DAD/CE/RFT/FOIA 2001-007-30
Mail Stop 320B2

1 document 6/4/01

JUN 4 2001

Ms. Patricia Dunmire Bragg
Gardere, Wynne, Sewell LLP
200 Oneok Plaza
100 West Fifth Street
Tulsa, Oklahoma 74103-4240

Dear Ms. Bragg:

This is to follow up our February 1, 2001, and April 10, 2001, responses to your November 14, 2000, Freedom of Information Act (FOIA) request. See Enclosures 1a, 1b and 1c.

Enclosure 2 contains 530 pages of documents that are a close approximation of what was provided to Mr. Grynberg in 1996, but destroyed under the Minerals Management Service (MMS) Records Management Handbook disposal authority. Jeff Shaw, of your office, agreed with this strategy of obtaining the original documents from the MMS custodial office and redacting any sensitive material.

Our policy, in keeping with the spirit of the FOIA, is the prompt release of records to the greatest extent possible. At the same time, we must protect the rights of individuals and the administrative processes surrounding such rights. The FOIA regulations require us to withhold information protected under FOIA exemptions at 43 CFR § 2.13 (2000) when disclosure is prohibited by statute or Executive Order, or if sound grounds exist to apply an exemption.

The appearance of privileged and confidential data in the enclosed material establishes a sound ground for applying Exemption 4 of the FOIA, which exempts from disclosure " ...trade secrets and commercial or financial information obtained from a person and privileged or confidential." We also apply this exemption because we believe that the public release of this financial information could jeopardize the competitive and financial standing of those parties associated with it. We have withheld information related to return on investment, depreciation, and confidential financial information on sales contracts and agreements. We have replaced such information with the marking "X-4" to indicate that the material is withheld under Exemption 4 of the FOIA.

As the Minerals Revenue Management FOIA Officer, I am the official denying portions of your request. If you disagree with this determination, you have the right, under Department of the Interior regulations at 43 CFR § 2.18 (2000), to appeal to:

Freedom of Information Act Appeals Office
Office of Information Resources Management
Mail Stop 5312
1849 C Street, NW
Washington, DC 20240

Your written appeal must be delivered to the FOIA Appeals Officer no later than 20 working days from the date of this letter. The appeal must include copies of your original request and of the initial denial. To expedite the appellant process and to ensure full consideration of your appeal, include a brief statement as to why you believe this decision is in error. Both the envelope containing the appeal and the face of the appeal itself should include the legend "FREEDOM OF INFORMATION ACT APPEAL."

In accordance with 43 CFR § 2.20(a)(1) (2000), we assess user fees to fulfill a FOIA request. Personnel charges cover our costs to conduct document searches and to review, identify, and delete privileged and confidential information. Other charges cover the direct costs of providing the material. Standard charges are:

Professional support	$18.60/hour	Computer/mag tapes	$25.00/each
Clerical support	$ 9.20/hour	CD	$ 6.00/each
Photocopies	$ .13/page	8 mm. tapes	$10.00/each
Microfiche	$ .08/page	Computer Diskettes	$ 1.25/each
	Computer (CPU) time	$35.00/minute ($25.00 minimum)	

Fees for overdue bills include a $35 administrative charge plus interest at the prevailing Treasury rate.

Enclosure 3 is a bill for $572.43, the cost to fulfill your request. If you have any questions, please contact Ms. Diana Ostenson at (303) 231-3719 or me at (303) 231-3628.

Sincerely,

Laurita C. Summerton
Freedom of
Information Act Officer

Enclosures

bc: RM File (705-16)
✓ MMS FOIA Officer, MS 2200 (e.t.)
✓ ONCAM FOIA Coordinator (J. Courtney), MS 392G1 (H.C.)
✓ CE Chron

LMS:MRM/DAD/CE/RFT:MS320B2:DOstenson:05/31/01:303-231-3719:T:\CE-OIA\2001Logs&Letters\2001-007-30b.doc
Final:06/04/01:dw

Yellow

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

IN REPLY REFER TO:

FEB - 2 1995

MMS-VSD-OG:95-0051
Mail Stop 3152

ATTACHMENTS CONTAIN COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC./SHELL OIL COMPANY

Memorandum

To: Freedom of Information Act Coordinator

From: for Chief, Valuation and Standards Division

Subject: Leo Crowley's Freedom of Information Act (FOIA) Request

The Valuation and Standards Division (VSD) was requested to review its files for documentation relating to Leo Crowley's FOIA request dated January 4, 1995. Attached are various documents that relate to Mr Crowley's request regarding the McElmo Dome Unit.

Please be advised that certain information included in Mr. Crowley's request is not available at the VSD offices, such as:

- Item 1 - Issue/Demand letters should be obtained from the State of Colorado auditors.
- Item 3 - Forms MMS-4295 from March 1, 1988, to the present are available from Source One.
- Item 4 - There is no marketing information regarding sales of CO_2 provided to VSD by any oil companies.

Please note that the information provided in this request is considered proprietary data by the payors.

55 Attachments

049

MMS-VSD-OG:93-0424
Mail Stop 3922

BRIEFING PAPER

SHELL & MOBIL CO_2 TRANSPORTATION ALLOWANCE CORTEZ PIPELINE TARIFF CALCULATION PROCEDURE

ISSUE: Shell Oil Company (Shell) for Shell Western E&P Inc. (SWEPI) and Mobil Exploration & Producing U.S. Inc. (MEPUS) for Mobil Producing Texas & New Mexico Inc. (MPTM), owners of the Cortez Pipeline, insist that the tariff calculation procedure, which contains nonallowable costs, was approved by the Minerals Management Service (MMS) for an unlimited duration and has no termination date. The MMS strongly disagrees.

There are several minor issues, which are addressed in the narrative. Two major issues are identified, as follows:

1. Shell and MEPUS requested MMS approval to use a calculation procedure based on a 1941 consent decree in lieu of using actual costs to calculate an allowance for transporting CO_2 through the Cortez Pipeline from McElmo Dome to sales points in West Texas.

   - The Royalty Valuation and Standards Division (RVSD) approved the procedure except for the inclusion of Federal and State income taxes.

   - The MMS Director upheld the RVSD decision, but Shell and MEPUS appealed to the Interior Board of Land Appeals (IBLA).

   - The IBLA ruled against the RVSD decision, allowing the income taxes to be included within the tariff rate.

2. The RVSD attempted to terminate the calculation procedure effective March 1, 1988, by informing SWEPI and MPTM that they were required to calculate the allowance based on actual costs under the new regulations.

   - The new oil and gas regulations effective March 1, 1988, specifically disallow Federal and State income taxes, (and some other costs) in any actual cost allowance calculation.

   - The MMS Director issued a draft decision stating that RVSD must specifically terminate the approval to use the 1941 consent decree calculation procedure on a specific date for both SWEPI and MPTM, prospectively.

RECOMMENDATION: Under non-arm's-length or no contract situations, MMS regulations require that a lessee calculate its actual costs when determining a transportation allowance rate, unless the MMS approves, upon application by the lessee, the use of a FERC or State approved tariff. Currently, neither Mobil nor Shell have a FERC or State approved tariff in effect for the Cortez Pipeline, to transport CO_2 from McElmo Dome to West Texas. Therefore, both are required by Title 30 CFR § 206.157(b) to calculate the actual costs, to determine the transportation allowance rate for the Cortez Pipeline.

° Shell received the MMS letter dated November 5, 1990, terminating the calculation procedure, on November 12, 1990. Therefore, it is appropriate that the calculation procedure be terminated for SWEPI, prospectively from November 12, 1990.

° Mobil received the MMS letter dated May 28, 1992, terminating the calculation procedure, on June 1, 1992. Therefore, the calculation procedure is terminated for MPTM, prospectively from June 1, 1992.

BACKGROUND: SWEPI is the Operator of the McElmo Dome Unit (Unit) located in Dolores and Montezuma Counties, Colorado. The Unit is a consolidation of several previous units into a single unit covering a subsurface unitized formation known as the Mississippian Leadville Formation. The Unit contains about 203,234 acres, of which approximately 154,639 acres are federal lands, 2,440 acres are state lands, and 46,155 acres are fee lands. The U.S. Department of Interior, Bureau of Land Management approved the Unit Agreement on March 29, 1983, effective April 1, 1983.

Carbon dioxide (CO_2) is produced from the Unit and is transported by the Cortez Pipeline Company to various sales points in West Texas for use in enhanced oil recovery projects.

The Cortez Pipeline Company, a general partnership composed of Shell Cortez Pipeline Company (50 percent), Mobil Cortez Pipeline Company (37 percent), and Cortez Vickers Inc. (13 percent), owns the 500 mile, 30 inch CO_2 pipeline which transports CO_2 from the Unit to West Texas. The Cortez Pipeline is operated by Shell Pipe Line Corporation as a common carrier pipeline. In addition to transporting CO_2 for SWEPI and MEPUS, the Cortez Pipeline transports CO_2 for other non-pipeline owner producers of CO_2 from the Unit. The CO_2 production and royalties due from the unit for the small share working interest owner-producers is reported to MMS by SWEPI.

Although neither the Interstate Commerce Commission nor the Federal Energy Regulatory Commission (FERC) elected to exercise jurisdiction over the transportation of CO_2 in interstate commerce, the Cortez Pipeline Company established a tariff similar to the methodology used by pipeline companies under the 1941 Consent Decree in the case of United States v. The Atlantic Refining Company, et al., C.A. 14060, D.D.C. (Dec. 23, 1941).

Following is a chronological listing of correspondence relevant to this case:

Date	Correspondence
December 9, 1983	Letter from Shell to MMS requesting approval to use, as a transportation allowance, a calculation procedure elected by pipeline partners based on a certain 1941 Pipeline Consent Decree methodology (Attachment 1).
December 16, 1983	Letter from Shell to MMS with copy of 1941 Pipeline Consent Decree attached (Attachment 2).
March 29, 1984	Letter from MMS to Shell approving the calculation procedure, as the appropriate procedure to calculate transportation allowance deductions, with the exception that, for royalty purposes, Federal and State income tax can not be included in computing transportation costs (Attachment 3).
May 1, 1984	Letter from Shell, on behalf of SWEPI, to MMS, filing a Notice of Appeal to MMS' March 24 letter excluding the Federal and State income taxes in the tariff calculation procedure (Attachment 4).
September 10, 1984	Memorandum from RVSD to Chief, Division of Appeals, Office of Program Review, regarding appeal by SWEPI. RVSD recommended that its previous position, excluding income taxes as a cost of operations, be upheld (Attachment 5).
May 6, 1985	Memorandum from RVSD to Chief, Division of Appeals, expanding on the arguments contained in the Memorandum dated September 10, 1984 (Attachment 6).
September 9, 1985	Response and comments from Shell to Chief, Division of Appeals, concerning RVSD May 6 Memorandum with respect to Shell's appeal (Attachment 7).
October 28, 1985	Letter from MPTM to MMS, requesting a transportation allowance approval for CO_2 transported from McElmo Dome to various distribution points in West Texas (Attachment 8).
January 14, 1986	Letter from Cortez Pipeline Company to Mobil Cortez Pipeline Inc. with Letter Tariff No. 1, effective April 15, 1984, attached (Attachment 9).
May 7, 1986	Letter from MMS to MPTM requesting additional information before considering MPTM's request for transportation allowance (Attachment 10).
May 29, 1986	Letter from MPTM to MMS providing additional information in response to MMS May 7 letter

	(Attachment 11).
August 6, 1986	Decision from Chief, Division of Appeals, to SWEPI denying the appeal filed by Shell May 1, 1984 (Attachment 12).
October 9, 1986	Letter from Shell to the IBLA, Office of Hearings and Appeals, filing its Statement of Reasons (SOR) in support of its September 9, 1986, Notice of Appeal (Attachment 13).
December 31, 1986	Letter from MMS to MPTM approving a transportation allowance for 1985, excluding income taxes (Attachment 14).
January 30, 1987	Letter from MPTM to MMS requesting approval for 1985 transportation allowance from other MPTM McElmo Dome CO_2 deliveries not previously approved by MMS letter dated December 31, 1986 (Attachment 15).
February 3, 1987	Letter from MEPUS, on behalf of MPTM, filing a Notice of Appeal (with SOR dated March 5, 1987, attached) to MMS' December 31, 1986, letter excluding Federal and State income taxes, limiting operating expenses to 10 % of investment expenditures, rate of return used by MMS, and various other issues in the tariff calculation procedure (Attachment 16).
May 22, 1987	Memorandum from RVSD to Chief, Division of Appeals, responding to appeal by MPTM. RVSD recommended that its Decision dated December 31, 1986, be upheld in its entirety (Attachment 17).
June 18, 1987	MPTM response to RVSD Memorandum to Division of Appeals (Docket No. MMS-87-0194-O&G), dated May 22, 1987 (Attachment 18).
July 1, 1987	Letter from MMS to MPTM (Project No. 87-0102) approving a transportation allowance for deliveries of CO_2 from McElmo Dome for 1985, not previously approved by MMS letter dated December 31, 1986, again excluding Federal and State income taxes and other exceptions (Attachment 19).
October 30, 1987	Decision from Chief, Division of Appeals, to MPTM, denying the appeal filed by MEPUS February 3, 1987, on five points, and remanded to MMS, for recalculation of the rate of return (Attachment 20).
December 21, 1987	Letter from Stutzman & Bromberg, on behalf of MPTM, to IBLA, filing its SOR in support of its November 23 and December 14, 1987, Notice of Appeal (Attachment 21).

January 26, 1988	Memorandum from RVSD to Chief, Division of Appeals, requesting reconsideration of the remand to MMS to recalculate the rate of return (Attachment 22).
February 25, 1988	Memorandum from Chief, Division of Appeals, to RVSD, stating that there was no basis for reconsideration of the Director's Decision (Attachment 23).
March 25, 1988	Letter from MEPUS to MMS requesting approval for a 1987 transportation allowance (Attachment 24).
April 20, 1988	Letter from MEPUS to MMS requesting approval for a transportation allowance from January 1, 1987, through February 29, 1988 (Attachment 25).
May 5, 1988	Memorandum culminating dispute over October 30, 1987, Director's Decision concerning rate of return (with interim memoranda on the same issue) (Attachment 26).
May 13, 1988	Letter from MEPUS to MMS requesting a transportation allowance from January 1, 1988, through February 29, 1988 (Attachment 27).
June 26, 1989	Letter from MMS to MEPUS approving a transportation allowance for 1987 (Project No. MMS-RVS-OG:88-0277) (Attachment 28).
June 26, 1989	Letter from MMS to MEPUS approving a transportation allowance from January 1, 1988, through February 29, 1988 (Project No. MMS-RVS-OG:88-0453) (Attachment 29).
December 21, 1989	Letter from MEPUS to MMS requesting a revised transportation allowance for 1985 and approval to exceed 50 % of the value of CO_2 (Attachment 30).
January 5, 1990	Letter from MEPUS to MMS requesting a revised transportation allowance for 1986 and approval to exceed 50 % of the value of CO_2 (Attachment 31).
January 23, 1990	IBLA Decision (112 IBLA 394 (1990)) in response to SWEPI's appeal filed September 9, 1986. The IBLA set aside and remanded the August 6, 1986, decision of the MMS Director regarding the disallowance of Federal and State income taxes in the tariff calculation procedure (Attachment 32).
June 28, 1990	IBLA Decision (115 IBLA 164 (1990)) in response to MEPUS' appeal filed November 23, 1987. The Decision was set aside and remanded to MMS regarding the disallowance of Federal and State income taxes same as above (Attachment 33).

October 24, 1990	Letter from MMS to MEPUS denying its December 21, 1989, request to exceed 50 % of the value of CO_2 transported from McElmo Dome for the 1985 period (Project No. MMS-RVS-OG:89-1012) (Attachment 34).
October 24, 1990	Letter from MMS to MEPUS approving its request to exceed 50 % of the value of CO_2 transported from McElmo Dome in 1986 (Project No. MMS-RVS-OG:90-0020) (Attachment 35).
November 5, 1990	Letter from MMS to SWEPI accepting Federal and State income taxes as allowable components of the tariff calculation procedure as a result of the IBLA Decision (112 IBLA 394 (1990)) dated January 23, 1990, and requiring SWEPI to calculate its transportation allowance using actual costs under the new oil and gas regulations, effective March 1, 1988 (Attachment 36).
December 4, 1990	Letter from MEPUS, notifying MMS that MEPUS has not received a response to its letter dated April 20, 1988, (Attachment 25) requesting approval to use a tariff rate of $0.39/Mcf for the Cortez Pipeline segment for the period January 1, 1987, through February 29, 1988. MEPUS also requested an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome for the same period (Attachment 37).
December 10, 1990	Letter from Shell, on behalf of SWEPI, to MMS, filing a Notice of Appeal to MMS' November 5 letter regarding the termination date of the Cortez tariff calculation procedure and the effective date to calculate the transportation allowance using actual costs (Attachment 38).
October 1, 1991	Letter from MEPUS to MMS requesting approval to use the Cortez Pipeline Tariff and for an allowance to exceed 50 % of the value of CO_2 transported from McElmo Dome to West Texas for Calendar Years 1989, 1990, and 1991 (Attachment 39).
February 7, 1992	Memorandum from MMS to Chief, Division of Appeals, regarding appeal by SWEPI. RVSD recommends that the termination date, to use the Cortez Pipeline Tariff, of February 29, 1988, be revised to April 30, 1990, (the end of the six contract years) (Attachment 40).
February 19, 1992	Letter from MMS to MEPUS granting approval for a transportation allowance from January 1, 1987, through February 29, 1988, and approval to exceed 50 % of the value of CO_2 transported from McElmo Dome to Yoakum County, Texas (Attachment 41).

March 24, 1992	Letter from Shell, on behalf of SWEPI, filing its Notice of Appeal to MMS' February 7 letter terminating the Cortez Pipeline Tariff effective April 30, 1990 (Attachment 42).
March 31, 1992	Letter from Shell, on behalf of SWEPI, to MMS, requesting approval for an allowance to exceed 50 % of the value of CO_2 transported from McElmo Dome to West Texas, from March 1, 1988, through December 31, 1992 (Attachment 43).
May 28, 1992	Letter from MMS to MEPUS approving the use of the Cortez Pipeline Tariff rate through April 30, 1990, consistent with MMS' notification to SWEPI and the contract terms of six years (Attachment 44).
June 26, 1992	Letter from Davis, Graham & Stubbs (DGS), on behalf of MEPUS, filing a Notice of Appeal (with undated SOR received by MMS on August 17, 1992, attached) to MMS' May 28 letter, regarding April 30, 1990, termination date of the Cortez Pipeline Tariff (Attachment 45).
February 22, 1993	Letter from MEPUS to MMS (in response to MMS' letter dated February 8, attached) providing additional information to support a transportation allowance in excess of 50 % of the value of CO_2 transported from McElmo Dome (Attachment 46).
March 9, 1993	Letter from MMS to Shell requesting additional information to support its request to exceed 50 % of the value of CO_2 transported from McElmo Dome, on behalf of SWEPI (Attachment 47).
October 13, 1993	Letter from MMS to MEPUS denying its request for an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome to various sales points in West Texas from March 1, 1988, through December 31, 1991 (Attachment 48).
November 5, 1993	Memorandum from Chief, Appeals and Litigation Support Division to Chief, VSD, requesting a review of the proposed decision of Shell Oil Company appeal (Attachment 49).
November 9, 1993	Letter from MMS to MEPUS withdrawing its October 13, 1993, letter denying MEPUS' request for an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome (Attachment 50).

CHRONOLOGY:

Initially, Shell requested MMS approval to use, as a transportation allowance, a calculation procedure, based on a 1941 Pipeline Consent Decree methodology. The MMS approved the use of the calculation procedure except for the inclusion of Federal and State income taxes. Shell appealed the decision, on behalf of SWEPI (Attachment 4), but the MMS Director denied the appeal (Attachment 12). Shell appealed the MMS Director's Decision to the IBLA (Attachment 13).

The RVSD upheld its previous position with regard to income taxes. In William and Meyers Oil and Gas Law, Vol. 3, §604.6(b) defines which costs are included as cost of operation; "the current cost of operation has been held to include taxes (other than income taxes) payable by the owner of the working interests." In addition, in Matzen v. Hugoton Production Co., (321 P.2d 576), the Supreme Court of Kansas upheld evidence which established that "from an accounting standpoint, income tax is a sharing of profits, not a cost; that in cost accounting, income tax is never used as a factor in determining cost of operation, cost of sales, nor of any other item." (Attachment 5)

The United States Geological Survey (USGS) Conservation Division Manual (CDM) guidelines under "producer-owned and operated pipelines, 647.5A, provide guidance on which operating costs are allowable as part of the total pipeline transportation costs to be deducted from Federal royalty including:

> "Intangible and direct costs in the following or like categories which can be shown to the satisfaction of the Supervisor to be part of the operating costs: Insurance (hazard, liability, workman's compensation, etc.); Taxes (Social Security, property taxes assessed on the pipeline and other equipment approved as pipeline investment items, etc. However, corporate income taxes are not an allowable deduction); . . . ." (Emphasis added.)

SWEPI contended that the MMS decision to deny income tax as a deductible cost of transportation was arbitrary, capricious, and constituted a departure from previous MMS determinations on transportation allowances. SWEPI further stated that MMS has provided no justification for such departure and has thus discriminated against SWEPI.

It has been, and is, MMS policy to deny income tax as an allowable cost of transportation in those cases where the costs can be identified. Therefore, SWEPI's claim that MMS discriminated against SWEPI and acted arbitrarily is unsubstantiated.

SWEPI referenced the Internal Revenue Service Wellhead Evaluation Formula (also known as the "Fiske Formula"). Essentially, this formula is a net-back formula for determining wellhead value of natural gas when there is no market for unprocessed gas at the wellhead. This formula is used when natural gas is processed at a plant and the producer (a percentage plant owner) receives a percentage of the plant proceeds. Similar to the 1941 Pipeline Consent Decree, this formula allows a "reasonable return on the investment in the plant, usually ten percent per year." (From C. Smith and G. Anderson, Jr., Federal Taxation of Oil and Gas Transactions 8-9 to 8-10). The Decree allows a seven percent return on investment. SWEPI concludes, from this example, that because income tax is an allowable deduction for tax purposes, income tax

is also an allowable deduction for royalty purposes. RVSD believes that deductions used for tax purposes are not pertinent to deductions used for royalty purposes. (Attachment 6)

MPTM requested approval for a transportation allowance on CO_2 produced and transported from McElmo Dome to various locations in Yoakum and Gaines Counties, Texas, based on the Cortez Pipeline Tariff and other pipelines, from January 1, 1984, through July 31, 1985. The MMS approved the use of the Cortez Pipeline Tariff except for the inclusion of Federal and State income taxes. MEPUS appealed the decision, on behalf of MPTM (Attachment 16), concerning income taxes excluded from the Cortez Pipeline Tariff, as well as five other issues for the other pipelines, but the MMS Director denied the appeal, regarding the exclusion of income taxes (Attachment 20). However, the Decision was remanded to RVSD to change the rate of return used by RVSD as of January 2, 1985, the beginning of the allowance period requested by MPTM, to the prime interest rate effective December 31, 1986 (the date of MMS' approval letter). The RVSD recommended that this issue regarding the recalculation of the rate of return for MPTM's transportation allowance be reconsidered (Attachment 22). The RVSD recommendation was denied (Attachment 23).

The Associate Director for Royalty Management addressed this issue further and requested that the Director approve the historic practice of using the prime interest rate in effect on the first day of the first deduction period, defined as any 12-month period for which the allowance is effective. The MMS was required to issue an addendum to the decision to correct the record for the published decisions. The Acting Director, approved the MMS historic policy by her signature (Attachment 26).

Stutzman & Bromberg, attorneys for MPTM, appealed the MMS Director's Decision, on all six counts, to the IBLA (Attachment 21). MPTM believes that Federal and State income taxes should be allowed as a cost component of the Cortez Pipeline Tariff, as to do otherwise would unfairly discriminate between CO_2 producers who are owners of the pipeline and CO_2 producers who are not owners.

MEPUS requested approval for an allowance, on behalf of MPTM, for CO_2 produced and transported from McElmo Dome to West Texas, based on the Cortez Pipeline Tariff rate and actual costs for other pipeline segments, from January 1, 1987, through February 29, 1988 (Attachments 24, 25, and 27). The MMS approved the use of the Cortez Pipeline Tariff rate except for the inclusion of Federal and State income taxes (Attachments 28 and 29).

MEPUS' approval request dated April 20, 1988 (Attachment 25) was not acknowledged, individually, by MMS, although the timeframe did overlap two other requests (Attachments 24 and 27). The MMS approved the request to use the Cortez Pipeline Tariff rate for CY 1987 (Attachment 28) and for the period January 1, 1988, through February 29, 1988 (Attachment 29), except for the inclusion of Federal and State income taxes. MEPUS also requested to exceed 50 percent of the value of CO_2 transported from McElmo Dome for the period January 1, 1987, through February 29, 1988 (Attachment 37). The MMS approved the transportation allowance by letter dated February 19, 1992, for the period January 1, 1987, through February 29, 1988 (Project No. 90-0755), and approved the exception to 50 percent limitation for those leases and months when the transportation costs exceeded 50 percent (Attachment 41).

MEPUS submitted a revised filing for a transportation allowance to exceed 50 percent of the value of CO_2 for 1985, which included compression costs for one segment. MEPUS calculated its allowance using actual costs in lieu of the Cortez Pipeline Tariff rate for the first segment from McElmo Dome to the Denver Unit/Allred Station (Attachment 30). The MMS denied MEPUS' request, by letter dated October 24, 1990 (Project No. 89-1012), because allowable actual costs provided by MEPUS did not exceed 50 percent of the value of CO_2 for 1985 (Attachment 34).

MEPUS submitted a revised filing for a transportation allowance to exceed 50 percent of the value of CO_2 for 1986, which included compression costs for one segment. MEPUS calculated its allowance using actual costs in lieu of the Cortez Pipeline Tariff rate for the segment from McElmo Dome to the Denver Unit/Allred Station (Attachment 31). The MMS approved the request to exceed 50 percent of the value of CO_2 for 1986, by letter dated October 24, 1990 (Project No. 90-0020), (Attachment 35).

The IBLA issued its Decision, dated January 23, 1990 (112 IBLA 394), in response to SWEPI's appeal, regarding the RVSD order excluding Federal and State income taxes as elements of transportation costs in calculating royalties on CO_2 transported by the Cortez Pipeline (Attachment 32). The IBLA Decision set aside and remanded the decision of the MMS Director, stating that,

> " MMS unfairly discriminates against a CO_2 lessee in denying a deduction for that component of a pipeline tariff relating to Federal and state income taxes solely on the basis that such lessee is an affiliate of the pipeline operator."

