin	Texaco	(713) 752-7793
Bob Steubing	Hall-Houston Oil Company	(713) 228-0711
Michael L. Adams	State of Louisiana	(913) 630-0093
Fin Doughty	Calcasieu Refining Company	(713) 652-0018
Bryce Bales	University of Texas Lands	(512) 499-4700
Valdean Severson	State of New Mexico	(505) 827-0952
Tommy Allen	Marathon Oil Company	(419) 421-3551
Robin Perrine	Scurlock Permian	(713) 646-4150
Bob Teeter	Coastal	(713) 877-7019
Mary Ann O'Malley	BP	(216) 586-3664
Robert Leo	Amoco	(805) 880-4386
Georgianna Haines	Marathon	(419) 421-2659
Dow Cambell	Marathon	(419) 421-4121
Fred Hagemeyer	Marathon	(713) 296-2505

Treva Kigar	Marathon	(713) 296-2547
Deniese Palmer-Huggins	NYMEX	(713) 658-9293
David Darouse	State of Louisiana	(972) 783-0029
Jerry Schanke	API	(202) 682-8116
Donald Norman	API	(202) 682-8546
Greg Moredock	Cabot	(281) 589-4600
Terry Kyle	Kerr-McGee	(405) 270-7295
David Lawrence	Scurlock Permian Corp	(713) 646-4387
Becky McGee	Oryx Energy/DPC	(972) 715-3198
Adrian AcEvedo	Oryx Energy	(972) 715-3865
Lawrence Dreyfuss	Scurlock Permian Corp	(713) 646-4143
April Kanah	Anadarko Petroleum Corp	

CRUDE OIL VALUATION WORKSHOP (October 14, 1997)
HOUSTON

9:00am

Deborah Gibbs Tschudy

-- Introductions/Houskeeping/agenda
-- Summary of previous workshops.
-- Purpose is to receive comments on existing alternatives and new ones.
-- Next 3 workshops--Bakersfield, California, and Casper, Wyoming on October 16 and Roswell, New Mexico on October 21.
-- Summary of previous workshops will be on Internet.
-- At Denver workshop September 30-October 1, 1997, had 8 industry, and 9 State representatives. Deborah Gibbs Tschudy summarized topics covered (Alternatives 1-5) and industry/State responses. Brainstormed various other alternatives.
-- At Houston workshop October 7 - 8, 1997, further discussed alternatives. Lots of feedback from marketers. Concern about MMS unwillingness to permit marketing cost deductions. Some State support for fixed costs. Many wanted to use gross proceeds after multiple exchanges. Discussion of gross proceeds use even where calls involved. Proposal to limit aggregation points to simplify differentials. Support for different methods for California, Rocky Mountains, rest-of country. Discussed sales where company acts as refiner in some areas and marketer elsewhere.
-- Want to talk about practical valuation methods for Rocky Mountains area

Bob Teeter (Coastal)

-- Owns 5 domestic refineries--one in New Jersey, 1 in Corpus Christy--mostly supplied by <u>foreign</u> crude--thus doesn't think should be classified as <u>refiner</u>.
-- Doesn't think refiner/non-refiner breakdown should depend on refinery <u>ownership</u>. (If there's a <u>sale</u>, should be treated differently.)

Deborah Gibbs Tschudy

-- Comments on Alternative 1 (bid-out program)?

Ben Dillon

-- Switching of format may lead to lack of comments. IPAA was willing to discuss significant quantities regarding tendering programs (putting industry volumes "at risk"). Thinks tendering can be 1st benchmark onshore and offshore.

Deborah Gibbs Tschudy

-- General State/industry support for tendering as 1st benchmark?

Audience

-- General Agreement

Mary Ann O'Malley

-- Wanted better description of tendering. BP does outright sales every day--hopes these types of cases can be included in tendering

Ben Dillon

-- Philosophically, outright purchases and sales should be considered along with tendering. Need to work on specific criteria. Seems Number 1 issue was comparability. Thought we could reach agreement, though, on like-quality and field or area. Not much movement seen on MMS's part on comparability. Wants "sideboards" so don't move to next benchmarks because auditors don't see "comparability"--single biggest issue he sees.