Accordingly, MMS responded to SWEPI, by letter dated November 5, 1990, granting the use of Federal and State income taxes as acceptable cost components in its Cortez Pipeline Tariff from April 15, 1984, through February 29, 1988 (Attachment 36). Effective March 1, 1988, SWEPI elected to come under the new transportation allowance regulations, since they filed the Gas Transportation Allowance Report, Form MMS-4295, for the period March 1, 1988, through December 31, 1988.

SWEPI filed a Notice of Appeal, dated December 10, 1990 (Attachment 38), to the RVSD November 5 letter, concerning the ending date for use of the Cortez Tariff. SWEPI cited Title 30 CFR § 206.157(c)(2)(v) (1988) which provides that, with respect to non-arm's-length contract based transportation allowances, which are in effect on March 1, 1988, such allowances will be allowed to continue until such allowance terminates. SWEPI believes that this regulation applies to its continued use of the Cortez Tariff after March 1, 1988, as the approved allowance with respect to SWEPI's transportation of CO_2 from McElmo Dome.

The RVSD responded to SWEPI's appeal of the termination date for using the Cortez Pipeline Tariff calculation procedure, by Memorandum to the Chief, Division of Appeals, on February 7, 1992. The RVSD revised its requirement to calculate the transportation allowance for the Cortez Pipeline using actual costs effective March 1, 1988. In Shell's initial proposal of December 9, 1983, Shell stated that "it has obligated itself by the CO_2 Sale and Purchase

Contract to base such pipeline tariff for the first six contract years on the assumption that the Cortez Pipeline throughput is 1,000,000 Mcf per day." (Emphasis added.) As defined in the "Carbon Dioxide Sale and Purchase Contract," dated March 31, 1983 (Attachment 52), between MPTM and Shell, the "first six contract years" that the tariff calculation procedure applies is the period April 15, 1984, through April 30, 1990 (William Riddoch, Shell, telecommunication of November 21, 1991). In light of these findings, RVSD concluded that the intent of the March 29, 1984, decision was to approve the calculation procedure for the "first six contract years." Accordingly, RVSD recommended that MMS approval to use the tariff calculation procedure for the transportation allowance terminated on April 30, 1990, and effective May 1, 1990, Shell should compute the transportation allowance based upon its reasonable actual costs in accordance with the regulations at 30 CFR § 206.157(b) (Attachment 40).

The IBLA issued its Decision, dated June 28, 1990, (115 IBLA 164), in response to MPTM's appeal, which was based on the same policy and rationale as SWEPI's appeal (Attachment 33). For reasons stated in the SWEPI opinion, the IBLA found that the denial of a transportation allowance for income tax purposes . . . solely on the basis that SWEPI (MPTM) is an affiliate of the pipeline operator was improper. Accordingly, the IBLA set aside the decision of the MMS Director, as to this matter, and remanded it to MMS.

Shell responded to the February 7, 1992, report and recommendation from RVSD to the Chief, Division of Appeals, revising the termination date of the Cortez Pipeline Tariff from February 29, 1988, to April 30, 1990 (Attachment 42). Shell stated that the subsidized tariff rate of 39 cents per Mcf had a six year contractual limitation on it, but there was nothing in its request to RVSD or in its sales contracts that placed a six year limit on the use of the 1941 Pipeline Consent Decree as a tariff calculation procedure. Until such tariff calculation procedure is abandoned by the owners of the Cortez Pipeline, Shell believes it is entitled to continue using the transportation allowance determined by such tariff calculation procedure as a deduction, subject to the 50 percent limitation rule, in calculating the value of CO_2 at the McElmo Dome Unit for MMS royalty purposes.

MEPUS submitted its letter dated October 1, 1991, and stated its intention to use the Cortez Pipeline Tariff as the allowance for royalty purposes for transporting production from McElmo Dome from March 1, 1988, through December 31, 1988, and for Calendar Years 1989, 1990, and 1991. MEPUS also requested MMS approval for an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome for the same time periods. Under the terms of the Partnership Agreement for the Cortez Pipeline Company, the artificially induced ceiling on the tariff amount terminated after 1989 and actual throughput was used. The tariff rate of $0.39/Mcf for the years 1983-1989 substantially increased in 1990 when actual throughput volumes were used because actual throughput volumes were much lower (543 MMcf/day in 1990). As a result, the tariff rate for 1990 was $0.493/Mcf and $0.525/Mcf in 1991. MEPUS recites language from the recent IBLA Decision, stating "To deny Mobil's use of the tariff, solely on the basis that it is affiliated with a pipeline owner is unlawful." "Moreover, the IBLA expressly held that it was arbitrary and capricious for the MMS to permit third parties to deduct federal and state taxes included within the tariff while prohibiting Mobil from doing likewise."

(Attachment 39)

The RVSD responded to MEPUS October 1, 1991, letter (Attachment 44) concerning its intention to use the Cortez Pipeline Tariff rate through 1991 and future periods. The RVSD informed MEPUS that since the effective date of the tariff is April 15, 1984, and the contract is for six years, the termination date of the tariff is April 30, 1990. Consistent with MMS' recent notification to SWEPI of the termination date, MMS issued its notification to Mobil of the April 30, 1990, termination date. Effective May 1, 1990, Mobil is required to compute its transportation allowance based on actual costs in accordance with the regulations at 30 CFR § 206.157(b0 (1991).

The VSD denied MEPUS' October 1, 1991, request to exceed 50 percent of the value of CO_2 transported from McElmo Dome to various sales locations in West Texas, as certain costs claimed by MEPUS were not allowable transportation costs (Attachment 48). After a meeting between MMS and Mobil representatives on November 4, 1993, the MMS agreed to withdraw its letter until MEPUS recalculates the overhead costs and prepares and resubmits its itemized schedules identifying the costs (Attachment 50). As of January 27, 1994, the recalculations were not received by MMS.

Shell, on behalf of SWEPI, requested an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome retroactive to March 1, 1988, and through January 1992 (Attachment 43). The MMS requested additional information and detailed documentation to explain and support the expenses claimed on various schedules provided by SWEPI (Attachment 47). After a meeting between MMS and Shell representatives in June 1993, the request to exceed 50 percent was cancelled, as Shell recognized that their allowable costs did not exceed 50 percent of the value of CO_2 produced and transported from McElmo Dome.

Davis, Graham & Stubbs filed a Notice of Appeal, on behalf of MEPUS, from the MMS letter dated May 28, 1992, terminating the use of the Cortez Pipeline Tariff rate for determination of transportation allowances (Attachment 45).

MEPUS based its appeal on the following arguments:

1. The MMS approved transportation allowance for the Cortez Pipeline remains in full force and effect.

   ° MMS regulations provide that allowances in effect on March 1, 1988, continue in effect until such allowance terminates.

   ° The MMS approval to use the Cortez Pipeline Tariff calculation procedure to arrive at a value deduction for transportation costs contained no termination date.

2. MMS efforts to find a supportable ground to terminate the Cortez Pipeline Transportation Allowance are unavailing.

   ° The record in this case simply cannot convert approval of a transportation allowance calculated on the basis of the Cortez Pipeline tariff calculation procedure of unlimited duration into

approval of a six-year transportation allowance in effect only so long as a theoretical throughput is used in performing 1941 Consent Decree calculations. MMS approved use of the Cortez Pipeline tariff calculation procedure, not a six-year transportation allowance using 1941 Consent Decree procedures with a theoretical throughput of 1,000 MMcf per day.

° The interests of the Federal government are protected by the transportation allowance that MMS approved.

° The interests of the Federal government are not prejudiced by continued acceptance of the Cortez Pipeline transportation allowance that MMS approved and that the IBLA affirmed.

° To permit the MMS Decision to stand, would fly in the face of the MMS' own regulations authorizing pre-March 1, 1988, transportation allowances to continue until they terminate.

MEPUS also stated that the rationale that supported a long list of MMS decisions are as applicable now as when the allowance was approved. MEPUS identified additional items in its SOR, as follows:

° The administrative burden to both transporters and the MMS of calculating actual costs,

° The atypical nature of CO_2,

° The fact that MMS authorizes others to claim a transportation allowance of an amount equal to the Cortez Pipeline transportation calculation procedure--

The Valuation and Standards Division (VSD), formerly RVSD, responded to the subject appeal and SOR in its (as yet unpublished) field report to the Chief, Appeals and Litigation Support Division (Project No. MMS-VSD-OG:92-0457) (Attachment 51).

1. The McElmo Dome Transportation Allowance Has Terminated.

It has never been MMS' policy or intention to approve transportation or processing allowances without an effective beginning and ending date.

° By decisions dated December 31, 1986 (Attachment 14), and July 1, 1987 (Attachment 19), issued to MPTM, MMS approved a 1985 transportation allowance for McElmo Dome. These two decisions state that "The Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable."

° MMS' letter to MEPUS dated October 24, 1990 (Attachment 34) denied its request to exceed 50 percent of the value of CO_2 transported from McElmo Dome for calendar year 1985 (Project No.

89-1012).

° MMS' letter to MEPUS dated October 24, 1990 (Attachment 35), approved its request to exceed 50 percent of the value of CO_2 transported from McElmo Dome for calendar year 1986 (Project No. 90-0020).

° MMS' letter dated February 19, 1992 (Attachment 41), approved a transportation allowance for the period January 1, 1987, through February 29, 1988. Therefore, the MMS-approved transportation allowance for McElmo Dome terminated February 29, 1988, and there was no allowance in effect on March 1, 1988. For this reason, the regulations at 30 CFR § 206.157(c)(2)(v) (1992), extending the transportation allowance approval beyond March 1, 1988, do not apply for McElmo Dome.

2. MMS Grounds To Terminate the Cortez Pipeline Transportation Allowance Are Available.

A. The "Carbon Dioxide Sale and Purchase Contract" (Contract) dated March 31, 1983 (Attachment 52), between MPTM ("Seller") and Shell ("Buyer"), Article II - Quantities, § 2.3 Transportation states,

> ° The carbon dioxide sold hereunder shall be transported by Cortez Pipeline Company for the account of Seller. Seller's ability to deliver carbon dioxide hereunder shall be at all times subject to the provisions of the Tariff in effect from time to time for the Cortez Line.
>
> ° Article III - Prices and Taxes, § 3.1 Prices (b)(ii) states, during the Initial Period and the first five Annual Periods, calculated on the assumption that the throughput in the Cortez Line is 1,000 MMcf per day and computed to achieve an annual return on valuation (as such valuation is determined by Cortez Pipeline Company from time to time) of 7%."
>
> ° Article I defines "Initial Period" as a period beginning on the date of initial delivery of CO_2 and ending on the first anniversary of such date. In addition, "Annual Period" means a period having a duration of 1 year beginning at the end of the initial period and on each subsequest anniversary thereof. Since the date of initial delivery of CO_2 occurred in April 1984, the initial period and first five annual periods cited in the Contract above constitute 6 contract years.

The terms of the Contract, as cited above, demonstrate that the Contract has terminated. The VSD considers the termination date of the calculation procedure as 6 years from the date of initial delivery of CO_2 since it

corresponds to the Contract terms of 6 years. Therefore, the calculation procedure applies to the period April 15, 1984, through April 30, 1990.

MEPUS' statement (SOR, p.5, last para.) that, ". . . calculations are to be performed using 1941 Consent Decree procedures which for the first six years merely to assume a theoretical throughput of 1,000 MMcf per day." (emphasis added) is not factual. The theoretical throughput of 1,000 MMcf per day was used initially resulting in a rate of $0.39/Mcf through December 1989. However, beginning January 1, 1990. actual costs and actual throughput were used increasing the rate to $0.493/Mcf, as stated by MEPUS in its letter dated October 1, 1991, page 4 (Attachment 39). The Cortez Tariff was no longer subsidized with a fixed theoretical throughput of 1,000 MMcf per day after December 31, 1989, which does not correspond with the six-year Contract terms ending April 30, 1990.

MEPUS' statement (SOR, p.6, first para.) that, "The record in this case simply cannot convert approval of a transportation allowance calculated on the basis of the Cortez Pipeline Tariff calculation procedure of unlimited duration (emphasis added), into approval of a six-year transportation allowance in effect only so long as a theoretical throughput is utilized in performing 1941 Consent Decree calculations", is totally without basis.

- The MMS December 31, 1986, and July 1, 1987, letters never stated that the Calculation Procedure was acceptable for an unlimited duration. The letters approved a transportation allowance for Calendar Year 1985, and were merely silent on the termination date issue. This does not imply that the proposed calculation procedure was acceptable for an unlimited duration.

- Furthermore, the MMS letter (Project No. 90-0020) dated October 24, 1990, approved a transportation allowance to exceed 50 percent of the value of CO_2 for Calendar Year 1986 only; not for an unlimited duration.

- Also, the MMS letter dated February 19, 1992, approved a transportation allowance to exceed 50 percent of the value of CO_2 from January 1, 1987, through February 29, 1988; again, not for an unlimited duration.

B. The interests of the Federal government are not protected by continuing the Calculation Procedure that was accepted by MMS before March 1, 1988.

Title 30 CFR § 206.157(b)(5) (1992) states in part,

> A lessee may apply to the MMS for an exception from the requirement that it compute actual costs in accordance with . . . . The MMS will grant the exception only if the lessee has a tariff for the transportation system approved by the Federal Energy Regulatory Commission (FERC) (for both Federal and Indian leases) or a State regulatory agency (for Federal leases) . . . . MMS shall deny the exception request if:

(i) No FERC or State regulatory agency cost analysis exists and the FERC or State regulatory agency, as applicable, has declined to investigate pursuant to MMS timely objections upon filing; and

(ii) the tariff significantly exceeds the lessee's actual costs for transportation as determined under this section.

The tariff calculation procedure has never been approved by any State or FERC jurisdictional authority.

Title 30 CFR § 206.157(b)(2) (1992) states,

> The transportation allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial depreciable investment in the transportation system multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.
>
> (i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.
>
> (ii) Allowable maintenance expenses include: Maintenance of the transportation system; maintenance of the equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.
>
> (iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses. (Emphasis added.)

The Decision dated June 28, 1990 (115 IBLA 164 (1990)) (Attachment 33), from the IBLA to MPTM, allowing the inclusion of Federal and State income taxes in the calculation procedure, concerned the time period under the USGS CDM Guidelines prior to the new Oil and Gas Valuation regulations. Effective March 1, 1988, the new regulations specifically prohibit the inclusion of these taxes as allowable expenses, as cited above.

After reviewing the elements that comprise the overhead costs included in the tariff rate, the VSD discovered that MEPUS included other nonallowable items, (MEPUS' letter dated February 22, 1993, Attachment C (MMS' Attachment 46)) in addition to the State and Federal income taxes, as follows:

- Dealer costs for the commercial paper program,

- Bank costs for the backup line of credit,

- Rating agency expenses.

The above categories were lumped together and identified as "Administrative costs of financing" under the heading C. Lessee's Overhead Allocation (specify) on the Non-Arm's-Length Transportation System/Segment Operations, Maintenance and Overhead Expenditures, Form MMS-4295, Schedule 1A. These administrative costs of financing are "other fees" and are not allowable costs under 30 CFR 206.157(b)(2)(iii) (1992).

Furthermore, the calculation procedure includes interest expense plus a 7 percent profit margin (also called "annual return on investment"). The Federal government is not obligated to subsidize MEPUS (or Shell's) profit margin. Since the regulations effective March 1, 1988, allow a return on investment (ROI) under the Standard and Poor's industrial BBB Bond rate, to allow MEPUS to include interest expense, the ROI, and a 7 perent profit margin would be triple-dipping. Therefore, the interests of the Federal Government are not protected by continuing the calculation procedure that was accepted by MMS before March 1, 1988.

The administrative burden of calculating actual costs is not a factor in considering the termination date of the tariff calculation procedure. Since actual costs must be accumulated and calculated to arrive at a rate per Mcf of CO_2 transported, the burden of calculating actual costs is no greater with or without the tariff calculation procedure.

Title 30 CFR § 206.157(c)(3) (1992) states in part,

> Upon request of a lessee, MMS may approve a transportation allowance deduction in excess of the limitation . . . The lessee must demonstrate that the transportation costs incurred in excess of the limitations . . were reasonable, actual, and necessary. An application for exception shall contain all relevant and supporting documentation necessary for the MMS to make a determination . . . ."

MEPUS routinely requests VSD approval to exceed 50 percent of the sales value of CO_2 when deducting transportation allowances from royalties due. Calculating actual costs, is a requirement in order to arrive at an amount to exceed 50 percent of the value of CO_2 transported. Therefore, MEPUS argument concerning the administrative burden of calculating actual costs is without merit.

The atypical nature of CO_2 has no bearing on the termination date of the tariff calculation procedure and since MEPUS has not provided any information showing otherwise, this argument is moot.

The fact that MMS authorizes third parties to claim a transportation allowance based on the tariff rate is not discriminatory and unlawful, since the costs for third party users are actual "out-of-pocket" costs paid directly to the owners of the pipeline, including MEPUS ans SWEPI.

The MMS approved transportation allowance terminated on February 29, 1988, by letter dated February 19, 1992. There was no MMS-approved allowance in effect on March 1, 1988. However, the decision from which MEPUS has appealed concerns the termination date of the tariff calculation procedure. The MMS letter dated December 31, 1986 (Attachment 14), in its CONCLUSIONS, stated, "The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable . . . ."

According to the Appeals and Litigation Support Division, that statement constitutes a commitment to recognize a transportation allowance based on the 1941 Consent Decree procedure, and until it is revoked, will remain in effect. Once a commitment of value is made, royalty liability may be fulfilled by payment on the approved basis until the lessee is notified that a prior determination is no longer in effect. West Coast Silica Company, a Division of Johns-Manville Sales Corporation, MMS-23-MIN September 16, 1982, 3 Gower; Supron Energy Corp., 46 IBLA 181, 189 (1980) (Attachment 49).

CO_2 Production Information: The total volumes transported through Cortez Pipeline, by company, where available, are shown below:

Year	Mobil Mcf	Shell Mcf	Total Mcf
1984	N/A	30,360,000 1/	30,360,000
1985	131,970,000	N/A	131,970,000
1986	184,955,000	N/A	184,955,000
1987	68,916,541 2/	N/A	68,916,541 2/
1988	64,135,623 3/	150,425,964 3/	214,561,587 3/
1989	91,602,962	197,512,555	289,115,517
1990	96,238,967	204,339,144	300,578,111
1991	48,932,944	206,473,691	255,406,635
1992	N/A	18,843,364 4/	18,843,364 4/

1/ = Information only for the fourth quarter.
2/ = Information covers 14 months from 1/1/87-2/29/88.
3/ = Information covers 10 months from 3/1/88-12/31/88.
4/ = Information for January 1992 only.

For the three years when full information is available (1989, 1990, and 1991) the daily production is shown as follows:

1989 = 792,097.30685
1990 = 823,501.673973
1991 = 699,744.20548

LEGAL ASPECTS: There are two potential legal problems that may arise after the appeals decisions are issued, as described below:

1. The IBLA Decisions (112 IBLA 394 (Attachment 32) and 115 IBLA 164 (1990) (Attachment 33)) dated January 23, 1990, and June 28, 1990, respectively, allowing Federal and State income taxes to be included in a transportation allowance calculation, could be re-

addressed. However, these two decisions were issued during the time period when royalty payments and allowance deductions came under the USGS CDM Guidelines prior to the new regulations. Effective March 1, 1988, the new oil and gas valuation regulations at 30 CFR § 206.157(b)(2)(iii) (1992) specifically prohibit the inclusion of these taxes as allowable expenses.

2. The presumption of noncontrol may be claimed by MEPUS, since its interest in the Cortez Pipeline is currently 37 percent.

Title 30 CFR § 206.151 (1992) Definitions states:

> "Arm's-length contract" means a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract (emphasis). For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. For purposes of this subpart, based on the instruments of ownership of the voting securities of an entity, or based on other forms of ownership:
>
> (a) Ownership in excess of 50 percent constitutes control;
>
> (b) Ownership of 10 through 50 percent creates a presumption of control; and
>
> (c) Ownership of less than 10 percent creates a presumption of noncontrol which MMS may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates.
>
> "Person" means any individual, firm, corporation, association, partnership, consortium, or joint venture (when established as a separate entity).

The preamble of 53 F.R. 1239 (1988) (codified at 30 CFR 206) (finalized January 15, 1988) states:

> . . . MMS included a provision that an arm's-length contract must be between persons with opposing economic interests regarding that contract which means that the parties are acting in their economic self-interest. Thus, although the parties may have common interests elsewhere, their interests must be opposing with respect to the contract in issue. In response to many comments on the second draft final rule, MMS has reduced the control threshold to 10 percent. The MMS can rebut presumptions of noncontrol between 0 and 10 percent and lessees can rebut presumptions of control between 10 and 50 percent.

MEPUS' ownership interest in the Cortez Pipeline is 37 percent. Since this interest is between 10 and 50 percent, it creates a presumption of control, according to 30 CFR § 206.151. Therefore, the possibility of any such claim by MEPUS is remote.

ROYALTY IMPACT: Since only SWEPI and MEPUS are royalty payors on CO_2 production from McElmo Dome (SWEPI reports and pays royalty for all small share working interest owners), the royalty impact would be negligible. The royalties would not change considerably, since both SWEPI and MEPUS would be required to calculate transportation allowances using actual costs. The transportation allowance deductions should decrease when only allowable costs are included, compared to the tariff calculation procedure that included various nonallowable costs.

OPTIONS: There are three options available for a termination date.

1. February 29, 1988, the day preceding the effective date of the new regulations.

2. January 1, 1990, when both companies started using actual cost data and actual throughput to calculate the tariff rate, instead of using a theoretical throughput of 1,000 MMcf per day.

3. It is appropriate that the tariff calculation procedure be terminated prospectively from the date that the letter terminating the approval is received by the lessee.

RECOMMENDATION: Under non-arm's-length or no contract situations, MMS regulations require that a lessee calculate its actual costs when determining a transportation allowance rate, unless the MMS approves, upon application by the lessee, the use of a FERC or State approved tariff. Currently, neither Shell nor Mobil have a FERC or State approved tariff in effect for the Cortez Pipeline, to transport CO_2 from McElmo Dome to West Texas. Therefore, both are required by Title 30 CFR § 206.157 (b) to calculate the actual costs, to determine the transportation allowance rate for the Cortez Pipeline.

° Shell received the MMS letter dated November 5, 1990, terminating the calculation procedure, on November 12, 1990. Therefore, it is appropriate that the calculation procedure be terminated for SWEPI, prospectively from November 12, 1990.

° Mobil received the MMS letter dated May 28, 1992, terminating the calculation procedure, on June 1, 1992. Therefore, the calculation procedure is terminated for MPTM, prospectively from June 1, 1992.

Attachment 54 b

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ANSWER

Facts

This appeal involves a Minerals Management Service ("MMS") determination that Shell Western E & P, Inc. ("SWEPI"), a subsidiary of Shell Oil Company ("Shell"), is subject to the reasonable actual cost provisions at 30 C.F.R. § 206.157(b) (1988) for calculating non-arm's-length transportation allowances for carbon dioxide ("CO2")[1] for production on or after the period beginning November 12, 1990.[2]

In determining the value of production from Federal leases, SWEPI is entitled to deduct applicable transportation allowances from the value of production. 30 C.F.R. § 206.153 (1988). MMS regulations require transportation allowances to "be based upon the lessee's reasonable actual costs" for non arms-length transportation contracts. 30 C.F.R. § 206.157(b). If MMS approved a transportation allowance prior to MMS's issuance of the new transportation allowance regulations in 1988, the allowance is

[1]MMS defines CO2 as a gas, thus, the gas transportation allowance regulations apply to this case. See 30 C.F.R. §206.151 (MMS definition of gas).

[2]Shell has appealed on behalf of SWEPI.

"allowed to continue until such allowances terminate." 30 C.F.R. § 206.157(c)(2)(v) (1988). Upon termination of a prior approved transportation allowance, transportation allowances must be calculated in accordance with section 206.157. SWEPI alleges that its transportation allowance has not terminated. Thus, SWEPI contends that it may continue calculating its transportation allowance pursuant to the allowance MMS previously approved, rather than in accordance with section 206.157(b)'s reasonable actual cost requirement.

SWEPI had been calculating transportation allowances pursuant to a non-Federal, non-State approved "tariff" procedure the partners of the Cortez Pipeline[3] elected to use based on a 1941 Consent Decree methodology.[4] By letter dated March 29, 1984, MMS's Royalty Valuation and Standards Division ("RVSD") accepted SWEPI's "tariff" procedure on an **interim** basis until MMS could make a final determination regarding pricing of the CO2. However, RVSD denied SWEPI's inclusion of applicable State and Federal income tax costs in its calculations because MMS believed that taxes were not a cost of operation. Shell appealed RVSD's refusal to include State and Federal income tax in its allowance calculations to the MMS Director ("Director"). The Director affirmed MMS's decision in

[3]Shell has an ownership interest in the pipeline which SWEPI uses to transport CO2 produced by SWEPI to oil fields in west Texas.

[4]The underlying contract for the sale of CO2 was for a period of six years.

Shell Western E & P, Inc., MMS-84-0013-MISC (August 6, 1986), Gower Federal Service, Royalty Valuation and Management, Rocky Mountain Mineral Law Foundation.

Shell appealed the August 6, 1986 Director's Decision to the Interior Board of Land Appeals ("IBLA"). The IBLA set aside and remanded to RVSD its decision to disallow tax costs. Shell Western E & P, Inc., 112 IBLA 394 (1990).

In response to the IBLA decision, by letter dated November 5, 1990, RVSD notified SWEPI that SWEPI's interim "tariff"-based allowance terminated when it submitted a Form MMS-4295, "Gas Transportation Allowance Report," to RVSD for the period March 1, 1988 through December 31, 1988. RVSD stated that by submitting the new allowance forms, SWEPI elected to come under the new regulations effective March 1, 1988. RVSD based its determination on the provisions at 30 C.F.R. § 206.157(c)(2)(v). Thus, RVSD required SWEPI to calculate its transportation allowances in accordance with 30 C.F.R. § 206.157(b) prospectively from March 1, 1988.

On December 10, 1990, Shell appealed RVSD's November 5, 1990 decision to the MMS Director.[5] The MMS Deputy Director granted in

[5]Pending the appeal, in a letter dated February 7, 1992, MMS "approve[d] the Cortez Pipeline calculation procedure for the 'first six contract years.'" MMS' approval was based on SWEPI's underlying six year contract period for the sale of CO2. Thus, MMS approved use of the "tariff" calculation for the period April 15, 1984 through April 30, 1990. From April 30, 1990, allowances were to be calculated pursuant to 30 C.F.R. § 206.157(b).

part, and denied in part Shell's appeal, by decision dated March 1, 1994. ("Deputy Director's Decision"). Specifically, the Deputy Director held that MMS could not terminate the allowance approval retroactively. Deputy Director's Decision at 6. However, the Deputy Director also held that MMS terminated SWEPI's allowance approval prospectively from November 12, 1990, when SWEPI received the November 5, 1990 termination letter. Deputy Director's Decision at 6. Therefore, because MMS "revoked" the transportation approval in accordance with 30 C.F.R. § 206.157(c)(2)(v) (1988), SWEPI became subject to the reasonable actual cost provisions at 30 C.F.R. § 206.157(b) on November 12, 1990. Deputy Director's Decision at 6.

This appeal and Shell's Statement of Reasons ("Statement") followed on May 3, 1994. In its Statement, Shell makes the following unsupported allegations as to why the Deputy Director's Decision is unenforceable:

1. MMS is without authority to prospectively terminate a previously approved transportation allowance in effect on March 1, 1988 pursuant to 30 C.F.R. § 206.157(c)(2)(v) (1988) without following the rulemaking procedures under the Administrative Procedure Act ("APA") at 5 U.S.C. § 553. Statement at 5.

2. In the alternative, if MMS has such authority, the November 5, 1990 letter from MMS was not due and proper notice to effect such termination. Statement at 6.

Discussion

I. Pursuant to 30 C.F.R. § 206.157(c)(2)(v) (1988), MMS May Prospectively Terminate a Previously Approved Transportation Allowance in Effect on March 1, 1988.[6]

Shell contends that the plain language of 30 C.F.R. § 206.157(c)(2)(v) (1988) allows a pre-1988 approved transportation allowance to "continue until such allowance terminates of its own accord, such as by Shell requesting a new allowance procedure."[7] Statement at 2-3. Thus, Shell concludes that its transportation allowance did not expire when it received RVSD's November 5, 1990 decision.

Shell's argument is without merit. MMS correctly applied section 206.157(c)(2)(v) which provides that:

> Non-arm's length contract or no contract based transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(Emphasis added). Pursuant to section 206.157(c)(2)(v), RVSD did "terminate" the original interim allowance by its November 5, 1990

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[6]Shell argues that MMS may not terminate an allowance without following the rulemaking procedures under the Administrative Procedure Act at 5 U.S.C. § 553. This argument is illogical because, as Shell concedes, MMS duly promulgated the rule governing the determination of this case, 30 C.F.R. § 206.157(c)(2)(v), and, MMS complied with the regulation's provisions when it terminated SWEPI's interim allowance. Statement at 4-5.

[7]The new regulations became effective March 1, 1988. 53 Fed. Reg. 1230 (January 15, 1988).

letter to SWEPI. The initial approval clearly stated that the tariff-based allowance was only to be used on an interim basis. Approval Letter at 2 (March 29, 1984). More importantly, the Approval Letter stated that Shell's interim transportation allowance would terminate when "a final determination [could] be made by MMS regarding the value of the CO2 for royalty purposes." Approval Letter at 2. In its November 5, 1990 letter, MMS notified Shell that it had made a final determination regarding the value of the CO2 for royalty purposes. By that letter, MMS terminated the interim allowance.[8] Because MMS allowed Shell's transportation allowance to continue until it terminated, MMS complied with the provisions of 30 C.F.R. § 206.157(c)(2)(v). Thus, the Deputy Director's Decision must be affirmed.

The Deputy Director's Decision also properly applies section 206.157(c)(2)(v). The decision states that 30 C.F.R. § 206.157(c)(2)(v) requires an approved transportation allowance to remain in effect "until it is revoked" by MMS. Deputy Director's Decision at 5. The Deputy Director stated that:

> just as [MMS] could have in the first instance, limited the period for which the earlier approval was to apply, [MMS] may terminate an open-ended approval prospectively by notification to the lessee.

Deputy Director's Decision at 5 (emphasis added). Accordingly, the November 5, 1990 letter gave SWEPI notice that the prior interim,

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[8]In other instances, if MMS approved a transportation allowance for a time certain, such transportation allowance would terminate at the end of the designated time.

or "open ended," approval terminated. MMS thus complied with 30 C.F.R. § 206.157(c)(2)(v) when it terminated the interim allowance. Therefore, the IBLA must affirm the MMS Deputy Director's Decision.

II. The November 5, 1990 Letter From RVSD Was Due and Proper Notice That Shell's Previously Approved Transportation Allowance Terminated Prospectively.

Shell states that the November 5, 1990 letter was not sufficient notice that MMS terminated Shell's previously approved interim "tariff"-based transportation allowance. Statement at 7. Shell bases its allegation on the fact that the Deputy Director found RVSD's reason for sending the November 5, 1990 letter incorrect. Statement at 7.[9]

Shell is wrong. The Deputy Director correctly concluded that:

> By its terms, the letter served notice that the earlier approval was not effective after February 29, 1988. The only defect with the letter . . . is that the termination of the allowance approval cannot . . . be effected on a retroactive basis.

Director's Decision at 6 (emphasis added).

In addition, Shell was aware the November 5, 1990 letter was a notice of termination. In fact, Shell's Notice of Appeal to the MMS Director, dated December 10, 1990, demonstrates that Shell

[9]The Deputy Director decided Shell had not elected to come under the new regulations for calculation of transportation allowances by filing Form MMS-4295. Deputy Director's Decision at 6.

understood that RVSD's November 5, 1990 letter terminated its interim transportation allowance. In its appeal, Shell stated:

> [its] interpretation of the November 5, 1990 letter [was] that the MMS will not permit SWEPI to deduct the Cortez tariff as the applicable transportation allowance for the period commencing March 1, 1988.

Notice of Appeal (Docket No. MMS-92-0093-O&G). Clearly, RVSD's November 5 1990 letter put Shell on notice that MMS intended to terminate the interim allowance. Therefore, pursuant to 30 C.F.R. § 206.157(c)(2)(v), Shell's interim allowance terminated by its own terms with the November 5, 1990 notice and Shell became subject to the new allowance prospectively from its receipt of that notice on November 12, 1990.

Conclusion

For the foregoing reasons, the MMS Director's Decision must be affirmed.

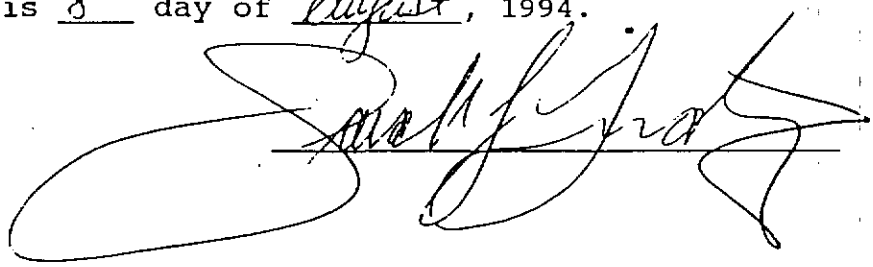
Respectfully submitted,

Date: August 8, 1994

Peter J. Schaumberg
Howard W. Chalker
Geoffrey Heath
Sarah L. Inderbitzin
Counsel for Minerals
Management Service

CERTIFICATE OF SERVICE

The foregoing Answer of the Minerals Management Service was served upon appellant by mailing a true copy thereof by certified mail, return receipt requested, to its attorney, Mr. William Riddock, Senior Counsel, Shell Western E & P, Inc., P.O. Box 576, Houston, Texas 77001, this 8th day of August, 1994.



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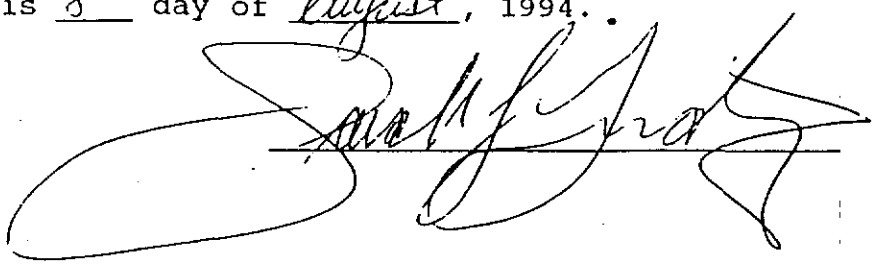


Mobil - MMS CO2 Review

Cortez Pipeline

- **Partnership - 3 Partners**

  Shell - 50%
  Mobil - 37%
  Vickers - 13%

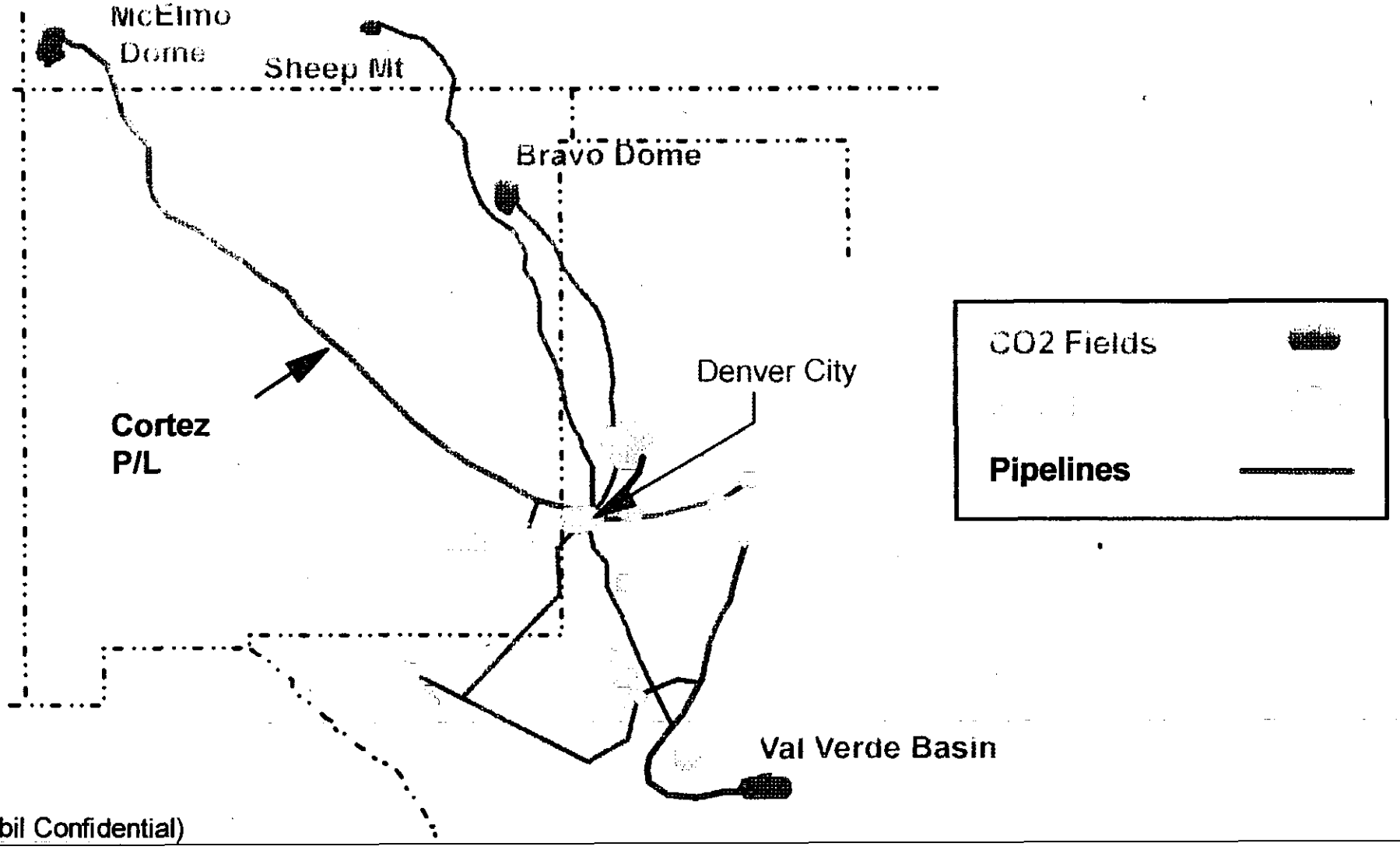
- **Pipeline Investment** ——— X-4 ———

- **Tariff Calculation**
  - Partnership Agreement
  - 1941 Consent Decree
  - Vickers Investment Only Interest
  - Externally Debt Financed
    (Pension Funds, Insurance Companies)

Attachment 55

Mobil - MMS CO2 Review

CO2 Sources, Pipelines & EOR Fields



UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE

MOBIL EXPLORATION & PRODUCING U.S. INC.

MMS-93-0997-O&G

RECEIVED
MAR 7 1994
DIVISION OF APPEALS

SUPPLEMENTAL STATEMENT OF REASONS

In light of the discussions at several meetings between Mobil Exploration & Producing U.S. Inc. ("MEPUS")[1] and the Minerals Management Service ("MMS") regarding this appeal, MEPUS accepts MMS's invitation to submit a statement of reasons to supplement the initial statement MEPUS filed on August 17, 1992. This supplemental statement also constitutes MEPUS's response to the field report from the Valuation and Standards Division ("VSD").

For the reasons explained below, the law requires MMS to accept the Cortez Pipeline tariff as the proper cost of transporting carbon dioxide from the McElmo Dome Unit to the first market. MMS's May 28, 1992, decision must therefore be reversed.

FACTUAL BACKGROUND

A. OPERATION OF THE CORTEZ PIPELINE

This appeal concerns the allowance of the cost of

[1] MEPUS is the agent of the Mobil Producing Texas & New Mexico Inc. ("MPTM") and Mobil Oil Corporation, two of the lessees in the McElmo Dome Unit.

transporting carbon dioxide produced on federal leases in the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado.[2] The Unit is operated by Shell Western E & P Inc. ("SWEPI"), which owns working interests in the Unit. MPTM and Mobil are working interest owners in the Unit. In addition, over 100 other companies own working interests in the Unit, including Chevron U.S.A. Inc. ("Chevron").

There is virtually no market for carbon dioxide at or near the Unit. To carry this gas to market, three corporations formed a general partnership pursuant to Article 6132b of the Texas Revised Civil Statutes, named the Cortez Pipeline Company, to construct a 500-mile pipeline to western Texas. Two of the corporate partners are Shell Cortez Pipeline Company, owning a 50 percent interest, and Mobil Cortez Pipeline Inc., owning a 37 percent interest. Shell Cortez is affiliated with SWEPI, Mobil Cortez is a subsidiary of MPTM. The third partner is Cortez Vickers Pipeline Company, owning a 13 percent interest. Cortez Vickers has no interest (through itself or affiliates) in the production shipped through the pipeline from the McElmo Dome Unit.

Though unregulated by the Interstate Commerce Commission ("ICC") or the Federal Energy Regulatory Commission ("FERC"),[3] the

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[2] Consolidated from several earlier units, the McElmo Dome Unit covers a subsurface formation known as the Mississippian Leadville Formation. *Shell Western E & P Inc.*, 112 IBLA 394 n.1 (1990).

[3] *Cortez Pipeline Co.*, ICC No. 37427, 46 Fed. Reg. 18805 (1981) (under 49 U.S.C. § 10501(a)(1)(C), carbon dioxide carried by pipeline is outside ICC jurisdiction); *Cortez Pipeline Co.*, 7 FERC ¶ 61,024 (1979) (carbon dioxide is not a "natural gas" subject to regulation under the Natural Gas Act).

Cortez Pipeline required rights-of-way from the Interior Department. These were issued under section 28 of the Mineral Leasing Act, 30 U.S.C. § 185(a). *See Exxon Corp. v. Lujan*, 970 F.2d 757 (10th Cir. 1992) (upholding agency view that carbon dioxide was a "natural gas" requiring pipeline right-of-way under section 28). The pipeline therefore must be operated as a common carrier, 30 U.S.C. § 185(r)(1), and must "accept, convey, transport, or purchase without discrimination all oil or gas delivered to the pipeline without regard to whether such oil or gas was produced on Federal or non-Federal lands." 30 U.S.C. § 185(r)(2)(A). As a common carrier the pipeline has a common law obligation not to charge an excessive rate.[4] (Exhibit 13, p.3 fn. 4.) Having obtained the necessary authorizations, the company completed the pipeline in 1983 at a cost of approximately one-half billion dollars. Deliveries of carbon dioxide began in April 1984.

Cortez Pipeline Company has generally not entered into written transportation contracts with its shippers. Instead, it has notified the public of the terms and conditions of its service

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[4] Although the Department lacks general authority "to regulate [section 28 pipelines] respecting ratemaking, valuation, or transportation to the market," it can seek judicial enforcement of the obligation to maintain reasonable rates. 30 U.S.C. § 185(r)(5). *See* Memorandum to Director, Bureau of Land Management from Acting Associate Solicitor, Energy and Resources, "Common Carrier Authority of the Secretary of the Interior under Section 28 of the Mineral Leasing Act" (May 13, 1986) (*citing Chapman v. El Paso Natural Gas Co.*, 204 F.2d 46 (D.C. Cir. 1953)) (Exhibit 1.)

The Department has never suggested that the Cortez Pipeline is charging excessive rates and has never attempted judicial enforcement against its rate methodology. This is no surprise because the methodology is one approved by the ICC and the Justice Department for the shipment of petroleum.

through a published tariff. (Exhibit 2.) The tariff's rate for shipping the gas is determined using a method historically used by pipeline companies operating under the 1941 Consent Decree in *United States v. Atlantic Refining Co.*, which settled litigation brought by the government under the Interstate Commerce Act to prevent allegedly discriminatory pricing practices in the transportation of oil by pipeline.[5] (Exhibit 3.)

The tariff rate thus is based on a traditional ICC ratemaking methodology for oil pipelines (commonly referred to as the "Oaks Formula"), with one notable exception. In the partnership agreement, the partners of the Cortez Pipeline Company agreed that "[f]or the first six years after the commencement of common carrier operations of the Pipeline, the tariff rate will be computed based on a projected through put of 1,000 MMCF/day using a Consent Decree approach with 7% return on valuation," as an

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[5] The essence of the litigation and the Consent Decree has been summarized by the Supreme Court.

> In 1941 the United States brought a complaint against ... several ... major oil companies and their common carrier pipeline subsidiaries claiming that the pipelines were granting illegal transportation rebates to their shipper-owners under the guise of paying dividends. Although the Government charged that no dividends at all could lawfully be granted in the same year in which a shipper-owner sent product over a pipeline, the suit was settled in late 1941 by a consent decree containing a provision which allowed a shipper-owner to receive a dividend equal to "its share of 7 percentum (7%) of the valuation" of the common carrier pipeline's property. Any dividend in excess of this figure, however, was forbidden.

United States v. Atlantic Refining Co., 360 U.S. 19, 20 (1959).

inducement to attract shippers.[6] (Exhibit 4, Partnership Agreement § 16(2).) (One million mcf/day was the full volume that the pipeline could transport daily.) By using this assumption, the tariff rate during the initial years of operation was 39 cents/mcf.

Effective January 1, 1990, the pipeline began to calculate the tariff rate using actual throughput volumes. Those volumes were significantly lower than the assumed rate of one million mcf per day. Accordingly, the tariff rate rose to 49.3 cents/mcf in 1990, 52.5 cents/mcf in 1991 and 1992, 53.6 cents/mcf in 1993, and 56.5 cents/mcf in 1994. (Exhibits 5, 6, 7, and 8.)

The numerous working interest owners in the Unit have shipped their carbon dioxide through the Cortez Pipeline. All save MEPUS and SWEPI have no interest in the Cortez Pipeline Company. All shippers have paid the same rate to the Company for its transportation services.

B. PRIOR MMS APPROVALS OF THE TARIFF RATE

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[6] Generally, the tariff rate is a per-thousand-cubic-foot rate determined by dividing the pipeline's allowable costs by the throughput, the volume of gas expected to be shipped. The higher the throughput, the lower the rate per mcf. The assumed rate of one million mcf per day was significantly higher than the actually anticipated rate of throughput for the first six years of operation. Accordingly, the tariff rate charged was lower than it would have been if actual throughput assumptions had been used. Thus, in a sense, the pipeline company was subsidizing the transportation of the carbon dioxide.

This subsidy benefitted the government's royalty interest in three ways. First, it reduced the amount of the transportation allowance deducted from the first sale price of the production. Second, it presumably encouraged Chevron to ship and sell carbon dioxide, thus increasing the total volume of federal production subject to royalty. Third, and more generally, it permitted all lessees to offer a lower price to purchasers in West Texas because it reduced the transportation component of the sales price.

As MMS has acknowledged, it has previously approved not just the tariff rate of 39 cents/mcf as a reasonable transportation allowance, it has approved "the tariff calculation procedure for the Cortez Pipeline." (Exhibit 9, "Findings and Conclusions," p. 2. MMS's October 1990 approval letter regarding the transportation allowance for 1986 for MPTM summarized the history of prior approvals of the tariff calculation procedure, with the following quotation focusing on the approval given to MPTM:

> The July 1[, 1987,] decision stated that the "... Cortez Pipeline 'tariff calculation' procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable...." The approved "tariff calculation" procedure allowed certain transportation charges assessed by Cortez Pipeline Company (Cortez) in accordance with a 1941 Pipeline Consent Decree.

(Exhibit 10, "Findings and Conclusions," p. 2.) Identical approvals of the tariff procedure based on the 1941 Consent Decree were given to MEPUS for subsequent periods and to SWEPI's predecessor.[7] None of MMS's approvals of the tariff calculation procedure contained a termination date.

Additionally, during those periods when Chevron has

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[7] MMS's approvals of the transportation allowance for McElmo Dome for 1987 through February 1988 also referred to the previously "approved 'tariff calculation' procedure" which "allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 pipeline consent decree." (Exhibits 11 and 12, "Findings and Conclusions," p. 1.)

Both approval letters also approved allowances for transportation through a segment of pipeline owned by MPTM, not by Cortez. Both letters distinguished between the approved Cortez tariff procedure and the allowance for the MEPUS pipeline, which "is computed annually based on actual allowable costs...." (*Ibid.* p. 6.)

shipped carbon dioxide through the Cortez Pipeline, MMS has authorized Chevron to deduct the full amount of the tariff as Chevron's reasonable transportation cost.

C. THE CURRENT PROCEEDINGS

On October 1, 1991, MEPUS requested that MMS approve the Cortez Pipeline tariff rate (as opposed to the tariff procedure) for production during January 1989 through December 1991. (Exhibit 13, p. 1.) MEPUS noted that MMS had previously approved the tariff procedure, that the tariff rate for this period was reasonable, that the tariff procedure protected MMS's interests just as fully as if the tariff were regulated by FERC, and that MEPUS's relationship with the pipeline, for purposes of the tariff, was essentially at arm's length. (*Ibid.* pp. 6-7.) MEPUS also reminded MMS that the IBLA had previously reversed the agency for unfairly treating MPTM differently than it treated third parties; and that MMS allowed Chevron and others to deduct the full amount of the tariff as a transportation allowance. (*Ibid.* p. 9.)

In its May 28, 1992, decision, MMS denied MEPUS's request. MMS admitted that it "has approved Mobil's use of the Tariff rate for the periods Calendar Year 1984 through February 29, 1988." (Exhibit 14, p. 1.) It also admitted that it had previously found that the "'Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs proposed by Mobil is acceptable....'" (*Ibid.* p. 2.) But from these sound premises, the decision veered unexpectedly. Citing provisions from one of the contracts for the sale (not transportation) of the carbon dioxide, MMS determined that the

pipeline's tariff reached its "termination date" on April 30, 1990.[8]

In light of this stunning "finding," MMS determined that the "Tariff calculation procedure" it had repeatedly approved "would [only] apply to the period April 15, 1984 through April 30, 1990." (*Ibid.*) Having "hereby ... [given] its notification to Mobil of the April 30, 1990, termination date[,]" MMS ordered MEPUS "to compute its transportation allowance based on reasonable actual costs in accordance with the regulations at 30 CFR § 206.157(b) (1991)." (*Ibid.*) The decision did not address MEPUS's points that it was in an arm's-length relationship with the pipeline or that denying its request would irrationally discriminate against it simply because of its affiliation with Mobil Cortez Pipeline Inc. MEPUS filed a timely notice of appeal.

D. MMS'S FEBRUARY 11, 1994, FIELD REPORT

On February 11, 1994, VSD submitted its field report on MEPUS's appeal. (Exhibit 15.) For the most part, VSD continues to adhere to its original decision, with reasons both old and new.

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[8] One would not ordinarily think that sales contracts would be immediately relevant to the appropriateness of a transportation allowance; one would look instead to the transportation contract. Indeed, MMS's rules on transportation allowances compel one to focus on the transportation contract. 30 C.F.R. § 206.157. In its July 1987 approval letter, MMS recognized that the relevant legal instrument was the "Cortez Pipeline Company Letter Tariff." (Exhibit 9, "Findings and Conclusions," p. 1.) As previously explained, these annual letters provide the relevant terms and conditions for the shipment of carbon dioxide through the pipeline. MEPUS is at a loss to explain VSD's recent fixation on a now expired sales contract. Furthermore, assuming that the sales contract was ever relevant, it only covered part of the total production shipped through the pipeline. It therefore cannot stand as definitive evidence that the tariff had terminated.

VSD first turns to an old favorite, continuing to believe that the text of MEPUS's carbon dioxide sales contract with Shell Oil Company demonstrates that the Cortez tariff calculation procedure terminated on April 30, 1990.[9] (*Ibid.* p. 5.) But VSD also introduces several newcomers. It asserts, for example, that MMS approved transportation allowances only for specified years; and that one such approval terminated on February 29, 1988, the day before the new regulations became effective. To VSD, this has special significance: "[f]or this reason, the regulations at 30 CFR § 206.157(c)(2)(v) (1992), extending the transportation allowance approval beyond March 1, 1988, do not apply to McElmo Dome." (*Ibid.* p. 4.)