Deborah Gibbs Tschudy

-- Should outright sales be included in tendering program?

Mary Ann O'Malley

-- Using tendering as benchmark <u>exclusive</u> of outright sales otherwise seems to be a change in way business actually done. Should consider outright sales under tendering umbrella.

Ben Dillon

-- How provide further comments to MMS on comparability?

Deborah Gibbs Tschudy

-- Comes down to: how can arm's-length payor know, the next month, whether it paid proper value, and how does MMS know it reflects total value received for production? And how does MMS know the 10 percent reflects value for all production? Need written comments on these.

Dave Darouse

-- No official position on tendering

Deborah Gibbs Tschudy

-- Move to alternative 2 -- DPC/IPAA benchmarks

Ben Dillon

-- Summarized what was agreed on last week:

Benchmark 1 Tendering

2 (different than original)--comparables using outright sales & purchases

3 dropped (3rd party sales/purchases)

4 MMS-calculated value with payor certification of arm's-length

5 Netback--if refiner, maybe netback from spot price. Non-refiner, use spot or netback through affiliate. But wants marketing cost deductions

Becky McGee

-- DPC had also endorsed benchmarks--position remains that, even beyond comparability issues, there will be complexities we must overcome. Whether under tendering or comparable sales, thinks lease indicator best. Netback only as last resort. Lots of costs are added value that MMS isn't considering as deductions. Some members may have refiners, but don't be quick to characterize or "cubbyhole" situations--look at actual facts. Supports benchmarks as modified in workshops--will give written comments.

Fred Hagemeyer

-- Alternative 2--focuses on arm's length notion. Audit criteria should not overwhelm concept of market value at lease. Need to find comfort level on verification. Segmenting classes of trade may be arbitrary (i.e., refiner/non-refiner). Lessors/operators may be willing to verity their arm's-length status.

Deborah Gibbs Tschudy

-- Little State support for lease-based benchmark?

Dave Darouse

-- Past comments stand.

Bob Teeter

-- Generally don't know status of 3rd party sales. But get paid by such entities--often know what other parties get in a field.

Deborah Gibbs Tschudy

-- But auditors may say you should have gotten another, higher price in field.

Bob Teeter

-- thinks should rely on what you got

Deborah Gibbs Tschudy

-- For Rocky Mountains--lease-based indicators. If arm's-length sales are less than 10 percent by volume, how should non-arm's-length production be valued. If not NYMEX, what?

Fred Hagemeyer

-- Standard (10 percent) becomes meaningless. The marginal barrel drives price.

Deborah Gibbs Tschudy

-- But auditors may say some percent (such as 9 percent) may not be significant quantities.

PUBLIC HEARING ON

MINERALS MANAGEMENT SERVICE'S

SUPPLEMENTARY PROPOSED RULES ON OIL VALUATION

taken on February 18, 1998,

beginning at 9:00 o'clock a.m.,

in the offices of the Mineral's Management Service,

Houston Compliance Division,

4141 North Sam Houston Parkway East,Houston, Texas,

before Amanda L. Smothers, Certified Shorthand Reporter

in and for the State of Texas,

taken pursuant to notice,

under the Texas Rules of Civil Procedure.

INDEX

APPEARANCES

MEMBERS OF THE PANEL:

Peter Christnacht, Mineral Economist for M M S

Dave Domagala, Mineral Economist for M M S

Dave Hubbard, Chief of Economic Valuation Branch with M M S

Bob Kronebush, Office of Policy and Management Improvement

Don Sant, Deputy Associate Director for Royalty Management of M M S

Debbie Gibbs Tschudy, Chief of the Royalty Valuation Division of M M S

Notes--meeting on MMS's proposed oil royalty valuation rule

Meeting held Thursday, July 9, 1998, at Senate Russell Building. Participants at table included:

Diemer True, True Oil Co.
Claire Farley, Texaco North American Production
Thomas P. White, Vision Resources, Inc.
Victor G. Beghini, Marathon Oil Co.
Jack E. Little, Shell Oil Co.
Robert L. Keiser, Oryx Energy Co.
J. Larry Nichols, Devon Energy Co.
Cynthia Quarterman, Director, MMS
Bob Armstrong, Assistant Secretary for Land and Minerals Management
Senator Breaux (Louisiana)
Senator Domenici (New Mexico)
Senator Landrieu (Louisiana)
Senator Bingaman (New Mexico)
Senator Nickles (Oklahoma)