For the first time, VSD also lists its reasons why MMS's prior approval of the tariff procedure should be terminated. First, the procedure "has never been approved by any State or FERC jurisdictional authority." (*Ibid.* p. 6.) Second, the procedure permits the pipeline to include federal and state income taxes as allowable expenses; and even though the inclusion of taxes was upheld by the IBLA, VSD finds their inclusion now barred by the 1988 regulations. (*Ibid.* p. 8.) Third, the procedure permits the pipeline to include certain administrative fees and interest costs which VSD believes are not allowable under the 1988 rules. (*Ibid.*) Fourth, VSD believes it would not be administratively burdensome

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[9] As explained more fully below, VSD now recognizes that its approval of the tariff procedure survived its apparent demise in April 1990, and lived on until June 1992. In light of this new position, MEPUS no longer needs to respond to VSD's contention that the sales contract is relevant to the approval of the tariff procedure and transportation allowances.

for MEPUS to calculate the pipeline's actual costs. And fifth, VSD asserts that its decision does not discriminate against MEPUS because of its affiliation with Mobil Cortez Pipeline Inc., even though Chevron and others are allowed to deduct the full cost of the tariff, because "the costs for third party users are actual 'out-of-pocket' costs paid directly to the owners of the pipeline, including Mobil."[10] (*Ibid.* p. 9.)

Finally, however, VSD concedes that it previously had approved not only annual transportation allowances, but also the tariff calculation procedure. *Citing Supron Energy Corp.*, 46 IBLA 181, 189 (1980), it concludes that "royalty liability may be fulfilled by payment on the approved basis until the lessee is notified that a prior determination is no longer in effect." (*Ibid.* p. 9.) It therefore recommends that the Director find that its approval of the procedure did not terminate until June 1, 1992, the day MEPUS received VSD's May 28, 1992, decision.

ARGUMENT

MMS's decision must be reversed for four independent reasons. First, although MPTM is affiliated with one of the partners in the Cortez Pipeline Company, its transportation agreement with the Company is an arm's-length contract for the purpose of determining the transportation allowance. As such,

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[10] VSD does not try to explain why this point, which IBLA twice found completely unpersuasive in 1990, has grown any more persuasive with age. The point is also inaccurate. All lessee-shippers, including those on whose behalf SWEPI ships, pay the same rate; and they pay it to the Cortez Pipeline Company. Profits (if any) from pipeline operations are distributed to the partners. The "Mobil" partner is Mobil Cortez, which is not a lessee in the McElmo Dome Unit.

MEPUS is entitled to deduct the full amount it pays to the pipeline. 30 C.F.R. § 206.157(a)(1)(i). Second, even if the contract is not considered arm's length, MEPUS is entitled to continue to use the previously approved tariff procedure because the approval has not yet terminated. 30 C.F.R. § 206.157(c)(2)(v). The decision's finding to the contrary is based on a complete misunderstanding of the facts and is clearly erroneous; and VSD's newly recommended termination date of June 1, 1992, violates due process and section 2(d)(2) of MEPUS's leases.

Third, for non-arm's-length transportation contracts, MMS allows the lessee to deduct the amount paid to a pipeline under a tariff approved by FERC or a state agency. 30 C.F.R. § 206.157(b)(5). The decision, however, prevents MEPUS from using a tariff rate determined under a methodology approved by the ICC and the Justice Department. The purposes behind allowing a tariff rate approved by FERC are completely satisfied by a tariff following a methodology approved by Justice and ICC. In both situations, a government agency has reviewed the methodology involved for reasonableness. The sole basis for treating MEPUS differently here is that FERC does not regulate carbon dioxide pipelines. The decision is therefore arbitrary.

Fourth, the Department has recognized that the best indicator of the reasonableness of a transportation allowance is the rate determined in arm's-length contracts. MEPUS has asked nothing more than to be allowed to use the same tariff rate that MMS allows Chevron and others to use. The decision's refusal to permit this results in the same irrational discrimination against

a producer affiliated with a pipeline that the IBLA denounced in *Shell Western E & P, Inc.*, 112 IBLA 394 (1990), and *Mobil Producing Texas & New Mexico, Inc.*, 115 IBLA 164 (1990).

A. MEPUS'S TRANSPORTATION IS UNDER AN ARM'S-LENGTH CONTRACT

Under the Department's regulations, a lessee transporting gas under an arm's-length contract may deduct the full cost incurred under the contract.[11]

> For transportation costs incurred by a lessee pursuant to an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting the unprocessed gas, residue gas and/or gas plant products under that contract....

30 C.F.R. § 206.157(a)(1)(i) (emphasis added).

The basic concept behind the notion of an arm's-length contract is that it is "a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract." 30 C.F.R. § 206.151 (definition of "arm's-length contract"). Under the Department's rules, two entities are affiliated "if one person controls, is controlled by, or is under common control with another person." *Id.* The Department assesses "control" by considering the entity's percentage of ownership of voting securities or other forms of ownership. "Ownership of 10 through 50 percent creates a presumption of control[,]" *id.*, which the lessee may rebut. 53 Fed. Reg. 1230, 1239 (1988) ("The MMS can rebut presumptions of noncontrol between 0 and 10 percent and lessees can rebut

[11] This general rule is subject to exceptions not relevant here. *See* 30 CFR § 206.157(a)(1)(ii) and (iii).

presumptions of control between 10 and 50 percent").

MPTM's subsidiary, Mobil Cortez Pipeline Inc., owns only a 37 percent interest in the Cortez Pipeline Company. MEPUS is therefore only presumed to control the pipeline; and it may rebut that presumption. What MEPUS must show in rebuttal is guided by the regulatory history behind the adoption of the 1988 definition of "arm's-length contract."

Under the old Conservation Division Manual ("CDM"), the U.S. Geological Survey treated any affiliation between the parties to a contract as sufficient to make it non-arm's-length.

> Arm's-length - A transaction between independent parties of adverse economic interest, not involving considerations other than the sale of the product; non-affiliated entities.

CDM Part 647.2.3B(5) (Release No. 35, August 15, 1977). The Department proposed to continue this approach in its comprehensive value rules. *See* proposed 30 C.F.R. § 206.151(d), 52 Fed. Reg. 4732, 4744 (1987) (not arm's-length "if one person owns an interest (regardless of how small), either directly or indirectly, in another person"). The concern which prompted the Department to propose continuing this narrow view was that any affiliation between the parties made the contracts "suspect as to their arm's-length nature."[12] 52 Fed. Reg. at 4734.

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[12] The thrust of the proposed arm's-length contract definition is to include within its coverage only those contracts between persons who have no affiliation or interrelationship of any kind that would cause the contract terms to be suspect as to their arm's-length nature. The MMS recognizes that by excluding (continued...)

After public comment, however, the Department broadened the scope of contracts to be considered arm's-length. With only slight modification, it adopted the definition of "control" from the Department's regulation, 43 C.F.R. 3400.0-5(rr)(3), implementing section 2(a)(2)(A) of the Mineral Leasing Act, 30 U.S.C. § 201(a)(2)(A).[13] 53 Fed. Reg. at 1238-39 (1988). It also added the phrase requiring that, to be arm's-length, the contract be one between "persons with opposing economic interests regarding that contract." That language was to ensure that the parties to the contract "are acting in their economic self-interest." 53 Fed. Reg. at 1239. The Department regarded this phrase as central to its concept, because "[w]hen parties to a contract ... [do not] have opposing economic interests, the reliability of that contract

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[12](...continued)
from the definition those contracts between persons where one party to the contract has any ownership interest in the other, it is narrowing the universe of contracts which would fall within the scope of the definition.

52 Fed. Reg. at 4734.

[13] Generally, section 2(a)(2)(A) prevents the Department from issuing leases to certain entities which fail to produce coal in commercial quantities after holding the lease for 10 years. The entities include a person or corporation and "any subsidiary, affiliate or persons controlled by or under common control with such" person or corporation. 30 U.S.C. § 201(a)(2)(A). *See generally* Solicitor's Opinion M-36951, "Section 2(a)(2)(A) of the Mineral Leasing Act of 1920," 92 I.D. 537 (1985).

Under the rule implementing this restriction, "[i]f an entity does not believe that the presumption of control is applicable to it, then it can provide information rebutting the presumption or declaring who, in fact, is in control." 51 Fed. Reg. 43910, 43917 (1986). For example, the "presumption of control can be rebutted by evidence that the single largest shareholder is incapable of control or has consistently been denied control by block voting of smaller shareholders." *Id.*

as an accurate indicator of value becomes suspect." *Id.*

On the facts, MMS can continue to treat MEPUS's transportation contract as non-arm's-length only if it reverts to a pre-1988 understanding of the phrase. MEPUS and MPTM are not free to manipulate the tariff rate in order inflate the transportation allowance. The tariff methodology is already established in the partnership agreement creating the Cortez Pipeline Company. (Exhibit 4.) The methodology can be changed only by unanimous vote of the partners: "Notwithstanding any other provision of the Agreement, the following actions may be taken on behalf of the partnership only by the agreement of all the partners: ... [a]mending the criteria for rate determination set forth in Article 16 hereof...." (*Ibid.* § 6.5(h).) Cortez Vickers owns an interest only in the pipeline, not in the McElmo Dome Unit. Its economic interest therefore is in opposition to MEPUS's. And because its vote is essential to any proposal to change the tariff methodology, its power keeps the Cortez Pipeline Company as a whole an economic interest in opposition to the federal lessees.

Additionally, MMS accepts the Cortez tariff as the proper value for the transportation allowance for Chevron and others. It has no reason to consider the tariff rates "suspect as to their arm's-length nature." 52 Fed. Reg. at 4734. And the Department accepts arm's-length transportation contracts as "an accurate indicator of value...." 53 Fed. Reg. at 1239.

Because MEPUS lacks the power to alter the tariff procedure without the consent of Cortez Vickers, and because MMS has no reason to suspect the arm's-length nature of the tariff

procedure and rate, MEPUS does not "control" the Cortez Pipeline Company within the meaning of 30 C.F.R. § 206.151. Its transportation contract is arm's-length.

B. MMS's Prior Approvals of the Tariff Procedure Are Still In Effect.

In its field report, the Valuation and Standards Division has correctly recognized that it not only approved transportation allowances for given periods, it also approved the tariff calculation procedure. (Exhibit 15, p. 9.) It concedes that this approval is binding on MMS until it is revoked or amended. *See Amoco Production Co. (On Reconsideration)*, 94 IBLA 129, 131 (1986), *aff'd sub nom. Amoco Production Co. v. Lujan*, 877 F.2d 1243 (5th Cir. 1989), *cert. denied*, 493 U.S. 1002 (1989) (approval is "binding on MMS, unless and until MMS rescinds or amends its acceptance of such valuation basis"). From these sound principles, VSD concludes that its approval of the tariff procedure was not terminated until MEPUS received notice of VSD's decision on June 1, 1992.

Unfortunately, VSD's conclusion overlooks a third sound principle: MEPUS's leases and Department precedent require VSD to give MEPUS a hearing before the effective date of its termination of the tariff procedure. VSD's approval of the procedure was based on the Secretary's lease right to "establish reasonable minimum values" for royalty valuation. (Exhibit 16, Lease Terms section 2(d)(2). This power encompasses the duty to consider "other relevant matters," *id.*, which is, of course, the historical basis

for the Department's grant of transportation allowances. *Shell Oil Co.*, 70 I.D. 393 (1963). In terminating an approval of a method for calculating a transportation allowance, MMS acts under the same power as it did in approving the method. Under the lease, MMS may act, "whenever appropriate, after notice and opportunity to be heard." *Id.*

VSD has offered no reason why providing MEPUS with notice and hearing was inappropriate before purporting to terminate the approval.[14] MEPUS can find no precedent upholding the agency's failure to provide the opportunity for a hearing, and this appears to be because the Department has never tried to make a change in an approved valuation method effective before granting the hearing. For example, in *Marathon Oil Co. v. United States*, 604 F.2d 1375 (D. Alaska 1985), *aff'd*, 807 F.2d 759 (9th Cir. 1986), *cert. denied*, 480 U.S. 940 (1987), the Department sought to change a previously approved method of valuing natural gas. Acting under the same lease authority as that present here, MMS first notified Marathon of its "intention to redetermine the reasonable value" of the production on January 6, 1983. 604 F. Supp. at 1377. It then provided Marathon with a hearing two months later. After the hearing and the receipt of written comments, MMS "on July 8, 1983 issued an order to Marathon directing the company to begin paying royalties as of August 1, 1983 based on the revised computations." *Id.* This procedure was afforded not as an act of grace, but

[14] VSD's decision came in response to MEPUS's request to approve a transportation allowance for a given period. MEPUS had no warning that the termination of the tariff procedure was under consideration.

because the Office of the Solicitor advised MMS that it was required.

MEPUS disputes the legitimacy of VSD's reasons for wanting to terminate the approval. These reasons have been supplied in writing for the first time in the field report, 20 months after VSD would make the termination effective! The very purpose of the hearing granted to Marathon was to allow it to challenge the legitimacy of MMS's reasons for change before the change took effect. The lease, and due process, require no less for MEPUS.

Absent special circumstances, due process requires notice and an opportunity to be heard before the government deprives a person of an interest in property. *Fuentes v. Shevin*, 407 U.S. 67, 81-82 (1972); *Toney v. Burris*, 650 F. Supp. 1227, 1234 (N.D. Ill. 1986). In this instance, VSD has provided neither to MEPUS.

VSD's February 11, 1994, field report finally provided MEPUS with notice of VSD's reasons for wanting to terminate the approval of the tariff calculation procedure. VSD's action would deprive MEPUS of part of its property interest in lease revenues for twenty months prior to a hearing. The net effect of VSD's decision is to retroactively disallow an approved method of valuation, thereby putting MEPUS on the hook to MMS for back royalty payments and depriving MEPUS of its property without due process of the law. *See Boutte v. Chevron Oil Company*, 316 F. Supp. 524 (E. D. La. 1970); *aff'd.*, 442 F.2d 1337 (5th Cir. 1971).

MEPUS was not only deprived of a hearing prior to the termination, it had no idea VSD was even considering terminating

its prior approval of the tariff procedure until MEPUS received notice of the purported termination. Adequate notice reasonably calculated to apprise interested parties about the pendency of agency action is essential to the right to be heard. *Marcello v. Regan*, 574 F. Supp. 586, 596 (D.R.I. 1983). Moreover, before it made its decision, due process required that VSD listen to what MEPUS had to say on the issue. *Housing Authority of the County of King v. Pierce*, 701 F. Supp. 844, 850, n. 13 (D.D.C. 1988).

Although required by the lease, MMS policy, and the fundamental principles of due process, VSD neglected to provide MEPUS with notice of its intent to terminate the approval of the Cortez pipeline tariff calculation procedure and utterly failed to provide MEPUS with any opportunity to be heard on the issue of the legitimacy of VSD's reasons prior to summary termination. Furthermore, VSD has never suggested that exceptional circumstances justify its summary action. Accordingly, VSD's decision violates due process of law. *Hines v. United States*, 105 F.2d 85, 89 (D.C. Cir. 1939); *Atwater v. Roudebush*, 452 F. Supp. 622, 631 (N.D. Ill. 1976) (due process requires right to submit evidence and argument prior to decision).

C. IT IS IRRATIONAL TO TERMINATE APPROVAL OF THE TARIFF PROCEDURE SIMPLY BECAUSE FERC HAS NOT APPROVED IT; TO THE EXTENT MMS BELIEVES THE 1988 RULES REQUIRE TERMINATION, THE RULES ARE ARBITRARY

If a transportation contract is non-arm's-length, the 1988 rules ordinarily allow the lessee to deduct its "reasonable actual costs" of transportation. 30 C.F.R. § 206.157(b)(1). MMS will allow a lessee to deduct the full value of a transportation

tariff if the tariff is "approved by the Federal Energy Regulatory Commission (FERC) (for both Federal and Indian leases) or a State regulatory agency (for Federal leases)." 30 C.F.R. § 206.157(b)(5). MMS will not allow a lessee to use a FERC or state approved tariff, however, "if it determines that the tariff is excessive as compared to arm's-length transportation charges by pipelines, owned by the lessee or others, providing similar transportation services in that area." *Id.*

The Department's reason for accepting approved tariffs is that it would be unnecessarily burdensome and duplicative for a lessee to subject its transportation costs to MMS's scrutiny when another government agency has already done so.

> MMS has concluded that where a lessee has a tariff approved by FERC or a state regulatory agency, it is unnecessarily burdensome and duplicative to recompute [reasonable actual] costs. Therefore, MMS will recognize FERC tariffs ... and tariffs approved by a State regulatory agency ... as ... an exception to the requirement to use actual costs for non-arm's-length or no-contract situations.

53 Fed. Reg. at 1261. Aware of concerns that a lessee might try to use an excessive tariff to minimize its royalty obligation, the Department nevertheless defended the exception as a way to reduce burdens both on lessees and on MMS.

> [I]n an effort to simplify procedures for both the lessee and MMS, the regulations at § 206.157(b)(5) will provide an exception to the requirement to compute actual costs where the lessor's interest is adequately protected.... However, the rules contain protection from unreasonably high tariffs. The MMS will deny the exception request if it determines that the tariff is excessive as compared to arm's-length transportation charges by pipelines owned by the lessee or others providing

similar transportation services in that area.

Id. Accordingly, once MMS grants the exception based on an approved tariff, the transportation is treated as if it were under an arm's-length contract. *See* 30 C.F.R. §§ 206.157(c)(2)(viii) and 206.157(f).

In this appeal, MEPUS has requested MMS to approve allowances based on the previously approved tariff procedure. That tariff is calculated under the so-called "Oaks Formula," a traditional ICC methodology for regulating the rates of oil pipelines, which was incorporated into the 1941 Consent Decree. If the Department is willing -- in the interest of avoiding duplication and reducing burden -- to accept FERC or state approved methodologies for regulating tariffs, then VSD has no reason to discontinue approval simply because it is the ICC and the Justice Department which approved the methodology.

Nor has VSD proffered any reason. The Department has not suggested that the Cortez Pipeline Company's tariff is too high. VSD has not argued that the ICC methodology for oil pipeline rates cannot rationally be applied to a carbon dioxide pipeline. VSD would concede that if FERC exercised jurisdiction of carbon dioxide pipelines, then the tariff would be accepted. VSD must also concede that the tariff is not too high, even for the limited purpose of the transportation allowance, because MMS has approved Chevron's use of the tariff as an arm's-length arrangement. Indeed, because § 206.157(b)(5) expressly uses arm's-length rates as the measure of the appropriateness of the tariff, MMS's approval of the rate for Chevron confirms that "the lessor's interest is

adequately protected." 53 Fed. Reg. at 1261. Therefore, to the extent VSD reads § 206.157(b)(5) to require terminating the approval of the tariff procedure because it lacks FERC or state approval, then that provision is arbitrary as applied to a pipeline over which FERC and state authorities have no power of rate regulation.

D. VSD's Attempt to Terminate Approval of the Tariff Procedure Irrationally Discriminates Against MEPUS

The Department has long recognized that one company may enter into a valid contract with an affiliated company.

> [A] parent corporation and its wholly owned subsidiary may enter into a valid contract. In United States v. Weissman, Judge Learned Hand wrote: "It is true that there can be legal transactions between two corporations all of whose shares are owned by a single individual, and that the same obligations will arise out of them as would arise, had they been between either corporation and a third person." It is the general rule that court will not, because of stock ownership or interlocking directorates, disregard the separate legal identities of corporations, unless such relationship is used to defeat public convenience, justify wrongs..., protect fraud, or defend crime.

Getty Oil Co., 51 IBLA 47, 50 (1980) (citations omitted). Applying these principles in the royalty context, the Department has recognized that "[a]lthough contracts between a parent corporation and its subsidiary may not be at arm's length, they may result in a fair market price. If a transaction is not at arm's length, some other manifestation that the price is nonetheless an accurate portrayal of the article's worth is required. It must be a price which independent buyers in arm's length transactions would be willing to pay." *Id.* at 51.

VSD's decision disregards these principles when preventing MEPUS from deducting the full cost of the tariff. It does so, oddly enough, by relying on the 1988 regulations; even though those rules largely adopt the *Getty* policy of accepting values under non-arm's-length contracts if they are comparable to those under arm-s-length contracts.

Thus, in adopting the 1988 rules on transportation allowances, the Department recognized that it had relied, and would continue to rely, on values in arm's-length contracts as the measure of the value of transportation.

> The MMS currently uses the payments made by a lessee under an arm's-length transportation agreement as an accurate indicator of reasonable, actual costs. The MMS has determined that payments made under arm's-length contracts are the best available indicator of reasonable, actual costs incurred by the lessee.

53 Fed. Reg. at 1259. Accordingly, as explained above, MMS will accept a FERC or state approved non-arm's-length tariff as a transportation allowance unless it appears excessive when compared with arm's-length contracts for comparable service in the area.

MEPUS, SWEPI, and Chevron pay the same tariff rate to the Cortez Pipeline Company. Chevron is allowed to deduct the full rate. Other working interests owners in the Unit, on whose behalf SWEPI ships some of the gas, are allowed to deduct the full rate. But MEPUS (if VSD has its way) is allowed only to deduct the actual costs charged to Mobil Cortez Pipeline Inc. Why? VSD is candid: because MEPUS is agent for MPTM, which is affiliated with Mobil Cortez.

VSD is particularly concerned that the tariff procedure includes certain costs in the rate base, such as federal and state income taxes, which could not be included if the procedure were being approved for the first time under the current 30 C.F.R. § 206.157(b)(2). Yet the 1988 regulations do not require that all non-arm's-length transportation allowances satisfy § 206.157(b)(2); instead, they allow FERC-approved tariffs and previously approved allowances to be used. And, of course, no arm's-length transportation contract is required to satisfy § 206.157(b)(2). The issue then is whether MMS may terminate the approval of the tariff procedure as to those lessees affiliated with the owners of the pipeline, while allowing it to continue as to unaffiliated lessees. And this issue is controlled by *Shell Western E & P, Inc.*, 112 IBLA 394 (1990), and *Mobil Producing Texas & New Mexico, Inc.*, 115 IBLA 164 (1990).

In those cases, MMS approved the use of the Cortez Pipeline tariff calculation procedure with one exception: for the purpose of calculating the transportation allowance, Shell and MEPUS were to exclude federal and state income taxes from the rate base. MMS's rationale was to "'eliminate the potential for abuse that could result from expense manipulation between pipelines and production facilities not wholly independent of each other....'" 112 IBLA at 399-400 (quoting Director's decision in MMS-84-0013-MISC). IBLA found this reasoning arbitrary.

> MMS proceeds on the assumption that when the lessee is an affiliate of the pipeline operator, the income tax burden of the operator may somehow be shifted to the lessee, thereby reducing the amount upon which Federal

> royalty on the CO_2 is calculated. MMS' policy, while "intended to preclude abuse and overcome audit burdens," unfairly discriminates against lessees who are affiliates of pipeline operators. In the absence of some manifestation that affiliated companies are using their corporate relationship to defeat MMS royalty collection efforts, the general rule recognized in Getty Oil Co.[, 51 IBLA 47 (1980),] applies. MMS does not allege, and there is nothing in the record to suggest, that Cortez is not transporting SWEPI's CO_2 at a price equal to that obtainable under an arms-length contract. MMS' denial of a transportation allowance for income taxes in this case solely on the basis that SWEPI is an affiliate of the pipeline operator was improper.

Id. at 400.

Here again VSD must concede that Cortez is transporting MEPUS's carbon dioxide at a price equal to that obtainable under an arm's-length contract, for VSD has acknowledged that Chevron is paying and deducting the same price. Nor has the Department ever suggested that the pipeline's rates are unreasonable. VSD remains bound by IBLA's rulings.[15]

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[15] For similar reasons, VSD's concerns about alleged "triple dipping" on interest are completely ill-founded. (Exhibit 15, p. 8.) VSD claims that because the tariff procedure treats Cortez Pipeline Company's interest payments to outside financers as a cost on which the seven percent rate of return is calculated, that this is a "double-dip;" and that the existence of a return on investment in section 206.157(b)(2)(v) somehow turns this practice into a "triple-dip."

First, by using the tariff procedure as its actual transportation cost, MEPUS is forgoing the opportunity to use the rate of return in section 206.157(b)(2)(v), the Standard and Poor's BBB rate. That rate applies only to those computing their allowance under section 206.157(b)(2); so there can be no triple-dipping. Second, because MEPUS is not benefiting from the use of the BBB rate, it is not getting a rate of return which compensates it for the interest the pipeline pays to its financers. Third, these interest payments are real costs to the Cortez Pipeline

(continued...)

To the extent that the Department believes that 30 C.F.R. § 206.157(b)(2) compels the termination of MMS's approval of the tariff procedure, the regulation is arbitrary. The sole reason the Department offered for excluding income taxes from allowable transportation expenses is that "MMS views income taxes to be an apportionment of profit rather than a valid operating expense." 53 Fed. Reg. at 1262. This is, of course, precisely the position MMS took before the IBLA in SWEPI's appeal. *See* 112 IBLA at 396. But as IBLA explained, then, as now, "MMS appears untroubled by the general concept of allowing a lessee to include income taxes paid by a pipeline as an element of transportation costs," *id.* at 399, because it only disallows the cost of taxes when the lessee is affiliated with the pipeline, and even then only in certain circumstances. So MMS's "rationale" does not match the regulation it has actually adopted, making that regulation arbitrary.

Nor can the Department support the application of section 206.157(b) to a pipeline shipping part of the gas under arm's-length contracts. *Getty Oil Co.* made clear that as long as the non-arm's-length prices are comparable to the arm's-length prices, the non-arm's-length prices may be used in royalty valuation. Even the Department's 1988 rules permit reference to arm's-length prices when valuing processed and unprocessed gas, and when valuing the

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[15](...continued)
Company, and any business expects a return on the money it spends. Fourth, nothing in the 1988 rules prevents a lessee from including interest costs in its actual transportation costs. Fifth, and most importantly, VSD ignores this concern about double- and triple-dipped rates of return when the lessee is unaffiliated with the pipeline. Its preoccupation with this concern in MEPUS's case is therefore improper. 112 IBLA at 399.

cost of processing. *See, e.g.*, 30 C.F.R. § 206.159(b)(4). If the Department's rules prevent MMS from using the arm's-length cost of transportation here as the measure for MEPUS's allowance, then those rules are arbitrary.

CONCLUSION

For these reasons, VSD's decision should be reversed and MEPUS's October 1, 1991, request should be granted.

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Mail Stop 3920

Memorandum

To: Chief, Appeals and Litigation Support Division

From: Chief, Valuation and Standards Division Deborah Gibbs Tschudy

Subject: Appeal by Mobil Exploration & Producing U.S. Inc. (Mobil) of the Minerals Management Service (MMS) Letter Dated May 28, 1992, Concerning Termination Date of the Cortez Pipeline Tariff Calculation Procedure (Calculation Procedure).

INTRODUCTION

By letter dated June 26, 1992, Mobil filed a Notice of Appeal from MMS' letter dated May 28, 1992, regarding the termination date of the Calculation Procedure for an allowance to transport carbon dioxide (CO_2) produced from the McElmo Dome Unit (McElmo Dome). Mobil also requested an extension to file its Statement of Reasons (SOR). Mobil's SOR was received by MMS on August 17, 1992. This report provides the Valuation and Standards Division's (VSD) response to Mobil's appeal and supporting arguments.

For the reasons listed below, MMS recommends that Mobil be required to calculate its actual costs for transporting CO_2 from McElmo Dome, effective June 1, 1992, in lieu of using the Calculation Procedure.

Following is a chronological listing of correspondence relevant to this case:

Date	Correspondence
October 1, 1991	Letter from Mobil to MMS requesting approval to use the Cortez Pipeline Tariff (Tariff) as the proper transportation allowance for the McElmo Dome leases and approval to exceed 50 percent of the value of CO_2, where necessary (Attachment 1).
January 20, 1992	Letter from Mobil to MMS with correct Accounting Identification (AID) Number listing for McElmo Dome (Attachment 2).

May 28, 1992	Letter from MMS notifying Mobil of the April 30, 1990, termination date for the Calculation Procedure (Attachment 3).
June 26, 1992	Letter from Davis, Graham & Stubbs (DGS), on behalf of Mobil, to MMS filing a Notice of Appeal and requesting an extension through July 31, 1992, to file its SOR in support of its appeal (Attachment 4).
July 17, 1992	Letter from MMS to DGS granting an extension until July 31, 1992, to file its SOR (Attachment 5).
July 29, 1992	Letter from DGS to MMS confirming additional extension to August 17, 1992, to file SOR (Attachment 6).
August 10, 1992	Letter from MMS to DGS granting extension to file SOR until August 17, 1992 (Attachment 7).
August 17, 1992	Receipt of undated SOR from DGS to MMS in support of appeal on behalf of Mobil (Attachment 8).

Appellant's Arguments

Mobil bases its appeal on the following arguments:

I. THE TRANSPORTATION ALLOWANCE MMS APPROVED FOR THE CORTEZ PIPELINE REMAINS IN FULL FORCE AND EFFECT.

A. MMS Regulations Provide That Transportation Allowances In Existence On March 1, 1988 Continue In Effect Pursuant To Their Terms.

MMS regulations are plain and unambiguous:

> Non-arm's-length contract or no contract based transportation allowances which are in effect at the time these regulations become effective [March 1, 1988] will be allowed to continue until such allowance terminates.

30 C.F.R. § 206.157(c)(2)(v) (1991) (emphasis added). Under these regulations, MMS is compelled to recognize the Cortez Pipeline transportation allowance it approved before March 1, 1988, unless it can demonstrate that that allowance has terminated.

B. The Cortez Pipeline Allowance Has Not Terminated.

The record in this case clearly reflects that the Cortez Pipeline transportation allowance has not terminated.

First, the transportation allowance that MMS approved is clear and unequivocal -- Mobil was expressly authorized to

use the "Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs." See May 28, 1992 Decision, Exhibit 1, p. 2. The transportation allowance that the MMS approved contained no termination date or conditions.

Second, the "Cortez Pipeline transportation calculation procedure" established by the 1982 Contract remains in full force and effect. Under that contract 1941 Consent Decree procedures continue to be used to determine transportation costs.

II. MMS EFFORTS TO FIND A SUPPORTABLE GROUND TO TERMINATE THE CORTEZ PIPELINE TRANSPORTATION ALLOWANCE ARE UNAVAILING.

In the face of this record, MMS' efforts to terminate the Cortez Pipeline transportation allowance are unavailing.

First, MMS has not demonstrated as required by its regulations that the Cortez Pipeline transportation allowance has terminated. As MMS admits in its May 28, 1992 Decision, Mobil was authorized to use the "Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs." See May 28, 1992 Decision, Exhibit 1, p. 2. The "Cortez Pipeline transportation calculation procedure" is that established by the 1982 Contract that remains in effect; calculations are to be performed using 1941 Consent Decree procedures which for the first six years merely to assume a theoretical throughput of 1,000 MMcf per day. See 1982 Contract, Exhibit 2, ¶ 16. The record in this case simply cannot convert approval of a transportation allowance calculated on the basis of the Cortez Pipeline tariff calculation procedure of unlimited duration into approval of a six-year transportation allowance in effect only so long as a theoretical throughput is utilized in performing 1941 Consent Decree calculations. Simply put, MMS approved use of the "Cortez Pipeline tariff calculation procedure," not a "six-year transportation allowance using 1941 Consent Decree procedures with a theoretical throughput of 1,000 MMcf per day."

Second, the interests of the federal government are protected by the transportation allowance that the MMS in fact approved. The 1941 Consent Decree methodology is reasonable, as reflected by the fact that both the Department of Justice and the MMS have repeatedly found it reliable in the past, and no showing is made as to why it is not considered reasonable now. See MMS' March 29, 1984, December 31, 1985, July 1, 1987, and October 24, 1990 Decisions with respect to the Cortez Pipeline. Moreover, the rationale that supported that long line of

> MMS decisions -- the administrative burden to both transporters and the MMS of calculating actual costs, the atypical nature of CO_2, and the fact that MMS authorizes others to claim a transportation allowance of an amount equal to the Cortez Pipeline transportation calculation procedure -- are as applicable now as when the allowance was approved. In short, the interests of the federal government are not prejudiced by continued acceptance of the Cortez Pipeline transportation allowance that MMS duly approved and that the IBLA duly affirmed, but to permit the MMS' March 28, 1992 Decision to stand would fly in the face of the MMS' own regulations authorizing pre-March 1, 1988 transportation allowance to continue until they terminate.

The VSD's Response

The VSD's response is in the same order as the Mobil arguments shown above.

I. THE McELMO DOME TRANSPORTATION ALLOWANCE HAS TERMINATED.

It has never been MMS' policy or intention to approve transportation or processing allowances without an effective beginning and ending date. (Subparts A and B are combined in the VSD response since Mobil's arguments A and B covered the same subject-only the words were rearranged.)

- By decisions dated December 31, 1986 (Attachment 9), and July 1, 1987 (Attachment 10), MMS approved a 1985 transportation allowance for McElmo Dome. These two decisions state that "The Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs proposed by Mobil Producing Texas & New Mexico Inc. (MPTM) is acceptable . . . ."

- MMS' letter to Mobil dated October 24, 1990 (Attachment 11), (Project No. MMS-RVS-OG:89-1012) denied Mobil's request to exceed 50 percent of the value of CO_2 transported from McElmo Dome for the 1985 period.

- MMS' letter to Mobil (Project No. MMS-RVS-OG:90-0020) dated October 24, 1990 (Attachment 12), approved Mobil's request to exceed 50 percent of the value of CO_2 transported from McElmo Dome for the 1986 period.

- In addition, MMS' letter dated February 19, 1992 (Attachment 13), approved a transportation allowance for the period January 1, 1987, through February 29, 1988. Therefore, the MMS-approved transportation allowance for McElmo Dome terminated February 29, 1988, and there was no allowance in effect on March 1, 1988. For this reason, the regulations at 30 CFR § 206.157(c)(2)(V) (1992), extending the transportation allowance approval beyond March 1, 1988, do not apply to McElmo Dome.

II. MMS GROUNDS TO TERMINATE THE CORTEZ PIPELINE TRANSPORTATION ALLOWANCE ARE AVAILABLE.

A. The Cortez Pipeline Company, a general partnership of Shell Oil Company (Shell), Mobil Cortez Pipeline Company, and Cortez Vickers, Inc., owns the Cortez Pipeline.

The "Carbon Dioxide Sale and Purchase Contract" (Contract) dated March 31, 1983 (Attachment 14), between MPTM ("Seller") and Shell ("Buyer"), Article II - Quantities, § 2.2 Transportation, states:

- The carbon dioxide sold hereunder shall be transported by Cortez Pipeline Company for the account of Seller. Seller's ability to deliver carbon dioxide hereunder shall be at all times subject to the provisions of the Tariff in effect from time to time for the Cortez Pipeline.

- Also, Article III - Prices and Taxes, § 3.1 Prices (b)(ii) states, that during the initial period and the first five annual periods, calculated on the assumption that the throughput in the Cortez Line is 1,000 MMcf per day and computed to achieve an annual return on valuation (as such valuation is determined by Cortez Pipeline Company from time to time) of 7%.

- Article I defines "Initial Period" as a period beginning on the date of initial delivery of CO_2 hereunder and ending on the first anniversary of such date. In addition, "Annual Period" means a period having a duration of 1 year beginning at the end of the initial period and on each subsequent anniversary thereof. Since the date of initial delivery of CO_2 occurred in April 1984, the initial period and first five annual periods cited in the Contract above constitutes six contract years.

The terms of Mobil's Contract, as cited above, demonstrate that the Contract has terminated. The VSD considers the termination date of the Calculation Procedure as 6 years from the date of initial delivery of CO_2 since it corresponds to the Contract terms of 6 years. Therefore, the Calculation Procedure applies to the period April 15, 1984, through April 30, 1990.

Mobil's statement (SOR, p.5, last para.) that, ". . . calculations are to be performed using 1941 Consent Decree procedures which for the first six years merely to assume a theoretical throughput of 1,000 MMCF per day." (emphasis added) is not factual. The theoretical throughput of 1,000 MMcf per day was used initially resulting in a rate of $0.39 per Mcf through December 31, 1989. However, beginning January 1, 1990, actual costs and actual throughput were used increasing the transportation allowance rate to $0.493 per Mcf, as stated by Mobil in its letter dated October 1, 1991, page 4 (Attachment 1). Mobil no longer subsidized the tariff with a fixed theoretical throughput of 1,000 MMcf per day after December 31, 1989, which does not correspond with the six-year Contract terms ending April 30, 1990.

Mobil's statement (SOR, p.6, first para.) that, "The record in this case simply cannot convert approval of a transportation allowance calculated on the basis of the Cortez Pipeline tariff calculation procedure of unlimited duration (emphasis added) into approval of a six-year transportation allowance in effect only so long as a theoretical throughput is utilized in performing 1941 Consent Decree calculations." is totally without basis.

- The MMS December 31, 1986, and July 1, 1987, letters never stated that the Calculation Procedure was acceptable for an unlimited duration. The MMS letters, cited above, approved a transportation allowance for the Calendar Year 1985, and were merely silent on the termination date issue of the Calculation Procedure. This does not imply that the proposed Calculation Procedure was acceptable for an unlimited duration.

- Furthermore, the MMS letter (Project No. MMS-RVS-OG:90-0020) dated October 24, 1990, approved a transportation allowance to exceed 50 percent of the value of CO_2 for Calendar Year 1986 only; not for an unlimited duration.

- Also, the MMS letter dated February 19, 1992, approved a transportation allowance to exceed 50 percent of the value of CO_2 from January 1, 1987, through February 29, 1988; again, not for an unlimited duration.

B. The interests of the Federal Government are not protected by continuing the Calculation Procedure that was accepted by MMS before March 1, 1988.

Title 30 CFR § 206.157(b)(5) states in part:

> A lessee may apply to the MMS for an exception from the requirement that it compute actual costs in accordance with . . . The MMS will grant the exception only if the lessee has a tariff for the transportation system approved by the Federal Energy Regulatory Commission (FERC) (for both Federal and Indian leases) or a State regulatory agency (for Federal leases). . . . MMS shall deny the exception request if:
>
> (i) No FERC or State regulatory agency cost analysis exists and the FERC or State regulatory agency, as applicable, has declined to investigate pursuant to MMS timely objections upon filing; and
>
> (ii) the tariff significantly exceeds the lessee's actual costs for transportation as determined under this section.

The Tariff (Calculation Procedure) has never been approved by any State or FERC jurisdictional authority.

Title 30 CFR §206.157(b)(2) states,

> The transportation allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial depreciable investment in the transportation system multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.
>
> (i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.
>
> (ii) Allowable maintenance expenses include: Maintenance of the transportation system; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.
>
> (iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses. (Emphasis added).
>
> (iv) A lessee may use either depreciation or a return on depreciable capital investment. After a lessee has elected to use either method for a transportation system, the lessee may not later elect to change to the other alternative without approval of the MMS.
>
> (A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the transportation system services, or a unit of production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a transportation system shall not alter the depreciation schedule established by the original transporter/lessee for purposes of the allowance calculation. With or without a change in ownership, a transportation system shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) The MMS shall allow as a cost an amount equal to the allowable initial capital investment in the transportation system multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transportation facilities first placed in service after March 1, 1988.

(v) The rate of return shall be the industrial rate associated with Standard and Poor's BBB rating. The rate of return shall be the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the reporting period for which the allowance is applicable and shall be effective during the reporting period. The rate shall be redetermined at the beginning of each subsequent transportation allowance reporting period.

The Decision dated June 28, 1990 (115 IBLA 164 (1990)) (Attachment 15), from the Interior Board of Land Appeals (IBLA) to MPTM, allowing the inclusion of Federal and State income taxes in the Calculation Procedure, concerned the time period under the United States Geological Survey (USGS) Conservation Division Manual (CDM) Guidelines prior to the new Oil and Gas Valuation regulations. Effective March 1, 1988, the new regulations specifically prohibit the inclusion of these taxes as allowable expenses, as cited above.

After reviewing the elements that comprise the overhead costs included in the tariff rate, the VSD discovered that Mobil included other nonallowable items, (Mobil's letter dated February 22, 1993, Attachment C (MMS' Attachment 16)) in addition to the State and Federal income taxes, as follows:

- Dealer costs for the commercial paper program,
- Bank costs for the backup line of credit,
- Rating agency expenses.

The above categories were lumped together and identified as "Administrative costs of financing" under the heading, C. Lessee's Overhead Allocation (specify) on the Non-Arm's-Length Transportation System/Segment Operations, Maintenance and Overhead Expenditures, Form MMS-4295, Schedule 1A. These administrative costs of financing are "other fees" and are not allowable costs under 30 CFR § 206.157(b)(2)(iii).

Furthermore, the Calculation Procedure includes interest expense plus a 7 percent profit margin (also called "annual return on investment"). The Federal Government is not obligated to subsidize Mobil's (or Shell's) profit margin. Since the regulations effective March 1, 1988, allow a return on investment (ROI) under the Standard and Poor's industrial BBB Bond rate, to allow Mobil to include interest expense, the ROI, and a 7 percent profit margin would be triple-dipping. Therefore, the interests of the Federal Government are not protected by continuing the Calculation Procedure that was accepted by MMS before March 1, 1988.

The fact that MMS authorizes third parties to claim a transportation allowance based on the tariff rate is not discriminatory and unlawful, since the costs for third party users are actual "out-of-pocket" costs paid directly to the owners of the pipeline, including Mobil.

The administrative burden of calculating actual costs is not a factor in considering the termination date of the Calculation Procedure. Because actual costs must be accumulated and calculated to arrive at a rate per Mcf of CO_2 transported, the burden of calculating actual costs is no greater with or without the tariff (Calculation Procedure).

Title 30 CFR § 206.157(c)(3) states in part,

> Upon request of a lessee, MMS may approve a transportation allowance deduction in excess of the limitation . . . . The lessee must demonstrate that the transportation costs incurred in excess of the limitations . . . were reasonable, actual, and necessary. An application for exception shall contain all relevant and supporting documentation necessary for the MMS to make a determination . . . ."

Mobil routinely requests VSD approval to exceed 50 percent of the sales value of CO_2 when deducting transportation allowances from royalties due. Calculating actual costs, is a requirement in order to arrive at an amount to exceed 50 percent of the value of CO_2 transported. Therefore, Mobil's argument concerning the administrative burden of calculating actual costs is without merit.

The atypical nature of CO_2 has no bearing on the termination date of the Calculation Procedure and since Mobil has not provided any information showing otherwise, this argument is moot.

The MMS approved transportation allowance terminated on February 29, 1988, by letter dated February 19, 1992. There was no MMS-approved allowance in effect on March 1, 1988. However, the decision from which Mobil has appealed concerns the termination date of the Calculation Procedure. The MMS' letter dated December 31, 1986 (Attachment 9), in its CONCLUSIONS, stated, "The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable . . . ." That statement constitutes a commitment to recognize a transportation allowance based on the 1941 Consent Decree procedure, and until it is revoked, will remain in effect. Once a commitment of value is made, royalty liability may be fulfilled by payment on the approved basis until the lessee is notified that a prior determination is no longer in effect. West Coast Silica Company, a Division of Johns-Manville Sales Corporation, MMS-23-MIN September 16, 1982, 3 Gower; Supron Energy Corp., 46 IBLA 181, 189 (1980).

Recommendation

Mobil received the MMS letter dated May 28, 1992, terminating the Calculation Procedure, on June 1, 1992. Therefore, it is appropriate that the Calculation Procedure be terminated prospectively from June 1, 1992. Under non-arm's-length or no contract situations, MMS regulations require that a lessee calculate its actual costs when determining a transportation allowance rate, unless the MMS approves, upon application by the lessee, the use of a FERC or State approved Tariff. Mobil has no FERC or State approved tariff in effect, currently, for transporting CO_2 from McElmo Dome to West Texas. Therefore, Mobil is required by Title 30 CFR § 206.157(b) to calculate its actual costs, to determine the transportation allowance rate, effective June 1, 1992.

16 Attachments

CARBON DIOXIDE SALE AND PURCHASE CONTRACT

MOBIL PRODUCING TEXAS & NEW MEXICO INC., SELL

attach 52

SHELL OIL COMPANY, BUYER

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CARBON DIOXIDE SALE AND PURCHASE CONTRACT

THIS CONTRACT, made and entered into as of March 31, 1983, by and between MOBIL PRODUCING TEXAS & NEW MEXICO INC. ("Seller") and SHELL OIL COMPANY ("Buyer");

W I T N E S S E T H :

WHEREAS, Seller has available certain carbon dioxide reserves in the McElmo Dome Field in Colorado and desires to sell certain carbon dioxide to be produced therefrom; and

WHEREAS, Seller is participating in a new pipeline to be constructed to transport carbon dioxide from Southwestern Colorado to West Texas; and

WHEREAS, Buyer desires to purchase carbon dioxide for delivery to points in West Texas.

NOW, THEREFORE, for and in consideration of the premises and the mutual benefits and covenants herein contained, Seller and Buyer hereby agree as follows:

ARTICLE I - DEFINITIONS

1.1 Defined words and terms. Except where the context otherwise indicates another or different meaning or intent, the following words and terms as used herein shall have the meanings indicated:

(a) The word "day" means a period beginning at 7:00 a.m. (local time) on a calendar day and ending at 7:00 a.m. (local time) on the next succeeding calendar day. The date of a day shall be that of its beginning.

(b) The word "month" means a period beginning at 7:00 a.m. (local time) on the first day of a calendar month and ending at 7:00 a.m. (local time) on the first day of the next succeeding calendar month.

(c) "Initial Period" means a period beginning on the date of initial delivery of carbon dioxide hereunder and ending on the first anniversary of such date.

(d) "Annual Period" means a period having a duration of one year beginning at the end of the Initial Period and on each subsequent anniversary thereof.

(e) The term "carbon dioxide" means a substance primarily composed of molecules containing one atom of carbon and two atoms of oxygen and containing at least 95 percent by volume of such molecules.

(f) The term "pound-mass" means the mass quantity of carbon dioxide equivalent to a pound-mass as defined by the United States National Bureau of Standards.

(g) The term "cubic foot" is the amount of carbon dioxide necessary to fill one cubic foot of space at a base pressure of 14.65 psia and at a base temperature of 60 degrees Fahrenheit.

(h) "Mcf" means 1,000 cubic feet of carbon dioxide.

(i) "MMcf" means 1,000,000 cubic feet of carbon dioxide.

(j) The term "psia" means pounds per square inch absolute.

(k) The term "psig" means pounds per square inch gauge.

(l) "Daily Contract Quantity" means, as to any day, 130 MMcf or the amount of carbon dioxide Seller is capable of delivering hereunder on such day, whichever is the lesser amount.

(m) "McElmo Dome Field" means that area of Dolores and Montezuma Counties; Colorado, which is outlined on the map attached hereto as Exhibit "A" which contains interests of Seller relating to the production of carbon dioxide. If such area is unitized with other lands, in whole or in part, this Contract will apply to the resulting unit or units to the extent that the interest of Seller in such unit or units is attributable to Seller's interest in the lands outlined on Exhibit "A".

(n) "Cortez Line" means the pipeline to be constructed for the transportation of carbon dioxide extending from a point or points in Montezuma County, Colorado, to a point or points in or near the Wasson Field, Yoakum County, Texas.

(o) "Cortez Pipeline Company" means the entity which operates the Cortez Line.

(p) "Unit Price" means, as to a particular period, an amount per Mcf determined by dividing the total amount of payments made to or due Seller by or from Buyer pursuant to Section 3.1 for carbon dioxide delivered hereunder during such period by the total number of Mcf delivered hereunder during such period.

(q) "FERC" means the Federal Energy Regulatory Commission or any successor agency having jurisdiction over the transportation of crude oil by pipeline.

ARTICLE II - QUANTITIES

2.1 Sale of carbon dioxide. Subject to all of the terms, conditions, and limitations of this Contract, Seller commits to the performance of this Contract and agrees to sell to Buyer the Daily Contract Quantity per day produced from and attributable to Seller's interest in the McElmo Dome Field, and Buyer agrees to purchase same from Seller; provided, however, (a) that said commitment shall not constitute any warranty of carbon dioxide reserves or deliverability, either express or implied, and (b) that the commencement of performance of each party under this Contract shall be subject to the conditions precedent that the Cortez Line be constructed and that the initial tariff adopted by Cortez Pipeline Company be on the basis described in Section 3.1(b).

2.2 Reservations. Seller reserves all rights to carbon dioxide produced from the McElmo Dome Field which is surplus to Seller's obligations to Buyer hereunder for Seller's own use, for use by Seller's affiliates and for sale to individuals, corporations, joint-stock companies, partnerships, associations, business trusts, organized groups of persons, whether incorporated or not, receivers or trustees of any of the foregoing; provided, however, that any such reservation shall only be exercised subject to Buyer's prior rights under this Contract to receive up to 130,000 Mcf per day from Seller's interest in the McElmo Dome Field.

2.3 Transportation. The carbon dioxide sold hereunder shall be transported by Cortez Pipeline Company for the account of Seller. Seller's ability to deliver carbon dioxide hereunder shall be at all times subject to the provisions of the tariff in effect from time to time for the Cortez Line. Any responsibility or operational obligation placed upon Seller hereunder, such as the operation of certain measuring facilities, may be performed by Cortez Pipeline Company, but Seller shall remain obligated to Buyer for the performance of such obligation pursuant to the terms of this Contract.

2.4 Take-or-pay quantities. Subject to the further provisions hereof, Seller agrees to sell and deliver to Buyer and Buyer agrees to purchase and take from Seller or, if available and not taken, Buyer shall pay Seller for, during the Initial Period and during each Annual Period, a quantity equal to 60% of the sum of the Daily Contract Quantities in effect during the applicable Period; provided, however, Buyer's obligation to purchase and take carbon dioxide hereunder, or to pay Seller for carbon dioxide if available and not taken, shall terminate as of the day on which the total of the carbon dioxide delivered hereunder and/or paid for hereunder exceeds 285,000 MMcf.

2.5 Minimum takes. Buyer agrees to accept deliveries hereunder, if available, during the Initial Period and during each Annual Period, of a volume of carbon dioxide equal to at least 39.39% of the volume of carbon dioxide sold and delivered by Buyer to the owners of the Denver Unit in the Wasson (San Andres) Field, Gaines and Yoakum Counties, Texas, during the applicable Initial Period or Annual Period; provided, however, that this Section shall not obligate Seller to deliver or Buyer to accept carbon dioxide in quantities in excess of the sum of the Daily Contract Quantities in effect during the applicable Initial Period or Annual Period.

2.6 Delivery rates. Seller and Buyer shall endeavor to deliver and to accept, respectively, carbon dioxide in as reasonably constant rates as is practicable. Upon request from Buyer, Seller may deliver carbon dioxide on any day in excess of the Daily Contract Quantity, but Seller shall not be obligated to do so.

2.7 Carbon dioxide not taken. Subject to Sections 2.4 and 2.9, if, for any reason other than force majeure, Buyer fails to take, during the Initial

Period or any Annual Period, a quantity of carbon dioxide equal to 60% of the sum of the Daily Contract Quantities in effect for the Initial Period or Annual Period, as the case may be, Buyer shall, within 60 days next following the end of such Period, pay Seller for a quantity of carbon dioxide equal to the difference between such sum and the quantity of carbon dioxide taken during such Period. The price to be paid for each Mcf of such carbon dioxide not taken shall be the Unit Price applicable to such Period.

2.8 Make up rights. If Buyer pays for a quantity of carbon dioxide not taken by Buyer, Buyer shall thereafter be entitled to make up, subject to the availability for Seller's account of capacity in the Cortez Line, without additional payment except as provided below in this Section, such quantity of carbon dioxide during the remaining term of this Contract, as such term may be extended as provided below. Such make up may be accomplished in one or more of the Annual Periods following the Period in which Buyer failed to take such carbon dioxide out of receipts in excess of 60% of the sum of the Daily Contract Quantities in effect for each such Annual Period. If, at the end of the basic term provided in Section 12.2, Buyer has not made up all of the quantity of carbon dioxide so paid for, then, this Contract shall nevertheless remain in effect, and from and after that date, all receipts shall be deemed to be make up quantities until the earlier of (a) the date on which all of such carbon dioxide has been made up or (b) the second anniversary of the end of the basic term provided in Section 12.2. Buyer shall pay or receive credit for any difference in the Unit Price between that upon which payments were made and that applicable during any Annual Period (including any Annual Period occurring during the extended term) in which such make up occurred. If Buyer has not made up such quantity of

carbon dioxide during the time provided above, Buyer shall have no further right to make up such quantity, and Seller shall have no liability to Buyer on account of Buyer's failure to have made up such quantity. Seller shall never be required to deliver make up volumes at a daily rate exceeding the Daily Contract Quantity.

2.9 Banked volumes. If, during the Initial Period or any Annual Period, Buyer has taken quantities of carbon dioxide in excess of the sum of (a) 60% of the sum of the Daily Contract Quantities in effect for such Period and (b) any volumes made up pursuant to Section 2.8, then such excess may be applied to offset deficiencies in takes during any subsequent Annual Period.