Senator Breaux convened the meeting at 2:05 p.m. He stated that his purpose in holding the meeting was to bring together those concerned by the disputes and controversy over MMS's proposed oil royalty valuation regulations. He and Senator Hutchison as Chair and Co-Chair of the Congressional Oil and Gas Caucus wanted to start a dialogue between industry and the Administration concerning the regulations by bringing the principals together. He noted that Senator Hutchison of Texas wanted to participate also, but was unable to. Senator Breaux noted that he wanted honest, frank talks and that note takers were present to record the proceedings. His goal was to resolve disputes; he believed there is a lot of common ground among the participants.

Senator Breaux then turned to Senator Domenici for additional opening remarks.

Senator Domenici stated that there is at least an inference that Congress should have input into the final rule, given the adversarial positions of industry and the Interior Department. He indicated the disputes must be resolved reasonably, or the current moratorium on the Department publishing a final rule may be extended. He expects Department staff to work in good faith toward a reasonable rule. He wants the process to move along to the point where industry CEO's can say that the Department is not being arbitrary, or that he believes industry itself is being arbitrary. He believed there is a long way to go to achieve this goal.

Senator Domenici emphasized that while some would say he and others are only concerned for the oil companies, that is not so. He is concerned with the needs of the public, including schoolchildren and others, but needs assurance of the rule's reasonableness. He added that Senator Hutchison was pleased he could participate in this meeting.

Notes--7/22/98 meeting on MMS's proposed oil royalty valuation rule

Meeting held at Senate Dirksen Building. Participants at table included:

Senator Hutchison (Texas)
Senator Breaux (Louisiana)
Senator Domenici (New Mexico)
Senator Bingaman (New Mexico)
Senator Thomas (Wyoming)
Cynthia Quarterman, Director, MMS
Bob Armstrong, Assistant Secretary for Land and Minerals Management
Claire Farley (Texaco North American Production)
Diemer True (True Oil Co.)
Thomas P. White (Vision Resources Inc.)
Peter Robertson (Chevron U.S.A. Co.)
Robert L. Keiser (Oryx Energy Co.)
Jack E. Little (Shell Oil Co.)
George Yates (Harvey E. Yates Co.)

Senator Hutchison convened the meeting at 2:10 p.m. She noted she wasn't able to attend the July 9 meeting, but got a report on it and felt good progress was made. She said she was one of the people who put the amendment forward to delay publication of MMS's rule, and more time was needed to discuss the rule. It's a critical time for the oil industry, and not a time for negative impacts on them. She wants a result that's right for taxpayers and producers alike, so tax revenues are maintained, jobs are preserved, and industry is stabilized.

Senator Hutchison then asked for briefs from MMS and industry on the issues involved and their status.

Ms. Quarterman noted that at the last meeting Senator Breaux asked for a summary of issues that MMS was to address in the interim between meetings. She pointed to the MMS's July 16, 1998 Federal Register notice in response to that request. The notice addresses 1) the affiliate definition, 2) language added to the proposed rule on "second guessing" lessees' marketing decisions, 3) requirements for applying gross proceeds under arm's-length sales following an exchange agreement, and 4) a request for comments on allowability of gathering costs as transportation under certain circumstances.

Senator Hutchison asked whether the Federal Register notice represented a supplemental proposed rule. Ms. Quarterman said yes. Senator Bingaman then noted that the same Interior Department officials had met yesterday with Representative Miller and others and wanted to know if other changes to the rule resulted from that meeting. Mr. Armstrong replied that no other changes had been made based on the other meeting. Senator Bingaman asked whether other changes were contemplated, and Ms. Quarterman said minor detail changes might be made, but otherwise the changes were done. She noted that the supplemental rule was meant to summarize those issues in which the Department had determined to move in the direction of

MINERALS MANAGEMENT SERVICE

PUBLIC MEETING ON SUPPLEMENTARY PROPOSED RULE

155 Van Gordon Court
Training Room B
Lakewood, Colorado

March 2, 1998

P R O C E E D I N G S

MS. GIBBS TSCHUDY: Welcome to the Minerals Management Service's public meeting on the February 6th Supplementary Proposed Rule Making. Let me introduce the people at the table.