2.10 Prepayment option. If, during the Initial Period or any of the first five Annual Periods, Seller has, for reason other than force majeure, failed to deliver at least 95% of the volumes of carbon dioxide requested to be delivered by Buyer during such Contract Year (disregarding requests for deliveries on any day in excess of the Daily Contract Quantity), then Buyer may, within 60 days after the end of such Period, make a prepayment to Seller for certain carbon dioxide to be delivered hereunder in one or more of the Annual Periods following such Period. The amount of such prepayment shall be determined by multiplying (a) the Unit Price applicable to such Period by (b) the difference between the number of Mcf so requested for delivery hereunder during such Period and the number of Mcf delivered hereunder during such Period. In the event of such a prepayment, Buyer shall be entitled to make up the volume of carbon dioxide so paid for in the manner set out in Section 2.8, except that Buyer shall not pay any increase in the Unit Price between that upon which such prepayment was made and that

applicable at the time of make up. In accounting for such make up, it shall be assumed that the volumes of carbon dioxide paid for pursuant to Section 2.7, if any, are made up before the volumes of carbon dioxide prepaid for pursuant to this Section are so credited. Within 60 days after the termination of this Contract, any amount prepaid pursuant to this Section which has not been so made up because of Seller's failure to make requested deliveries (but not in excess of the Daily Contract Quantity) shall be refunded by Seller to Buyer, without interest.

ARTICLE III - PRICES AND TAXES

3.1 Prices. Subject to the further provisions of this Article and to Sections 2.8 and 2.10, Buyer agrees to pay Seller, for each Mcf of carbon dioxide delivered or for which payment is due hereunder, a price, determined as of the first day of each month, which is the sum of:

(a) 90¢, which is adjusted, effective on April 1, 1983, and on the first day of each July, October, January and April thereafter by multiplying 90¢ by a fraction, the numerator of which is the arithmetic average of the prices per barrel posted by Amoco Production Company, Exxon Company, U.S.A., Gulf Oil Company - U.S., Mobil Oil Corporation and Shell Oil Company (or their successors) and applicable to API 33.0° gravity crude oil produced from the Wasson (San Andres) Field in effect on the first day of the applicable April, July, October or January, and the denominator of which is such average in effect on December 1, 1981; and

(b) the tariff per Mcf paid by Seller to Cortez Pipeline Company for carbon dioxide transported during the applicable month pursuant to the applicable tariff of Cortez Pipeline Company in effect from time to time; provided, regardless of the actual tariff charges incurred by Seller, Buyer shall not be obligated to reimburse Seller for tariffs so paid in excess of a tariff:

(i) calculated by using the methodology which has historically been used by pipeline companies subject to the 1941 Pipeline Consent Decree (in the case of United States v. Atlantic Refining Company, et al.),

(ii) during the Initial Period and the first five Annual Periods, calculated on the assumption that the throughput in the Cortez Line is 1,000 MMcf per day and computed to achieve an annual return on valuation (as such valuation is determined by Cortez Pipeline Company from time to time) of 7%,

(iii) calculated in accordance with the example of a seven percent tariff calculation attached to this Contract as Exhibit "B," and

(iv) limited as follows:

A) rate of depreciation shall be based on not less than fifteen-year life,

B) components for taxes shall be based on the statutory corporate rates of federal and state income taxes, and

C) inflation factors applied in calculating valuation shall be equal to those applicable valuation indices published by the FERC for oil pipelines under its jurisdiction; if

such indices cease to be published by FERC, then the valuation shall be calculated in subsequent years, first, by multiplying an amount which is equal to the last valuation calculated based on FERC published indices plus applicable capital additions and/or less applicable capital retirements by a fraction, the numerator of which is the latest available quarterly Implicit GNP Deflator Index and the denominator is the quarterly Implicit GNP Deflator Index last published before FERC ceased publishing its valuation indices for oil pipelines and, secondly, by subtracting from this product the financial depreciation accrued since the determination of the last valuation based on FERC published indices. From time to time, Seller shall furnish to Buyer a copy of the current tariff of Cortez Pipeline Company.

3.2 Tax liability. Seller shall pay or cause to be paid all taxes and assessments imposed on Seller with respect to the carbon dioxide delivered hereunder prior to its delivery to Buyer, and Buyer shall pay or cause to be paid all taxes and assessments imposed on Buyer with respect to the carbon dioxide delivered hereunder after its receipt by Buyer. Neither party shall be responsible or liable for any taxes or other statutory charges levied or assessed on or against any of the facilities of the other party which are used for the purpose of carrying out the provisions of this Contract. Nothing in this Section shall affect the rights and obligations imposed in Section 3.3.

3.3 Tax reimbursement. Seller and Buyer agree that, as of February 3, 1982, there were no taxes imposed by the State of Colorado on the production of carbon dioxide in Colorado. Buyer agrees to reimburse Seller for all severance, production or similar taxes actually paid by Seller for carbon dioxide delivered hereunder which were imposed after February 3, 1982, and which are in excess of 2¢ per Mcf, which 2¢ shall be adjusted in the same manner and at the same times set out in Section 3.1(a). The tax reimbursement herein provided shall not be applicable to any income, excess profits, capital stock, franchise and general property taxes. Such tax reimbursement shall be effected as a part of Buyer's regular monthly payments for carbon dioxide hereunder. The tax reimbursement herein provided shall not apply to any delinquent interest or penalty payments that may be applicable to any such taxes so paid by Seller.

ARTICLE IV - DELIVERY POINT AND PRESSURES

4.1 Title passage. The carbon dioxide shall be delivered hereunder at a mutually agreeable point at or near the terminus of the Cortez Line in or near the Wasson Field, Yoakum County, Texas. The exact point at which delivery shall be deemed to be made, and the point at which title to the carbon dioxide delivered hereunder shall pass from Seller to Buyer, shall be the flange or weld connecting the facilities of Cortez Pipeline Company with the facilities of Buyer, and such point is herein called the "Delivery Point".

4.2 Responsibility. As between the parties hereto, Seller shall be responsible for any injuries, losses, expenses, claims, liabilities, or damages caused thereby until the carbon dioxide shall have been delivered to Buyer, and, after such delivery, Buyer shall be responsible for any injuries, losses,

expenses, claims, liabilities, or damages caused thereby. The responsible party, as specified above, shall indemnify the other party in respect of any injuries, losses, expenses, claims, liabilities, or damages occurring while the carbon dioxide is in possession of the party so having responsibility.

4.3 Maximum pressure. Seller shall deliver carbon dioxide hereunder at the Delivery Point at a pressure sufficient to permit the carbon dioxide to enter Buyer's facilities thereat, but Buyer shall never operate such facilities at a working pressure in excess of 2,000 psig, nor shall Seller ever be obligated to deliver carbon dioxide at a pressure in excess of 2,000 psig.

ARTICLE V - MEASUREMENT

5.1 Measurement point. The carbon dioxide delivered hereunder shall be measured for custody transfer at the Delivery Point in accordance with the standards set out in this Article.

5.2 Procedure. Custody transfer measurement of carbon dioxide shall be determined on the basis of pound-mass quantities, which will be converted to cubic feet quantities. The molecular weight of the metered stream of carbon dioxide, calculated from the compositional analyses, shall be the basis for conversion of pound-mass measurement units to cubic feet measurement units.

5.3 Atmospheric pressure. The atmospheric pressure at the Delivery Point shall be as determined by test taken from time to time, but in the absence of such a test in any month, it shall be assumed to be 13.2 psia.

5.4 Meter standards. The carbon dioxide delivered hereunder shall be measured with orifice meters constructed and installed, and whose computations of pound-mass are made, in accordance with the October, 1981,

compilation of standards in the American Petroleum Institute, Manual of Petroleum Measurement Standards, Chapter 14, with any subsequent amendments, revisions and additions which may be mutually acceptable to Seller and Buyer.

5.5 Temperature. The temperature of the carbon dioxide shall be determined by an on-line thermometer so installed that it will sense the temperature of the carbon dioxide flowing through the meters.

5.6 Density. The density of the carbon dioxide shall be determined by an on-line densimeter referenced to weight in a vacuum.

5.7 Samples. A composite sample of the metered carbon dioxide stream shall be accumulated during each month and analyzed for its composition.

ARTICLE VI - MEASURING EQUIPMENT AND TESTING

6.1 Meter stations. At or near the Delivery Point, Seller shall insure that a measuring station for custody transfer of carbon dioxide delivered hereunder is installed, operated and maintained in accurate working order. The station shall be equipped in accordance with the standards referenced in Section 5.4 and will initially consist of orifice meters of standard type, an on-line thermometer, an on-line densimeter, a flow-paced composite sampler, and a flow computer for real-time calculation of metered flow. Measurement equipment will be subject to change to allow use of improved technology under such standards if the parties mutually agree to such a change.

6.2 Meter tests. Seller shall insure that the measuring equipment is accurate and in repair, and that such periodic tests as Seller may deem necessary are made at least once each month. Seller agrees to insure that Buyer is given reasonable notice of each such test of the measuring equipment in order that, if Buyer desires, Buyer may have its representative present to witness such tests. If, upon any test, any measuring equipment is found to be

inaccurate to the extent that it affects the measurement accuracy by an amount exceeding one percent, registrations thereof shall be corrected for a period extending back to the time such inaccuracy occurred, if such time is ascertainable, and, if not ascertainable, then back one-half of the time elapsed since the last date of calibration; provided, no correction shall be made for recorded inaccuracies of less than one percent in the aggregate. Special tests of the measuring equipment can be requested by Buyer, at Buyer's cost.

6.3 Meter out of service. If, for any reason, any meter is out of service or out of repair so that the amount of carbon dioxide delivered cannot be ascertained or computed from the readings thereof or corrected under Section 6.2, the carbon dioxide delivered during the period such meter is out of service or out of repair shall be estimated and agreed upon by the parties upon the basis of the best data available, using the first of the following methods which is feasible:

(a) By using the registration of any check meter, if installed and accurately registering;

(b) By correcting the error if the percentage of error is ascertainable by calibration, test or mathematical calculation;

(c) By estimating the quantity delivered by deliveries during preceding periods under similar conditions when the meter was registering accurately.

6.4 Check meters. Buyer may, at its option and expense, install and operate check meters to check the custody transfer meters, but measurement of carbon dioxide for the purpose of this Contract shall be by the custody transfer meters only, except in cases hereinabove specifically provided to the contrary. Any check meters installed shall be of standard type and shall be subject at all reasonble times to inspection or examination by Seller.

6.5 Record retention. Copies of delivery documents for metered quantities of carbon dioxide will be provided to Buyer. Neither party shall be responsible to the other party for the retention of records.

ARTICLE VII - QUALITY

7.1 Specifications. The carbon dioxide delivered to Buyer at the Delivery Point shall meet the following specifications, which herein are collectively called "Quality Specifications":

(a) Water. The carbon dioxide shall not contain any free water.

(b) Hydrogen sulphide. The carbon dioxide shall not contain more than fifteen parts by weight of hydrogen sulphide per 1,000,000 parts of carbon dioxide.

7.2 Testing. Seller shall insure that tests to determine the quality of carbon dioxide are made as often as reasonably required by approved standard methods in general use. Seller shall promptly furnish Buyer with copies of all test results. Seller shall insure that Buyer is given reasonable notice of all such tests in order that Buyer may have its representative present, if Buyer so desires.

7.3 Failure to meet. If any carbon dioxide fails to meet the Quality Specifications at the Delivery Point, Buyer shall have the right to waive such failure and to continue to receive such carbon dioxide. If Buyer refuses to receive such carbon dioxide and if Seller does not elect to treat the carbon dioxide so as to cause the same to meet the Quality Specifications because Seller does not deem it economically feasible to do so, then Seller shall cease deliveries of carbon dioxide to Buyer hereunder. If Seller has so ceased deliveries hereunder, then Seller may elect, by notice to Buyer given within 120 days after the cessation of deliveries, to remedy the cause of such failure, and, if Seller so elects, Seller shall proceed, as a prudent operator,

to effect such remedy. If Seller does not so elect within such period, then Buyer may, by notice to Seller, cancel this Contract, and, in such event, the respective obligations of Seller and Buyer hereunder shall terminate; provided, that Seller shall promptly refund to Buyer, without interest, any payments made by Buyer pursuant to Section 2.7 and 2.10 (or either of them) and which have not been made up as of the date of such cancellation.

ARTICLE VIII - ACCOUNTING

8.1 Payment. Seller shall furnish Buyer a monthly statement showing the total quantity of carbon dioxide delivered hereunder during the preceding month at the Delivery Point. Such statement shall include sufficient information in order that Buyer may make proper payment hereunder. Buyer shall make payment to such address as Seller may designate from time to time, by check, on or before the 30th day after the date of receipt of such statement for all of such carbon dioxide so delivered, such check being for all amounts payable pursuant to Article III.

8.2 Auditing. Each party shall have the right at reasonable business hours to examine the books, records, and measurement documents of the other party to the extent necessary to verify the accuracy of any statement, payment, calculation, or determination made pursuant to the provisions of this Contract for any calendar year within five calendar years following the end of such calendar year. If any such examination shall reveal, or if either party shall discover, any error or inaccuracy in its own or the other party's statement, payment, calculation, or determination, then proper adjustment and correction thereof shall be made as promptly as practicable thereafter.

8.3 Failure to pay. If Buyer fails to pay any amount payable to Seller hereunder when due, interest thereon shall accrue and be payable at the lesser of the highest legally permissible rate or the prime lending rate

established by the Chase Manhattan Bank, N.A., New York, from the date when payment was due until the date payment is made. If such failure to pay continues for 30 days after protest in writing by Seller, and if such failure is not due to a good faith dispute in the amount due, Seller may suspend its deliveries of carbon dioxide hereunder and, in addition, may terminate this Contract upon written notice to Buyer. The exercise of any such right by Seller shall be in addition to any and all other remedies available to Seller.

ARTICLE IX - FORCE MAJEURE

9.1 Definition. If either party is rendered unable, wholly or in part, by force majeure to carry out its obligations (except financial obligations) under this Contract, it is agreed that, on such party's giving notice and reasonably full particulars of such force majeure in writing or by telegraph to the other party within a reasonable time after the occurrence of the cause relied on, then the obligations of the party giving such notice, so far as they are affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period, and such cause shall so far as possible be remedied with all reasonable dispatch. The term "force majeure", as used herein, shall mean acts of God, strikes, lockouts or other industrial disturbances, acts of the public enemy, wars, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms, floods, high water, washouts, arrests and restraints of government and people, civil disturbances, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or lines of pipe, partial or entire failure of wells, and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension; such term shall likewise include (a) in those instances where either party hereto is required to obtain servitudes, rights-of-way grants, permits or licenses to enable such party to perform hereunder, the

inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such servitudes, rights-of-way grants, permits or licenses, and (b) in those instances where either party hereto is required to furnish materials and supplies for the purpose of constructing or maintaining facilities or is required to secure permits or permissions from any governmental agency to enable such party to perform hereunder, the inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such materials and supplies, permits and permissions. An occurrence of force majeure affecting the Cortez Line or Cortez Pipeline Company shall be deemed to be an occurrence of force majeure affecting Seller hereunder. An occurrence of force majeure affecting a person purchasing carbon dioxide from Buyer shall be deemed to be an occurence of force majeure affecting Buyer hereunder.

9.2 Extended force majeure. If, after deliveries have commenced hereunder, an event of force majeure affects the amounts of deliveries by Seller or the receipts by Buyer for a consecutive period of 365 days, then, at any time after such period prior to the time such event has been remedied, the party not claiming force majeure may cancel this Contract as to the amount of deliveries or receipts, as the case may be, so affected by such event of force majeure.

9.3 Strikes and lockouts. It is understood and agreed that the settlement of strikes or lockouts shall be entirely within the discretion of the party having the difficulty, and that the above requirement that any force majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes or lockouts by acceding to the demands of an opposing party when such course is inadvisable in the discretion of the party having the difficulty.

ARTICLE X - NOTICES

10.1 Addresses. All notices to be given hereunder shall be in writing and shall be sent by prepaid mail or telegram addressed to the respective parties at the addresses stated below or to such other addresses as they shall respectively designate hereafter in writing from time to time:

To Seller: Mobil Producing Texas & New Mexico Inc.
Nine Greenway Plaza - Suite 2700
Houston, TX 77046

To Buyer: Shell Oil Company

(mailing Attention: Natural Gas
P. O. Box 2463
Houston, TX 77001

(street) Attention: Natural Gas
900 Lousiana
Suite 3802
Houston, TX 77001

10.2 Dispatching notices. Buyer may notify Seller (or such representative as Seller may designate from time to time) in writing, by telegram or orally by telephone or radio of changes in Buyer's carbon dioxide requirements. Each oral request for changes in Buyer's requirements shall be confirmed in writing within a reasonable time (not in excess of seven days) after such request.

ARTICLE XI - SUCCESSORS AND ASSIGNS

11.1 Binding of terms. All the terms and conditions of this Contract shall extend to and be binding upon the respective successors and assigns of the parties hereto.

11.2 Assignments. The rights and obligations of a party hereunder shall not be assigned without the written consent of the other party, except that a party may assign all of its interest, rights and obligations hereunder

without the consent of the other party to an affiliate or subsidiary or pursuant to a merger or consolidation. Consent to an assignment of the rights and obligations hereunder shall not be unreasonably withheld.

11.3 Pledged rights. Nothing contained in this Article shall in any way prevent either party from pledging or mortgaging its rights hereunder for security of its indebtedness subject to the terms of this Contract.

ARTICLE XII - TERM

12.1 Seller's option. Seller may, by notice to Buyer given prior to the Initial Period, cancel this Contract, effective as of the date such notice is received by Buyer.

12.2 Basic term. Subject to Sections 2.8, 12.1 and 12.3, this Contract shall be effective as of the date hereof and, unless terminated pursuant to other provisions hereof, shall remain in full force and effect until the tenth anniversary of the date of initial delivery of carbon dioxide hereunder.

12.3 Termination option. Notwithstanding the provisions of Section 12.2, Buyer shall have the continuing option to cancel this Contract in its entirety by tendering payment to Seller in an amount determined by multiplying (a) the Unit Price applicable to the month in which such tender is made by (b) 285,000,000 Mcf minus the cumulative volume of carbon dioxide, expressed in Mcf, delivered hereunder prior to the date of such tender and minus the volume of carbon dioxide, expressed in Mcf, paid for and not made up hereunder prior to the date of such tender.

ARTICLE XIII - MISCELLANEOUS

13.1 Title. Seller hereby warrants title to the carbon dioxide sold and delivered hereunder, the right to sell the same, and that it is free

from all liens and adverse claims, and agrees, if notified thereof by Buyer, to indemnify Buyer against all suits, actions, debts, accounts, damages, costs (including attorneys' fees), losses and expenses arising from or out of any adverse legal claims of any and all persons to, or against, the carbon dioxide prior to delivery thereof to Buyer.

13.2 Waiver. No waiver by Buyer or Seller of any default of the other party under this Contract shall operate as a waiver of any subsequent default, whether of a like or a different character.

13.3 Headings. The Table of Contents and headings contained in this Contract are used solely for convenience and do not constitute a part of the agreement between the parties hereto, and they should not be used to aid in any manner in construing this Contract.

IN WITNESS WHEREOF, this Contract is executed as of the date first above written.

MOBIL PRODUCING TEXAS & NEW MEXICO INC.

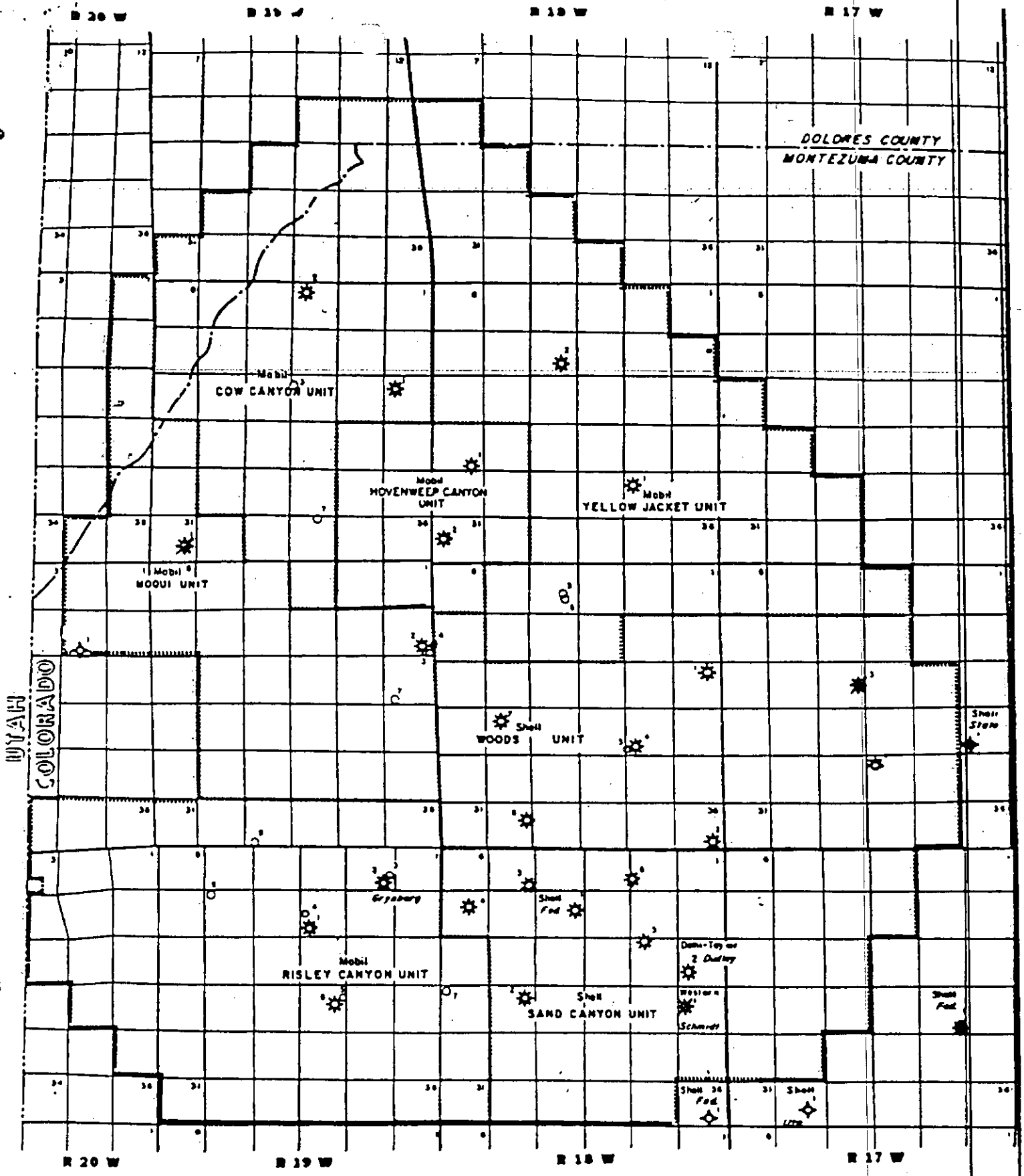
By J. W. Parish cpm
Attorney-In-Fact

Seller

SHELL OIL COMPANY

By R. A. Howard
Attorney-In-Fact

Buyer



Mobil Producing
Texas & New Mexico Inc.
Houston, Texas

Mc ELMO FIELD

MILES
0 1 2 3 4

MONTEZUMA COUNTY, COLORADO
4/82

United States Department of the Inter

attach 50

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

IN REPLY REFER TO:

MMS-VSD-OG:91-0548a
Mail Stop 3922

NOV - 9 1993

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

On November 4, 1993, Ms. Jill Rawhauser and other members of your staff met with Minerals Management Service (MMS) personnel at the MMS offices in Lakewood, Colorado. We agreed to withdraw MMS' letter dated October 13, 1993, denying the Mobil Exploration & Producing U.S. Inc. (MOBIL) request for an allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome to West Texas.

Upon receipt and review of your recalculation of overhead costs and itemized schedules identifying those costs, the MMS will issue a revised determination. Mobil agreed to:

1. Report royalties and related transportation allowances under selling arrangement 001 for those contracts where the total transportation costs do not exceed 50 percent of the value of CO_2 transported from McElmo Dome.

2. Report royalties and related transportation allowances under selling arrangement 002 for those contracts where the total transportation costs exceed 50 percent of the value of CO_2 transported from McElmo Dome.

If there are any questions, please call Ms. Shirley Keller at (303) 275-7217.

Sincerely,

Original Signed by
Deborah Gibbs Tschudy

Deborah Gibbs Tschudy
Chief, Valuation and
Standards Division

C.46

attach 49

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

RECEIVED
NOV -3 P
VAL. & STDS. DIV

Memorandum

To: [✓] Deputy Associate Director for Compliance
[ ] Chief, Division of Verification
[✓] Chief, Valuation and Standards Division
[ ] Deputy Associate Director for Audit
[ ] Area Manager, Dallas Area Audit Office
[ ] Area Manager, Houston Area Audit Office
[ ] Area Manager, Lakewood Area Audit Office
[ ] Area Manager, Tulsa Area Audit Office
[ ] Chief, State and Indian Program Audit Office
[ ] Deputy Associate Director for Operations
[ ] Chief, Reports and Payments Division
[ ] Chief, Royalty Accounting Division
[✓] Asst. Solicitor-Royalty, Division of Energy and Resources
Attention: Peter Schaumberg
[ ] Asst. Solicitor-Land and Minerals, Division of Indian Affairs
Attention: David Etheridge
[ ] _____

November 5, 1993

From: Chief, Appeals and Litigation Support Division Platte E. Clark

Subject: Review of Proposed Appeal Decision

Appellant Shell Oil Company

Docket Number MMS-92-0039-046

Appeals Analyst Hager

A proposed decision in the appeal is provided for your review and written comment. Please be as specific as possible and give reasons for suggested changes. Questions should be directed to the Analyst at (703) 787-1275.

Please forward comments (to the attention of the Appeals Analyst indicated above) to Appeals and Litigation Support Division (MS9110), Parkway Atrium Building, 381 Elden Street, Herndon, Virginia 22070-4817.

Your concurrence may be indicated by "surnaming" this document and returning it to the above address. If we do not hear from you within 3 weeks, the proposed decision will be forwarded for issuance. You may request an extension of time for comment.

We appreciate your assistance.

Due date for comments November 26, 1993

Attachment

* The copy of any case file provided should be returned to us.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

MMS-92-0039-O&G	:	McElmo Dome (Leadville) Unit, Montezuma and Dolores Counties, Colorado
Shell Oil Company	:	Appeal of Determination Concerning Non Arm's-length Transportation Allowance for Carbon Dioxide Gas
Appellant	:	Appeal Granted in Part; Denied in Part

Statement of Facts

Shell Oil Company's (Shell) subsidiary Shell Western E & P, Inc., is the operator of the McElmo Dome Unit and produces carbon dioxide (CO_2) which is transported through the 500 mile Cortez Pipeline to oil fields in west Texas for use in enhanced oil recovery projects. Shell has an ownership interest in the Cortez Pipeline.

By letter dated December 9, 1983, Shell requested approval to use as a transportation allowance in calculating Federal royalties on the CO_2, a non-Federal, non-State approved "tariff" procedure elected by the pipeline partners based on a certain 1941 Pipeline Consent Decree methodology. The Appellant states that at the time of the request, the contract for sale of the CO_2 was for a six year period.

By letter dated March 29, 1984, and decision in Shell Western E & P, Inc., MMS-84-0013-MISC (August 6, 1986), 4 Gower Federal Service, Royalty Valuation and Management, Rocky Mountain Mineral Law Foundation (Gower), the Minerals Management Service (MMS) approved the Consent Decree calculation procedure with the exception of the inclusion of applicable State and Federal

income tax costs in calculating the transportation allowance. The decision disallowing the tax costs was subsequently set aside and remanded to MMS by the Department's Interior Board of Land Appeals (IBLA) in Shell Western E & P, Inc., 112 IBLA 394 (1990).

By letter dated November 5, 1990, the MMS's Royalty Valuation and Standards Division (RVSD) approved the transportation allowance calculation procedure (including the tax costs) based on the Consent Decree "tariff" for the period April 15, 1984, through February 29, 1988. At the time of the request, the new regulations at 30 CFR 206.157(c)(2)(v) (1988) gave recognition to existing approved transportation allowances for non arm's-length arrangements in effect on March 1, 1988, "until such allowances terminate".

In the November 5, 1990, letter approving Shell's transportation allowance to conform to the IBLA decision, RVSD stated that because Shell had submitted a Form MMS-4295, "Gas Transportation Allowance Report," for the period March 1, 1988, through December 31, 1988, the company had made itself subject to the reasonable actual cost provisions at 30 CFR 206.157(b) (1988) for calculating non arm's-length transportation allowances, and that the Cortez pipeline "tariff" based allowance had therefore terminated effective March 1, 1988.

Shell appealed that latter determination on the grounds that so long as the Cortez Pipeline "tariff" is in effect, the company is entitled under 30 CFR 206.157(c)(2)(v) (1988) to continue its use as an approved allowance. The RVSD has since agreed that the subject "tariff" was in effect on March 1, 1988, but contends that because the term of the underlying CO2 purchase contract was six years ending April 30, 1990, the allowance must be calculated

thereafter on the basis of the reasonable actual cost provisions at 30 CFR 206.157(b) (1988).

Issue

The issue presented by the appeal is whether an existing non arm's-length transportation allowance approval in effect on March 1, 1988, continues in effect thereafter pursuant to 30 CFR 206.157(c)(2)(v) (1988).

Conclusions and Order

It has been a longstanding policy that in establishing the royalty value under Federal leases, it is appropriate to recognize reasonable costs incurred by a lessee in transporting lease production to the nearest available market.

For the period beginning March 1, 1988, transportation allowances are authorized at 30 CFR 206.156 and 206.157 (1992). For non arm's-length transportation arrangements, the new regulations provide generally at 30 CFR 206.157(b) that transportation allowances will be based upon the lessee's "reasonable actual costs". The non arm's-length provisions at 30 CFR 206.157(b)(5) (1992) also give authority to recognize FERC or State approved tariffs in lieu of a cost based allowance. For approved allowances in effect when the new regulations took effect on March 1, 1988, the provisions of 30 CFR 206.157(c)(2)(v) (1988) provide that:

> Non-arm's-length contract or no contract based transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

The RVSD initially took the position that by filing of the Form MMS-4295, "Gas Transportation Allowance Report," for the period March 1, 1988,

through December 31, 1988, the company had made itself subject to the reasonable actual cost provisions at 30 CFR 206.157(b) (1988) for calculating transportation allowances. The RVSD has since withdrawn the claim upon which the demand letter being appealed was based. To this extent the appeal must be granted. The filing of the Form MMS-4295 in this instance did not serve as an election to terminate the allowance in effect on March 1, 1988.

In the course of the appeal proceedings, RMP has introduced the further contention that the transportation allowance for the period after April 30, 1990, is subject to the reasonable cost provisions of the new regulations because the previously approved allowance terminated with the expiration of the initial term of the underlying CO2 purchase contract.

On this point, Shell states:

> In order to meet competition and to obtain sales of CO2 from the McElmo Dome Unit, Shell obligated itself to its customers under the CO2 Sale and Purchase Contract to base the pipeline tariff rate for the first six contract years on the assumption that the pipeline throughput was 1,000,000 MCF per day. Based on such throughput, which was at that time about three times what the actual throughput was, a tariff rate of 39 cents per MCF was established. This subsidized rate had a six year contractual limitation on it, but there was nothing in Shell's request to the RVSD or in its CO2 sales contracts that placed a six year limit on the use of the 1941 Pipeline Consent Decree as a tariff calculation procedure.

The record shows that the RVSD approval of a transportation allowance based on the 1941 Consent Decree (with the later overturned tax exclusion) made no reference to a 6-year time limitation. The March 1984 RVSD approval was as follows:

> The "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by Shell is acceptable, with the exception that, for

> royalty purposes, Federal and State income tax are not to be considered in computing transportation costs.

In its report on the appeal, RVSD contends that Shell's original proposal made reference to a 6-year period and that RVSD intended to approve the Cortez Pipeline calculation procedure for the first 6 contract years. The RVSD contends that the "tariff" based allowance is only effective to the 6-year period ending April 30, 1990.

No reasonable reading of the initial allowance approval dated March 29, 1984, nor the revised approval dated November 5, 1990, would incorporate a 6-year limitation on the transportation allowance approval. The approvals constitute an express commitment to give recognition to a transportation allowance based on the 1941 Consent Decree procedure, and until it is revoked, the allowance on March 1, 1988, remains in effect in accordance with the provisions of 30 CFR 206.157(c)(2)(v) (1988). Once a final commitment of value is made, royalty liability may be fulfilled by payment on the approved basis until the lessee is notified that a prior determination is no longer of effect. West Coast Silica Company, a Division of Johns-Manville Sales Corporation, MMS-23-MIN September 16, 1982, 3 Gower; Supron Energy Corp., 46 IBLA 181, 189 (1980).

For the foregoing reasons, we do not accept that the allowance approval terminated by its own terms. However, just as RMP could have in the first instance, limited the period for which the earlier approval was to apply, RMP may terminate an open-ended approval prospectively by notification to the lessee.

The November 5, 1990, letter stated that the consent decree based allowance:

> is acceptable as a transportation allowance for the Cortez pipeline from April 15, 1984, through February 29, 1988.

By its terms, the letter served notice that the earlier approval was not effective after February 29, 1988. The only defect with the November 5, 1990, letter, here under appeal, is that the termination of the allowance approval cannot, in these circumstances, be effected on a retroactive basis. To this extent, the appeal is granted in part.

For purposes of 30 CFR 206.157(c)(2)(v) (1988), however, the November 5, 1990, letter terminated the allowance approval prospectively. Accordingly, for the period beginning upon receipt of that letter by Shell on November 12, 1990, any transportation allowances claimed by the Appellant must be calculated in accordance with the reasonable actual cost provisions at 30 CFR 206.157(b) (1988) for non arm's-length transportation allowances. To this extent the appeal is denied.

Under the circumstances of this case, the 3-month retroactive limitation for filing applicable Forms MMS-4295 or revisions thereto prescribed by 30 CFR 206.157(b) (1992) is extended for good cause to permit consideration of allowance applications consistent with this decision for the month beginning December 1990.

This decision may be appealed to IBLA pursuant to 30 CFR Part 290 (1991) and 43 CFR 4.411 and 4.413 (1991). A copy of 43 CFR 4.411 and 4.413 (1991) is enclosed for reference. Notice of such appeal must be transmitted to the Director, Minerals Management Service, U.S. Department of the Interior, 1849 C Street, NW., Washington, D.C. 20240, within 30 days after the date of service of the decision. Copies of the notice of appeal and any statement of reasons, written arguments, or briefs should be served upon the Associate Solicitor,

Division of Energy and Resources, U.S. Department of the Interior, 1849 C Street, NW., Washington, D.C. 20240; and upon the Chief, Division of Appeals (MS1300), Minerals Management Service, U.S. Department of the Interior, Parkway Atrium Building, 381 Elden Street, Herndon, Virginia 22070-4817.

Director

Enclosure

bcc: MMS General File
AS/LM (2)
Director's Chron
Appeals (MMS-92-0039
RMMLF
Desk Files (Reading) (CEH)
LMS:MB:APPEALS:MS1300:EHager:rcm:10/21/93:787-1275
G:\HOME\HAGERE\DECISION\92-0039

Recommended Decision Summary

Action: Signature the Director

Appellant: Shell Oil Company

Docket Number: MMS-92-0039-O&G

Issue Non Arm's-length Transportation Allowance for Carbon Dioxide Gas

Facts: By letter dated March 29, 1984, as revised by letter dated November 5, 1990, after an IBLA revision to the allowance, MMS approved the calculation procedure in a 1941 Consent Decree as the basis for a pipeline transportation allowance for the Carbon Dioxide Gas. The November 5 letter, however, stated that the previously approved allowance terminated with the adoption of the new product regulations made effective March 1, 1988, because the company's filing of the new form thereunder constituted an election to be subject to the new regulations. RMP has since retracted this contention but argues that the new reasonable cost based allowance provisions of the new regulations still apply because the prior approval was implicitly limited to the life of the CO2 purchase contract.

Analysis: The new regulations at 30 CFR 206.157(c)(2)(v) (1988) gave recognition to existing approved transportation allowances for non arm's-length arrangements in effect on March 1, 1988, until "such allowances terminate". The RMP's approval contained no 6-year limitation and the contention that the approval in effect on March 1, 1988, was implicitly so limited is not sustainable.

The approvals constitute an express commitment to give recognition to a transportation allowance based on the 1941 Consent Decree procedure, and until it is revoked, the allowance on March 1, 1988, remains in effect in accordance with the provisions of 30 CFR 206.157(c)(2)(v) (1988).

For purposes of 30 CFR 206.157(c)(2)(v) (1988), the November 5, 1990, letter terminated the allowance approval prospectively. Accordingly, for the period beginning upon receipt of that letter by Shell on November 12, 1990, any transportation allowances claimed by the Appellant must be calculated in accordance with the reasonable actual cost provisions at 30 CFR 206.157(b) (1988) for non arm's-length transportation allowances.

Review: Surnamed by Director

Recommended Decision: Grant the appeal in part, deny the appeal in part.

Option:

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

TAKE PRIDE IN AMERICA

IN REPLY REFER TO:

MMS-VSD-OG:91-0548
Mail Stop 3922

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

OCT 13 1993

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated October 1, 1991, Mobil Exploration & Producing U.S. Inc. (Mobil) requested the Minerals Management Service (MMS) approval for an allowance to exceed 50 percent of the value of carbon dioxide (CO_2) transported from the McElmo Dome Unit, located in Dolores and Montezuma Counties, Colorado, to various sales points in Yoakum County, Texas, from March 1, 1988, through December 31, 1991. See Enclosure 1 for a listing of the leases included in the McElmo Dome Unit.

The MMS requested additional information by letters dated May 29, 1992, February 8, 1993, and May 3, 1993. Mobil provided the requested information by letters dated October 22, 1992, February 22, 1993, and July 1, 1993.

The MMS reviewed the documentation provided by Mobil. Certain costs claimed by Mobil are not allowable transportation costs and are deleted from the calculation of the transportation allowance rate, as follows:

- Exploration and producing overhead costs for MPTM and Slaughter Pipelines, as follows:

Year	MPTM	Slaughter
3/1/88-12/31/88	$25,469.57	- - - -
1989	$40,168.86	$82,566.79
1990	$34,204.29	$68,589.39
1991	X-4	X-4

- Well reconditioning costs of X-4 for the MPTM Pipeline in 1991.

OFC

These costs apply to production or lease costs; not the transportation system. As such, these are not allowable transportation expenses, and must be deleted from the transportation allowance calculation.

Title 30 CFR § 206.157(b)(2)(iii) (1992) states in part: "Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense."

Mobil's example of overhead allocation, submitted with it's July 1 letter, as Attachment B, is not based on actual identified costs, and is not acceptable.

In reference to a telephone conversation between Ms. Beverly Ward of Mobil and Ms. Shirley Keller of MMS on September 30, 1993, an example of acceptable overhead allocation follows:

Overhead Category	Annual Expense
Telephone	X-4
Postage	
Secretary	
Total Overhead Expense =	

Total overhead expenses for the overhead services categorized above are allocated to the various pipelines serving the McElmo Dome Unit, as follows:

Operating and Segment & Maintenance Costs		Percentage of Total Op. & Maint. Costs	Overhead Amount
Cortez Pipeline	X-4	X-4	X-4
Slaughter Pipelir			
MPTM Pipeline			
Totals			

Since the nonallowable exploration and producing overhead costs were deleted from the allowance calculation, the resulting allowance rate is below 50 percent of the value of CO_2 during each of the time periods for which Mobil requested to exceed the 50-percent limitation, as shown on Enclosure 2. For that reason, Mobil's request for an allowance to exceed 50 percent of the value of CO_2 transported from the leases in the McElmo Dome Unit to west Texas from March 1, 1988, through December 31, 1991, is denied.

You have the right to appeal this decision. Please refer to the Appeals Procedure and Bonding Requirements, Enclosure 3.

If you have any questions, please call Ms. Keller at (303) 275-7217.

Sincerely,

Original Signed by
Deborah Gibbs Tschudy

Deborah Gibbs Tschudy
Chief, Valuation and
Standards Division

3 Enclosures

bcc: RM File:91-0548
RM Chron Lkwd/DC
VSD Chron (2)
O&G
States
LMS:RMP:VSD:O&G:SKELLER:MS3922:275-7217:N:\USR\OANDG\91-0548
revised:llb:10-8-93

attach. 47

United States Department of the In

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

IN REPLY REFER TO:

MMS-VSD-OG:92-0279A
Mail Stop 3922

MAR 9 1993

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. William G. Riddoch
Senior Counsel
Shell Oil Company
P.O. Box 576
Houston, Texas 77001

Dear Mr. Riddoch:

By letter dated March 31, 1992, you requested approval for a transportation allowance in excess of the 50-percent limitation for carbon dioxide ("CO_2") transported by the Cortez Pipeline Company for the periods March 1, 1988, through December 31, 1988; January 1, 1989, through December 31, 1989; January 1, 1990, through December 31, 1990; January 1, 1991, through December 31, 1991; and January 1, 1992, through December 31, 1992.

By letter dated February 1, 1993, the Valuation and Standards Division (VSD) requested additional information. Shell Oil Company (Shell) responded with additional information by letter dated February 10, 1993.

In order for VSD to review Shell Western E&P Inc.'s (SWEPI) request, the following additional information is needed:

- The VSD's initial determination is that Shell incorrectly calculated the rate of return for the period March 1, 1988 through December 31, 1988. SWEPI needs to recalculate the rate of return by adjusting the rate of return for a partial year instead of claiming the total amount for the calendar year.

- Shell did not submit all Supplemental Schedules 1A which explain "other expenses" claimed on Schedules 1A for all applicable time periods. To adequately review SWEPI's request, a detailed list, explanation, and documentation, of those expenses listed as "other expenses" is needed.

- A copy of the contract and a detailed explanation for expenses claimed as "contract services" for the Cortez Pipeline for the period January 1, 1991, through December 31, 1991, is needed.

- Interest and Banking Fees are listed as expenses claimed for the Cortez Pipeline for the Period January 1, 1991, through December 31, 1993. SWEPI needs to submit detailed documentation for these expenses.

Accordingly, SWEPI must submit the additional information within 30 days from the date of this letter to:

Minerals Management Service
Attention: Deborah Gibbs Tschudy
Chief, Valuation and Standards Division
P.O. Box 25165, Mail Stop 3922
Denver, Colorado 80225-0165

If SWEPI is unable to meet the 30-day requirement, you must submit a request with sufficient justification to obtain an Minerals Management Service (MMS) extension.

Please refer to Project No. MMS-VSD-OG:92-0279 when submitting the requested information. If you have any questions, please call Ms. Colette Haines at (303) 275-7215.

Sincerely,

Original signed by
Martin C. Grieshaber

Martin C. Grieshaber
Chief, Oil and Gas Valuation Branch
Valuation and Standards Division

bcc: RM File
RM Chron/Lkwd/DC
VSD Chron
LMS:RM:VSD:OG:MS3922:CHAINES:275-7215:03/01/93:OANDG:92-0279A
revised:llb:3-4-93
Finalized:3/9/93

Mobil Exploration & Producing U.S. Inc.

PIO BOX 650232
DALLAS, TEXAS 75265-0232

February 22, 1993

Minerals Management Service
Attention: Deborah Gibbs Tschudy
Chief, Valuation and Standards Division
P. O. Box 25165, Mail Stop 3922
Denver, CO 80225

attach. 46

McELMO DOME CO2 TR
REQUEST TO EXCEED
LIMITATION
MARCH 1988 - DECEMBER 1991
MMS-VSD-OG:91-0548a

Dear Ms. Tschudy:

Per letter dated February 8, 1993, the Minerals Management Service (MMS) has requested additional calculations and / or explanations on the items Mobil submitted on October 22, 1992 for approval of a transportation allowance amount in excess of 50 percent of the value of the CO2 transported from McElmo Dome.

Enclosed as Attachment A are summarized schedules for each reporting period, complete with a sales value column and totals for the period March 1, 1988 through December 31, 1989. The overhead expenses for the MPTM Pipeline (Wasson Facility) and the Slaughter Pipeline are explained in Attachment B. The administrative cost of financing the Cortez Pipeline is also explained in Attachment C.

Beverly Ward of Mobil spoke with Shirley Keller of MMS on February 11 regarding the request for calculations showing how Mobil arrived at a transportation allowance in excess of the 50 percent limitation and the specific percentage for each reporting period. Beverly "walked through" the work papers previously submitted to MMS with Ms. Keller, explaining how the excess amount above the 50 percent limitation was calculated. In addition, the request for the specific percentage for each reporting period was retracted by Ms. Keller as the circumstances surrounding the McElmo Dome request do not lend itself for the calculation of the requested percentage.

If there are additional questions, please contact Beverly Ward at (214) 951-4004.

Very truly yours,

R. R. Bates

R. R. Bates, Manager
Royalty Compliance

BBWard
Attachments

ATTACHMENT A

MMS ROYALTY VALUATION
Summary – 1991 Reporting period -- January through December 1991 production month

METER	DESCRIPTION	GROSS VOLUME	LAYDOWN PRICE	SALES VALUE	TRANSPORTATION >>>>>>>>>>>>>>>>>>>>>>>>>>: CORTEZ	MPTM	SHEEP MTN	SLAUGHTER	TOTAL TRANS ALLOW	50% OF LAYDOWN	TRANS ALLOW >50%
74211-502A	E.VACUUM	876,324									
74211-502B	ARCO E.VACUUM	732,956									
74211-502C	EXXON E.VACUUM	1,116,545									
74211-502D	ARCO E.VACUUM	0									
74221-500A	WELLMAN	2,927,206									
74221-500B	SEMINOLE	1,422,944									
74221-500C	MAHONEY	3,941,931									
74221-500D	WILLARD	0									
74221-500E	GMK	0									
74221-500F	WELLMAN EXCH	826,808									
74221-504A	AMOCO YATES	0									
74221-504B	AMOCO NO COWDEN	0									
74222-511C	MALLET IK	507,506									
74222-511D	MALLET S	61,941									
74222-501A	DENVER UNIT SALES	0									
74222-501B	DENVER I.K.	930,219									
74222-501C	ARCO I.K. D.U.	3,574,647									
74222-501D	ARCO I.K. D.U.	169,437									
74222-506A	DOLLARHIDE	2,680,404									
74222-506B	SO. WASSON-MOC	1,777,217									
74222-506C	SO. WASSON-AMER	255,435									
74222-506D	SO. WASSON-EXXON	369,190									
74222-510	SO. WASSON-MOC	0									
74236-500A	TEMP DIK MCELMO CK	0									
74236-FM1-A	MOBIL DIK MCELMO CK	2,841,576									
74236-FM1-B	EX E.V. EXCH MCLMO CK	2,160,110									
74211-505	CONOCO MALJAMAR	6,171,105									
74221-510A	SALE SACROC	0									
74221-510B	DIK SACROC	0									
74221-510C	N. WARD ESTES	10,653,032									
74221-511	BIG FINEY	0									
74222-511A	LINE FILL	3									
74222-511B	EAST MALLET	4,936,408									
		48,932,944									

* Pressure base adjusted.

X-4

MMS ROYALTY VALUATION
Summary -- 1990 Reporting Period -- January through December 1990

METER	DESCRIPTION	GROSS VOLUME	LAYDOWN PRICE	SALES VALUE	TRANSPORTATION >>>>>>>>>>>>>>>>>>>>>>>>>>>>>>>>>>: CORTEZ	MPTM	SHEEP MTN	BIG THREE	SLAUGHTER	CNTRL BASIN	TOTAL TRANS ALLOW	50% OF LAYDOWN	TRANS ALLOW >50%
74211-502A	E.VACUUM	993,049	0.953228	946,601.90	0.384773						0.384773	0.476614	0
74211-502B	ARCO E.VACUUM	699,123	0.959006	670,462.90	0.384773						0.384773	0.479503	0
74211-502C	EXXON E.VACUUM	1,265,268	0.953228	1,206,088.74	0.384773						0.384773	0.476614	0
74211-502D	ARCO E.VACUUM	131,463	0.922500	121,274.62	0.384773						0.384773	0.461250	0
74221-500A	WELLMAN	1,495,670	1.305066	1,951,948.40	0.384773	0.007368					0.392141	0.652533	0
74221-500B	SEMINOLE	3,105,853	0.754273	2,342,660.10	0.384773	0.094174	0.036219				0.515166	0.377136	0.138030
74221-500C	MAHONEY	3,905,756	0.819724	3,201,643.00	0.384773	0.007368					0.392141	0.409862	0
74221-500D	WILLARD	0		0.00							0.000000	0.000000	N/A
74221-500E	GMK	0		0.00							0.000000	0.000000	N/A
74221-504A	AMOCO YATES	0		0.00	0.384773						0.384773	0.000000	N/A
74221-504B	AMOCO NO COWDEN	0		0.00	0.384773						0.384773	0.000000	N/A
74222-501A	DENVER UNIT SALES	37,440,000	0.941110	35,235,176.37	0.384773						0.384773	0.470555	0
74222-501B	DENVER I.K.	558,263	0.880065	491,318.70	0.384773						0.384773	0.440042	0
74222-501C	ARCO I.K. D.U.	2,145,292	0.880064	1,888,038.03	0.384773						0.384773	0.440042	0
74222-501D	ARCO I.K. D.U.	101,682	0.880081	89,488.44	0.384773						0.384773	0.440041	0
74222-506A	DOLLARHIDE	2,457,228	0.925512	2,274,194.84	0.384773						0.384773	0.462756	0
74222-506B	SO. WASSON-MOC	1,629,044	0.909384	1,481,426.09	0.384773			0.010849			0.395622	0.454692	0
74222-506C	SO. WASSON-AMER	234,138	0.909384	212,921.24	0.384773						0.384773	0.454692	0
74222-506D	SO. WASSON-EXXON	338,409	0.909384	307,743.71	0.384773						0.384773	0.454692	0
74222-510	SO. WASSON-MOC	0		0.00	0.384773						0.384773	0.000000	N/A
74236-500A	TEMP DIK MCELMO CK	0	*	0.00							0.000000	0.000000	N/A
74236-FM1-A	MOBIL DIK MCELMO CK	2,709,999	0.566506 *	1,540,655.58							0.000000	0.284254	0
74236-FM1-B	EX E.V. EXCH MCLMO CK	2,060,062	0.566506 *	1,171,172.28							0.000000	0.284254	0
74211-505	CONOCO MALJAMAR	7,692,551	0.860604	6,621,781.72	0.384773						0.384773	0.430402	0
74221-510A	SALE SACROC	4,328,946	1.045886	4,527,582.77	0.384773					0.165192	0.549965	0.522943	0.027022
74221-510B	DK SACROC	0		0.00							0.000000	0.000000	N/A
74221-510C	N. WARD ESTES	18,904,642	0.888085	16,788,920.01	0.384773						0.384773	0.444042	0
74221-511	BIG PINEY	158,456	0.893000	141,502.99							0.000000	0.446500	0
74222-511A	LINE FILL	0		0.00							0.000000	0.000000	0
74222-511B	EAST MALLET	5,884,051	1.107908	6,518,968.06	0.384773				0.198502		0.583275	0.553954	0.029321
		98,238,987		89,731,590.50									

*Pressure base adjusted.