To my far right is Dave Domagala, a Mineral Economist with MMS, and one of the primary authors of the Economic Impact Analysis of the Rule. To his left is Peter Christnacht, also a Mineral Economist with MMS, one of the primary individuals working on the Form 4415 and the instructions.

To my immediate right is Dave Hubbard, he's Chief of our Economic Valuation Branch and one of the primary authors of the Rule. My name is Debbie Gibbs Tschudy, I am Chief of the Royalty Valuation Division.

A few housekeeping items; the rest rooms are down at the end of the hall past the elevators. There's a number of handouts available at the entrance of the door. We do ask that you sign in and sign up if you're interested in speaking. And as long as the court reporter can hear you you can speak from where you sit, but if she has trouble hearing you we'll have to ask you to go to the podium with the microphone.

We had planned on providing a brief explanation of the Supplementary Rule before we opened it up to public comment, but with so few people here could I see a show of hands of those people that are interested in a brief overview? Okay. We'll just go straight to the public comment, then.

The transcripts of this meeting are available from the court recorder. You can get her name and number from her directly and order those transcripts directly from her.

And with that I will open it up to anyone who would like to make a statement. We didn't have anyone sign up to speak, but if there's anyone that would like to come forward and make a comment on the Supplementary Rule you're free to do that at this time. This is not good.

We had a number of questions in the preamble that we specifically wanted public comment on. Could I ask a few of those questions and let me see if anyone's willing to give us some feedback on those questions?

The first was on our definition of the Rocky Mountain area, the six state region; should that definition include other states? Should it exclude some states, particularly New Mexico? We were interested if the whole state of New Mexico should remain in the rest of the country or whether portions of it should be part of the Rocky

Mountains. Is there anyone that cares to comment on that?

Okay. Before I go through all nine questions and their subparts, if I ask any of these questions is there anyone that's going to give me any answers? Can I see a show of hands of anyone who's going to provide any comment on any of the questions? And no one's going to make any statements for the record?

Could you identify yourself, Bill?

MR. STONE: Bill Stone, Exxon. Maybe just a brief overview might spark a few questions. I don't know if the rest of the people want that or not, but if not that's fine.

MS. GIBBS TSCHUDY: Would that make a difference to the attendees, if we did an overview would you make comments?

UNIDENTIFIED SPEAKER: (inaudible)

MS. GIBBS TSCHUDY: I'd be willing to do an overview, but if we aren't going to get any comment on it I don't know if it's worth it or not.

MR. STONE: I guess there may be some points or questions that might need clarification for something that might--the attendees here today.

MS. GIBBS TSCHUDY: Okay. All right. Why don't we just go ahead and go through this. I was just going to give a little bit of background about the Rule and then go through the Rule itself.

The Rule results from changes in the market that have occurred over the last 20 years and our objectives to decrease reliance on posted prices, develop rules that reflect market value and reduce the administrative costs of royalty valuation.

We published the first proposed Rule in January of last year. It said if you had a true outright arm's-length sale value would be based on gross proceeds; however, in the case of a non-arm's-length sale an exchange agreement, a crude oil call or if you bought oil from anyone anywhere in the United States in the last two years value would be based on index, and that was proposed to be the Alaska North Slope spot prices for California and Alaska and NYMEX for the rest of the country, less a location and quality differential.

We published a Supplementary Proposed Rule in July that would eliminate the two-year purchase provision, require payers that had calls on their production to use NYMEX only if the call was exercised and only if it was non-competitive, and it would have allowed payers that had an arm's-length exchange agreement to pay on the resale the arm's-length resale after the exchange.

So under that Supplementary Rule, value would be based on arm's-length gross proceeds with five exceptions.

The first two are contained in the current regulations, in the '88 regulations, and that's that the sales contract does not reflect total consideration; and two, that the value is not reasonable due to misconduct.

The third was if oil was disposed of under an exchange agreement except, again, if you had a simple arm's-length exchange you could base value on the arm's-length resale after the exchange.

The fourth was if an overall balance was maintained between the buyer and the seller, and the fifth was if the lessee had a non-competitive crude oil call that was exercised by the purchaser.

We re-opened the comment period last September and asked for comments on five of the alternatives that came out of the comments on the previous rules. Those five alternatives were to value production sold not arm's-length based on; 1, an outright sale such as a tendering program; 2 would be a new series of benchmarks that were proposed by one trade association; 3 was a proposal by one of the state commenters where MMS would publish values based on prices reported to us for geographic regions; No. 4 was to use fixed or flat differentials as deducts from index prices, and the 5th was a comment from a state commenter that we use spot prices instead of NYMEX.

The comment period closed on that re-opened comment period last November. We held two public meetings during this entire process in April and seven workshops across the country. We've gotten written comments on the five alternatives from 28 different entities, and based on that published this second Supplementary Proposed Rule Making that's the subject of this meeting. It was published February 6th. The comment period closes March 23rd.

In addition to the three public meetings we've already held in Houston, Washington and today in Denver we've got public meetings set next week for Bakersfield on March 11th and Casper on March 12th.

The second Supplementary Proposed Rule is based on five principles, the first being that royalty must be based on the value of production at the lease; the second is that for arm's-length contracts royalty obligations should be based on gross proceeds, and 3, for other than arm's-length contracts MMS still believes that index prices are the best measure of value for most parts of the country.

No. 4, the lessee has a duty to market production at no cost to the federal government, and No. 5, MMS believes that customized regulations for unique producing areas are preferable to a one size fits all approach.

So the second Supplementary Proposed Rule Making proposes that gross proceeds under an arm's-length contract by the lessee or its affiliate determine value with four exceptions. Again, those first two are contained in the '88 regs, they were contained in the January proposal.

The third is oil disposed of under an exchange agreement except one or more exchange agreements, in which case value can be based on the arm's-length resale after those multiple exchanges. The fourth is oil disposed of under a non-competitive crude oil call. Fifth; oil is not sold arm's-length before it's refined, not sold by the lessee or its affiliate. Value is determined differently for three different parts of the country.

In the Rocky Mountain area it's determined based on the first applicable of a series of four benchmarks. The first is an MMS approved tendering program to be approved by MMS. The lessee has to tender at least a third of its federal and non-federal production in an area. It has to receive a minimum of three bids, and value has to be based on the highest of the bid received.

The second benchmark is the weighted average the lessee's or its affiliate's arm's-length sales and purchases in the field or area provided that those arm's-length sales and purchases exceed 50 percent of the lessee's and its affiliate's federal and non-federal production in the field or area.

The fourth is a NYMEX-based price adjusted for a location and quality, and the final is if a lessee can demonstrate that the first three do not yield a reasonable value the value would be determined and established by MMS.

For California and Alaska we've retained a proposal to use the spot price for Alaska North Slope crude adjusted for location and quality, and for the rest of the country the Proposed Rule would rely on spot prices for the market center nearest the lease, again adjusted for location and quality.

And those location and quality adjustments are; 1, from the market center to the aggregation point, the lessee's own actual transportation rates either contained as a location differential in an exchange agreement or an actual transportation contract if they physically move the oil to a market center. If they don't then MMS would publish a rate based on information we collect on a much simplified Form 4415. And from the aggregation point to the lease it would be the actual cost of transportation. We've added a provision to allow the use of quality bank adjustments from the lease to the aggregation point.

And finally, if we have a situation where a lessee is forced to index pricing but they're actually selling at the well head arm's-length so they don't know their transportation costs from the lease MMS will determine the allowance for them.

We've greatly simplified the Form 4415 over earlier proposals. It requires information only on exchanges involving federal oil, only on exchanges between aggregation points and market centers. Much fewer data is required on this form than the earlier form, and there are roughly one-third less MMS identified aggregation points than the previous proposal.

Some of the other proposals that are part of the second Supplementary Rule you may be interested in is that we've changed in response to comments the timing of the index prices so that the production month coincides with the delivery month rather than the trading month as we earlier proposed.

And we've also eliminated any proposed changes to 30 CFR 208, which was the portion of the regs that determine valuing production that we take in kind and make available to eligible refiners. The preamble states instead we decided to establish the value for that oil in the contract we have with the eligible refiner rather than through regulation.

So statistics on how federal crude oil production is distributed across the country; 73 percent of federal crude oil comes from the Gulf, 15 percent from onshore and offshore California, 6 percent from Wyoming, 4 from New Mexico and 2 for the remainder of the Rocky Mountain area.

The Economic Impact Analysis that we completed for the Rule demonstrates how we believe oil will be valued under the second Supplementary Rule. Based on the refining capacity of the various producers by area we estimated how much of the oil would remain on gross proceeds and how much of it would go to index, and as you can see for California and the Gulf over 70 percent will go to index. For New Mexico, the Rocky Mountain areas and Wyoming nearly 70 percent would remain on gross proceeds.

So that's all I had. Are there any public statements now that anybody would like to make or any clarifying questions you might have about the Rule?

MR. STRAIN: I have a question. On the adjustments for the--this is Bill Strain with Chevron; the adjustments, if you don't have a quality bank are you allowing for (inaudible)

MS. GIBBS TSCHUDY: Only to the extent that you are actually incurring quality adjustments and the market has somehow taken into account quality adjustments, so--but if you're not actually either getting a debit or a credit for your quality of your oil then you're not allowed a quality adjustment.

MR. STRAIN: (inaudible)

MS. GIBBS TSCHUDY: Right.

MR. STRAIN: (inaudible)

MS. GIBBS TSCHUDY: To the extent your purchaser made a gravity adjustment in the price you received then that is allowable, but if your purchaser did not and there is not a quality bank then you are not allowed a quality adjustment.

MR. STONE: Bill Stone, Exxon. Would you explain the process when you go directly from the lease to your own refiner?

MS. GIBBS TSCHUDY: In that situation if the oil is not sold arm's-length before it is refined value is determined based on the spot price nearest the lease, and then you are allowed your actual cost of transportation from your refinery--or I should say from the lease to the refinery to determine value at the lease.

There is a provision in the Rule that allows you to demonstrate that applying the spot price at the refinery yields an unreasonable value, and you can demonstrate that by actually showing what the market value of the oil is at the refinery by showing what purchases the refinery makes and at what price, and then again you would be allowed your actual cost of transportation from the lease to the refinery so that we arrive at value at the lease.

MR. STONE: The closest spot price is at the market center?

MS. GIBBS TSCHUDY: At market center. There is a quality adjustment allowed as well, Bill.

MR. HUBBARD: The difference between the quality as produced and the quality of the oil that represents the spot price you'd be allowed a quality adjustment in addition to the transportation from the lease to the refinery.

MR. STRAIN: And the quality adjustment?

MR. HUBBARD: That would have to be on an individual basis, too. You'd have to approach MMS on that. I mean, we wouldn't have a table or anything you could consult.

MS. GIBBS TSCHUDY: Mary?

MS. BLACKWOOD: Mary Blackwood with Amoco. The question has been asked of us as a purchaser if we're purchasing another party's oil in a lease that we own an interest in we fall under the spot index pricing scenario. The way they're--in the regs would they also have to be valued at that even though it is a true arm's-length situation?

MS. GIBBS TSCHUDY: Well, let me clarify. Are you the designee?

MS. BLACKWOOD: Yes.

MS. GIBBS TSCHUDY: Okay. But you're paying on their behalf?

MS. BLACKWOOD: Yes. And it's a true arm's-length, there's no other--

MS. GIBBS TSCHUDY: The value is determined based on the disposition of the lessee's oil, so if a lessee is selling to you arm's-length that determines value. The gross proceeds under that contract determines value.

MS. BLACKWOOD: This producer was understanding the regs that it was--they had to be--

MS. GIBBS TSCHUDY: There's a pretty lengthy explanation in the preamble about if you're the--a working interest owner or a designee or you're an operator who's marketing on their behalf, and there's again, a fairly lengthy discussion I would refer them to in the preamble.

Any other questions or comments?

MR. STONE: Bill Stone, Exxon. In the Rule provision a payor can solicit guidance from MMS that the guidance will be provided that will be non-binding, is there an explanation on why that would be non-binding?

MS. GIBBS TSCHUDY: Essentially the Agency can