MMS ROYALTY VALUATION
Summary -- 1989 Reporting Period -- January through December 1989

METER	DESCRIPTION	GROSS VOLUME	LAYDOWN PRICE	SALES VALUE	TRANSPORTATION > CORTEZ	MPTM	SHEEP MTN	BIGTHREE	SLAUGHTER	CNTRL BASIN	TOTAL TRANS ALLOW	50% OF LAYDOWN	TRANS ALLOW > 50%
74211-502A	E.VACUUM	1,153,496	0.840000	968,936.64	0.390000						0.390000	0.420000	0
74211-502B	ARCO E.VACUUM	227,597	0.840000	191,181.48	0.390000						0.390000	0.420000	0
74211-502C	EXXON E.VACUUM	1,469,693	0.840000	1,234,542.12	0.390000						0.390000	0.420000	0
74211-502D	ARCO E.VACUUM	737,186	0.840000	619,236.24	0.390000						0.390003	0.585000	0
74221-500A	WELLMAN	268,294	1.170000	313,903.98	0.390000	0.006003					0.560635	0.460242	0.100393
74221-500B	SEMINOLE	2,231,814	0.920485	2,054,350.83	0.390000	0.135114	0.035821				0.396003	0.331350	0.064653
74221-500C	MAHONEY	3,627,194	0.662700	2,403,742.72	0.390000	0.006003					0.390000	0.000000	N/A
74221-500D	WILLARD	0		0.00	0.390000						0.390000	0.000000	N/A
74221-500E	GMK	0		0.00	0.390000						0.390000	0.000000	N/A
74221-504A	AMOCO YATES	0		0.00	0.390000						0.390000	0.000000	N/A
74221-504B	AMOCO NO COWDEN	0		0.00	0.390000						0.390000	0.426923	0
74222-501A	DENVER UNIT SALES	47,450,000	0.853646	40,514,991.40	0.390000						0.390000	0.384900	0.005100
74222-501B	DENVER I.K.	871,044	0.769800	670,529.87	0.390000						0.390000	0.384900	0.005100
74222-501C	ARCO I.K. D.U.	3,347,245	0.769800	2,576,709.20	0.390000						0.390000	0.384900	0.005100
74222-501D	ARCO I.K. D.U.	158,657	0.769800	122,134.16	0.390000						0.390000	0.396000	0
74222-506A	SHIDE	944,252	0.790000	745,959.08	0.390000						0.432110	0.426000	0.006110
74222-506B	SO. WASSON-MOC	1,253,778	0.852000	1,068,218.86	0.390000			0.042110			0.390000	0.426000	0
74222-506C	SO. WASSON-AMER	180,203	0.852000	153,532.96	0.390000						0.390000	0.426000	0
74222-506D	SO. WASSON-EXXON	260,462	0.852000	221,906.10	0.390000						0.390000	0.000000	N/A
74222-510	SO. WASSON-MOC	0		0.00	0.390000						0.000000	0.000000	N/A
74236-500A	TEMP DIK MCELMO CK	0		0.00							0.000000	0.216313	0
74236-FM1-A	MOBIL DIK MCELMO CK	2,758,369	0.432626 *	1,193,335.48							0.000000	0.216313	0
74236-FM1-B	EX E.V. EXCH MCLMO CK	2,096,849	0.432626 *	907,149.80							0.390000	0.406500	0
74211-505	CONOCO MALJAMAR	5,013,845	0.813000	4,078,255.99	0.390000						0.556537	0.490234	0.066303
74221-510A	SALE SACROC	5,726,704	0.980466	5,616,609.97	0.390000					0.166537	0.555537	0.488211	0.067326
74221-510B	DIK SACROC	373,125	0.976423	364,327.86	0.390000					0.166537	0.390000	0.405000	0
74221-510C	N. WARD ESTES	6,716,466	0.810000	7,060,355.28	0.390000						0.390000	0.470000	0
74222-511A	LINE FILL	76,000	0.940000	71,440.00	0.390000						0.854971	0.470000	0.384971
74222-511B	EAST MALLET	2,658,667	0.940000	2,499,166.78	0.390000				0.464971				
		91,602,962		75,648,714.08									

* Pressure base adjusted.

ATTACHMENT B

Exploration and producing overhead costs are calculated by multiplying an overhead rate times the sum of MMS allowed operating and maintenance costs. The overhead rate is the ratio of actual total producing indirect expenses to actual total producing direct expenses for a given calendar year.

ATTACHMENT C

The administrative cost of financing the Cortez Pipeline includes dealer costs for the commercial paper program, bank costs for the backup line of credit, and rating agency expenses. The administrative cost of financing is exclusive of any interest expense incurred from financing.

The Cortez Pipeline is a partnership between Mobil, Shell, and Cortez Vickers. The initial pipeline investment was largely financed from outside sources. In addition, ongoing investment has been and is largely financed from outside sources. Therefore, the administrative cost of financing is an integral part of the capital structure of Cortez Pipeline.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

MMS-VSD-OG:91-0548a
Mail Stop 3922

SLK 2/3/93
2/3/93
LBarnick 2/5/93

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

FEB - 8 1993

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated October 1, 1991, Mobil Exploration & Producing U.S. Inc. (Mobil) requested approval of an allowance amount to exceed 50 percent of the value of carbon dioxide (CO_2) transported from McElmo Dome, located in Dolores and Montezuma Counties, Colorado, to a sales point in Yoakum County, Texas, for the period March 1, 1988, through December 31, 1991.

The Minerals Management Service (MMS) requested additional information by letter dated July 15, 1992, including sales values for CO_2 during the time periods requested (March 1, 1988, through December 31, 1991), and Mobil's calculations showing how Mobil arrived at an allowance in excess of the 50-percent limitation. The requested information was provided by Mobil's letter dated October 22, 1992.

The MMS has reviewed the documentation provided by Mobil, and several items need further calculations and/or explanations, as follows:

- Sales value column and totals for the period March 1, 1988, through December 31, 1988 and Calendar Year (CY) 1989.
- Calculations showing how Mobil arrived at a transportation allowance in excess of the 50-percent limitation and the specific percentage for each reporting period.
- An explanation for how exploration and producing costs relate to transportation overhead expenses for the MPTM and Slaughter Pipelines.
- Identify the elements that comprise the Administrative Costs of Financing reported as "overhead costs" for the Cortez Pipeline for the reporting periods May 1, 1990, through December 31, 1990, and CY 1991, and explain how these costs relate to the transportation system.

Title 30 CFR § 206.157 (b)(2)(iii) (1992) states, "Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses." (Emphasis added).

It is MMS' policy to retain projects requiring additional documentation for 30 days. After the 30-day period, the project file is closed if the requested information has not been received, in this office. Please submit the requested information within 30 days from the date of this letter to:

Minerals Management Service
Attention: Deborah Gibbs Tschudy
Chief, Valuation and Standards Division
P.O. Box 25165, Mail Stop 3922
Denver, Colorado 80225

Please refer to Project No. MMS-VSD-OG:91-0548a when submitting the requested information. If there are any questions, please call Ms. Keller at (303) 275-7217.

Sincerely,

O/S by:

Mr. Martin C. Grieshaber
Chief, Oil and Gas Valuation Branch
Valuation and Standard Division

bcc: RM File
RM Chron/Lkwd
VSD Chron
LMS:RM:VSD:OG:MS3922:SKELLER:2-1-93:275-7217:R:\USR\OANDG\92-0548A
final:llb:2-3-93

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1992 AUG 17 PM 1:16
ROYALTY VAL. & STDS. DIV.

UNITED STATES DEPARTMENT OF THE INTERIOR

MINERALS MANAGEMENT SERVICE

MMS 92-_____

In re MOBIL EXPLORATION & PRODUCING U.S. INC.	STATEMENT OF REASONS

Mobil Exploration & Producing U.S. Inc. ("Mobil") respectfully submits this Statement of Reasons in support of its appeal from that portion of the Minerals Management Service's ("MMS") May 28, 1992 Decision concluding that "the termination date of the [Cortez Pipeline] Tariff is April 30, 1990." See May 28, 1992 Decision, Exhibit 1, p. 2. For the reasons articulated below, Mobil may continue to claim a transportation allowance determined on the basis of the "Cortez Pipeline tariff calculation procedure" that MMS has duly approved, and the MMS' May 28, 1992 Decision must therefore be reversed. Id.

STATEMENT OF FACTS

Mobil, Shell Oil Company ("Shell") and Cortez Vickers, Inc. own the Cortez Pipeline, a 500-mile CO_2 pipeline that connects the McElmo Dome Unit in Colorado where CO_2 is produced with west Texas oil fields where CO_2 is used to enhance oil recovery. Rates for transporting CO_2 through the Cortez Pipeline are established by long-standing contract. See May 18, 1982 Cortez Pipeline Company Contract ("1982 Contract"), relevant

portions of which are appended as Exhibit 2. The 1982 Contract provides, inter alia, (i) that rates shall be determined by using the methodology approved by the Department of Justice in the 1941 Consent Decree in United States v. Atlantic Refining Co. and (ii) that in performing the necessary calculations under the 1941 Consent Decree methodology, a theoretical projected throughput of 1,000 MMCF per day shall be assumed for the first six years after operations commence. See 1982 Contract, Exhibit 2, ¶ 16. The purpose of using a temporary, theoretical throughput in performing the 1941 Consent Decree calculations was to encourage use of the pipeline by all potential transporters during the early years of pipeline operations.[1/]

With the 1982 Contract in hand, Shell, as operator, and Mobil, as one of the principal users, requested the MMS to authorize them to claim a transportation allowance determined on the basis of the tariff calculation procedure established by the 1982 Contract. MMS agreed, subject to backing out federal and state income taxes that would have been included under the 1941 Consent Decree methodology. See March 29, 1984 MMS letter to Shell ("The 'tariff calculation' procedure to arrive at a value deduction for transportation costs proposed by Shell is acceptable, with the exception that, for royalty purposes,

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1/ Without such protection, potential transporters would be discouraged from using the Cortez Pipeline because a substantial portion of the pipeline costs would be chargeable to them until a critical mass of transporters had agreed to participate.

Federal and State income tax are not to be considered in computing transportation costs.") (Emphasis added); July 1, 1987 MMS letter to Mobil ("the Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs proposed by Mobil is acceptable . . . .") (Emphasis added); May 28, 1992 Decision, Exhibit 1, p. 2. Shell and Mobil appealed from those decisions insofar as they refused to permit "consideration . . . of Federal and State income taxes in computing transportation costs," and the Interior Board of Land Appeals ("IBLA") reversed those portions of the MMS decisions as Shell and Mobil requested. See Shell Western E&P Inc., 112 IBLA 394 (1990); Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164 (1990). Accordingly, both Shell and Mobil were entitled to claim a transportation allowance determined on the basis of "the Cortez Pipeline tariff calculation procedure" that MMS had duly approved and that the IBLA had duly affirmed. See May 28, 1992 Decision, Exhibit 1, p. 2.

Not long thereafter, MMS began rendering decisions that would have the effect if affirmed of terminating the approved transportation allowance. With respect to Shell, MMS first contended that the allowance had terminated on March 1, 1988 because Shell had filed transportation allowance forms authorized by the MMS' 1988 royalty valuation regulations, 30 C.F.R. §§ 206.100-206.159 (1989), but MMS now asserts that the allowance terminated on April 30, 1990, the end of the six-year period pursuant to which the theoretical throughput of 1,000 MMCF was

used in performing the calculations required by the 1941 Consent Decree. See November 5, 1990 letter from MMS to Shell; February 2, 1992 MMS Report and Recommendations to Shell. With respect to Mobil, MMS claims that the transportation allowance it approved terminated on April 30, 1990, again the end of the six-year period during which the theoretical throughput was used in performing the 1941 Consent Decree calculations. Mobil and Shell appealed from those decisions.

ANALYSIS

I. THE TRANSPORTATION ALLOWANCE MMS APPROVED FOR THE CORTEZ PIPELINE REMAINS IN FULL FORCE AND EFFECT.

A. MMS Regulations Provide That Transportation Allowances In Existence On March 1, 1988 Continue In Effect Pursuant To Their Terms.

MMS regulations are plain and unambiguous:

> Non-arm's-length contract or no contract based transportation allowances which are in effect at the time these regulations become effective [March 1, 1988] will be allowed to continue until such allowance terminates.

30 C.F.R. § 206.157(c)(2)(v) (1991) (emphasis added). Under these regulations, MMS is compelled to recognize the Cortez Pipeline transportation allowance it approved before March 1, 1988 unless it can demonstrate that that allowance has terminated.

B. The Cortez Pipeline Allowance Has Not Terminated.

The record in this case clearly reflects that the Cortez Pipeline transportation allowance has not terminated.

First, the transportation allowance that MMS approved is clear and unequivocal -- Mobil was expressly authorized to use the "Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs." See May 28, 1992 Decision, Exhibit 1, p. 2. The transportation allowance that the MMS approved contained no termination date or conditions.

Second, the "Cortez Pipeline transportation calculation procedure" established by the 1982 Contract remains in full force and effect. Under that contract 1941 Consent Decree procedures continue to be used to determine transportation costs.

II. MMS EFFORTS TO FIND A SUPPORTABLE GROUND TO TERMINATE THE CORTEZ PIPELINE TRANSPORTATION ALLOWANCE ARE UNAVAILING.

In the face of this record, MMS' efforts to terminate the Cortez Pipeline transportation allowance are unavailing.

First, MMS has not demonstrated as required by its regulations that the Cortez Pipeline transportation allowance has terminated. As MMS admits in its May 28, 1992 Decision, Mobil was authorized to use the "Cortez Pipeline tariff calculation procedure to arrive at a value deduction for transportation costs." See May 28, 1992 Decision, Exhibit 1, p. 2. The "Cortez Pipeline transportation calculation procedure" is that established by the 1982 Contract that remains in effect; calculations are to be performed using 1941 Consent Decree procedures which for the first six years merely to assume a theoretical throughput of 1,000 MMCF per day. See 1982 Contract,

Exhibit 2, ¶ 16. The record in this case simply cannot convert approval of a transportation allowance calculated on the basis of the Cortez Pipeline tariff calculation procedure of unlimited duration into approval of a six-year transportation allowance in effect only so long as a theoretical throughput is utilized in performing 1941 Consent Decree calculations. Simply put, MMS approved use of the "Cortez Pipeline tariff calculation procedure," not a "six-year transportation allowance using 1941 Consent Decree procedures with a theoretical throughput of 1,000 MMCF per day."

Second, the interests of the federal government are protected by the transportation allowance that the MMS in fact approved. The 1941 Consent Decree methodology is reasonable, as reflected by the fact that both the Department of Justice and the MMS have repeatedly found it reliable in the past, and no showing is made as to why it is not considered reasonable now. See MMS' March 29, 1984, December 31, 1985, July 1, 1987, and October 24, 1990 Decisions with respect to the Cortez Pipeline. Moreover, the rationale that supported that long line of MMS decisions -- the administrative burden to both transporters and the MMS of calculating actual costs, the atypical nature of CO_2, and the fact that MMS authorizes others to claim a transportation allowance of an amount equal to the Cortez Pipeline

transportation calculation procedure[2/] -- are as applicable now as when the allowance was approved. In short, the interests of the federal government are not prejudiced by continued acceptance of the Cortez Pipeline transportation allowance that MMS duly approved and that the IBLA duly affirmed, but to permit the MMS' March 28, 1992 Decision to stand would fly in the face of the MMS' own regulations authorizing pre-March 1, 1988 transportation allowance to continue until they terminate.

CONCLUSION

For these reasons Mobil respectfully requests that the May 28, 1992 Decision be reversed and that an order be entered

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2/ The IBLA has already held that MMS efforts to preclude Mobil and Shell from using federal and state income tax payments when performing 1941 Consent Decree calculations but allowing third parties such benefits is discriminatory and unlawful. See Mobil, 115 IBLA at 178; Shell, 112 IBLA at 399. A fortiori, MMS efforts to preclude Mobil and Shell from an allowance calculated on the basis of the 1941 Consent Decree methodology but permitting others to do so is discriminatory and unlawful.

recognizing that the Cortez Pipeline transportation allowance remains in full force and effect.

Dated this 17th day of August, 1992.

Respectfully submitted,

MOBIL EXPLORATION & PRODUCING U.S. INC.

By _____

Robert A. Luettgen
3000 Diamond Park
P.O. Box 650232
Dallas, Texas 75265-0232
(214) 951-3350

DAVIS, GRAHAM & STUBBS

By _____

Charles L. Kaiser
Mark D. Bingham
Suite 4700
370 Seventeenth Street
P.O. Box 185
Denver, Colorado 80201-0185
(303) 892-9400

ATTORNEYS FOR MOBIL EXPLORATION & PRODUCING U.S. INC.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

PRIDE IN AMERICA

IN REPLY
REFER TO:

MMS-RVS-TP:91-0548
Mail Stop 3530

MAY 28 1992

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. Robert A. Luettgen
Counsel
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Luettgen:

By letter dated October 1, 1991, Mobil Exploration & Producing U.S. Inc. (Mobil) requested Minerals Management Service's (MMS) approval to use its Cortez Pipeline Tariff (Tariff) rate in lieu of computing actual costs for transporting production from Federal leases within the McElmo Dome Unit (McElmo Dome) (Enclosure 1) for the period January 1, 1989, through December 31, 1991. Mobil also requested approval of an allowance amount to exceed 50 percent of the value of carbon dioxide (CO_2) transported from McElmo Dome, located in Dolores and Montezuma Counties, Colorado, to a sales point in Yoakum County, Texas, for the period March 1, 1988, through December 31, 1991.

BACKGROUND

Shell Western E&P Inc. (SWEPI) is a working-interest owner and operator of McElmo Dome. Mobil is also a working-interest owner in the unit. The Cortez Pipeline Company, a general partnership of Shell Oil Company (Shell), Mobil Cortez Pipeline Company, and Cortez Vickers, Inc., owns the Cortez Pipeline. In its October 1 letter, Mobil stated its intention to use the Tariff rate as the transportation allowance for royalty purposes, although the Tariff has not been approved as such by any State or Federal jurisdictional authority. The MMS has approved Mobil's use of the Tariff rate for the periods Calendar Year 1984 through February 29, 1988.

Title 30 CFR § 206.157(c)(2)(v) (1991) states in part, "Non-arm's-length contract or no contract based transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate . . . ."

The "Carbon Dioxide Sale and Purchase Contract" (Contract) dated March 31, 1983, between Mobil Producing Texas & New Mexico ("Seller") and Shell ("Buyer"), Article II - Quantities, § 2.2 Transportation states, "The carbon dioxide sold hereunder shall be transported by Cortez Pipeline Company for the account of Seller. Seller's ability to deliver carbon dioxide hereunder shall

be at all times subject to the provisions of the Tariff in effect from time to time for the Cortez Line." Also, Article III - Prices and Taxes, § 3.1 Prices (b)(ii) states, "during the Initial Period and the first five Annual Periods, calculated on the assumption that the throughput in the Cortez Line is 1,000 Mcf per day and computed to achieve an annual return on valuation (as such valuation is determined by Cortez Pipeline Company from time to time) of 7%." Article I defines "Initial Period" as a period beginning on the date of initial delivery of CO_2 hereunder and ending on the first anniversary of such date. In addition, "Annual Period" means a period having a duration of 1 year beginning at the end of the initial period and on each subsequent anniversary thereof. Since the date of initial delivery of CO_2 occurred in April 1984, the initial period and first five annual periods cited in the Contract above constitute 6 contract years. The MMS considers the termination date of the Tariff as 6 years from the date of initial delivery of CO_2. Therefore, the Tariff calculation procedure would apply to the period April 15, 1984, through April 30, 1990.

By letter dated December 9, 1983, SWEPI requested that MMS approve a Tariff calculation procedure based upon the 1941 Pipeline Consent Decree methodology for the Cortez Pipeline. In its request, SWEPI stated that it ". . . has obligated itself by the CO_2 Sale and Purchase Contract to base such pipeline Tariff for the first 6 contract years on the assumption that the Cortez CO_2 pipeline throughput is 1,000,000 Mcf per day. . . ." By letter dated March 29, 1984, issued to SWEPI, MMS approved the Tariff calculation procedure for the Cortez Pipeline.

By decision dated July 1, 1987, issued to Mobil, MMS approved the Tariff calculation procedure for the Cortez Pipeline. The July 1 decision stated that the ". . . Cortez Pipeline' tariff calculation' procedure to arrive at a value deduction for transportation costs proposed by Mobil is acceptable. . . ." Since the effective date of the Tariff is April 15, 1984, and the Contract is 6 years, the termination date of the Tariff is April 30, 1990. Consistent with MMS' recent notification to SWEPI of the termination date, MMS hereby issues its notification to Mobil of the April 30, 1990, termination date.

Effective May 1, 1990, Mobil is required to compute its transportation allowance based on reasonable actual costs in accordance with the regulations at 30 CFR § 206.157(b) (1991).

In response to Mobil's request for approval of its allowance to exceed 50 percent of the value of CO_2 transported from McElmo Dome to west Texas, the following additional information is required before MMS can proceed with your request:

- Sales values for CO_2 during the periods requested (March 1, 1988, through December 31, 1991). This information is necessary in order to determine if the costs exceed 50 percent of the value of CO_2 sold and transported.

- Supplemental Schedules 1A or other explanation to identify the Other Costs reported on lines 8, 9, 14, and 15 of Schedules 1A for the MPTM Pipeline and the Slaughter Pipeline.

- The selling arrangement code reported on Form MMS-4295 should always be three (3) digits; not two (2), as shown.

- Mobil's calculations showing how you arrived at an allowance in excess of the 50-percent limitation.

It is our policy to retain projects requiring additional information for 60 days. After the 60-day period, the project file is closed if the requested information has not been received in this office. Please submit the requested information within 60 days from the date of this letter to:

Ms. Shirley Keller
Minerals Management Service
Royalty Valuation and Standards Division
P.O. Box 25165, Mail Stop 3530
Denver, Colorado 80225

If the information is not received within 60 days, your application for an exception will be returned unapproved.

If you are unable to meet the 60-day requirement, you must submit a request, with sufficient justification, to obtain an MMS-approved extension.

Please refer to Project No. 91-0548 when submitting the requested information.

You have the right to appeal this decision. Please refer to Enclosure 2 for the Royalty Adjustments and Appeals Procedure.

If you have any questions, please call Ms. Keller at (303) 231-3178.

Sincerely,

Milton K. Dial
Chief, Royalty Valuation and
Standards Division

2 Enclosures

as a common carrier pipeline. In addition to transporting CO_2 for SWEPI, the Cortez pipeline transports CO_2 for other non-pipeline owner producers of CO_2 from the Unit.

Although neither the Interstate Commerce Commission nor the Federal Energy Regulatory Commission elected to exercise jurisdiction over the transportation of CO_2 in interstate commerce, the Cortez Pipeline Company established a tariff pursuant to the methodology utilized by pipeline companies under the 1941 Consent Decree in the case of United States v. The Atlantic Refining Company, et al.

The Cortez pipeline tariff calculation procedure was approved by the Minerals Management Service ("MMS") letter dated March 29, 1984, as the appropriate procedure to calculate the transportation allowance deduction.[1]

By letter dated November 5, 1990, the MMS advised SWEPI that for the period April 15, 1984 through February 29, 1988, the Cortez pipeline tariff calculation procedure was acceptable for determining a transportation allowance deduction. However, the MMS contends that effective on March 1, 1988, the Cortez pipeline transportation allowance must be calculated pursuant to 30 C.F.R. § 206.157(b) (the lessee's reasonable actual costs of transportation.) SWEPI believes that the Cortez pipeline tariff calculation procedure should continue to be used to determine the applicable transportation allowance. This issue is currently on appeal to the MMS (MMS-92-0039-O&G).

APPLICABLE REGULATIONS

Section 206.156 of Title 30, Code of Federal Regulations, provides that MMS shall allow a deduction for the reasonable actual costs incurred by the lessee to transport unprocessed gas from a lease to a point off the lease. Except as provided in paragraph (c)(3) of Section 206.156, the transportation allowance deduction shall not exceed 50 percent of the value of the unprocessed gas. Paragraph (c)(3) of Section 206.156 provides, however, that upon request of a lessee, MMS may approve a transportation allowance deduction in excess of the 50 percent limitation when the lessee can demonstrate that the transportation costs incurred in excess of the 50 percent limitation were reasonable, actual, and necessary.

REASONS SUPPORTING REQUEST FOR EXCEPTION RELIEF

The Mineral Leasing Act requires the payment of royalty based on the amount or value of the production removed or sold from the lease. 30 U.S.C. § 226(b) and (c). In establishing the value of production from a federal lease for the purpose of computing the royalty under that lease, the Secretary shall give due consideration to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, and

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[1] Although the MMS excluded federal and state income taxes from the calculation of the transportation allowance, these costs were later approved by the Interior Board of Land Appeals, Shell Western E&P Inc., 112 IBLA 394, decided January 23, 1990.

to other relevant matters. One such relevant matter is the cost of transportation of lease production to market when there is no market at the point of production. A transportation allowance recognizes that the price received for a product at a distance from the point of production is not the value of the product at the point of production because the costs incurred in transporting the product have added value to it. Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, at 172, decided June 28, 1990. It has long been considered reasonable with respect to federal oil and gas leases to deduct a transportation allowance from the market value of the product at the nearest open market. This determines value at the wellhead where no market exists at the wellhead. Shell Oil Company, 70 I.D. 393 (1963) (barging costs were relevant matters to be considered in establishing royalty value at the wellhead where there is no bona fide established market where the leases are situated.)

The imposition of a limitation on transportation allowances to 50 percent of the value of the products has been determined to be a proper exercise of the Secretary's discretion to establish minimum royalty values. However, the Secretary also has the discretion to grant relief from the 50 percent limitation in those cases in which the lessee can demonstrate unusual circumstances which warrant such action. Chevron U.S.A. Inc., MMS-85-0082-O&G, issued August 28, 1986; Mobil Producing Texas and New Mexico, MMS-87-0194-O&G, October 30, 1987.

SWEPI believes that the circumstances pertaining to its sales of CO_2 from the Unit to markets in Texas, which are 500 miles distant, warrant a grant of relief from the 50 percent limitation on transportation allowance deductions. In our opinion, such relief is appropriate irrespective of whether the Cortez pipeline tariff calculation procedure is utilized to determine the transportation allowance deduction, or whether SWEPI's reasonable actual costs of transportation as determined by its Form MMS-4295 filing is utilized as the applicable transportation allowance deduction. Under either method of determining the transportation allowance deduction, the 50 percent limitation has the effect of increasing the value of the CO_2 for royalty purposes over and above the delivered price of the CO_2 less the actual cost of transportation from the point of production to the market. Thus, this request for exception relief is not dependent upon the outcome of SWEPI's appeal currently pending in MMS-92-0039-O&G.

TRANSPORTATION COSTS ARE REASONABLE

The MMS has previously determined that use of the Cortez pipeline tariff calculation procedure is an appropriate procedure for determining the transportation allowance for CO_2 produced from the McElmo Dome Unit in Colorado and sold in various markets in West Texas. The reason that such transportation allowance now exceeds the 50 percent limitation imposed by the Secretary is due to two factors: (1) the Cortez pipeline tariff rate has increased from the subsidized level of 39 cents per MCF established in 1984, in order to attract potential sales of CO_2 from the McElmo Dome Unit, to a current rate of 52.5 cents per MCF which is based on the tariff calculation procedure approved by the MMS and the expected actual throughput; and (2) the delivered price of CO_2 at the market place has decreased as a result of a surplus of CO_2 available to a shrinking market demand caused by lower crude oil prices. This combination of factors has caused the current Cortez pipeline tariff rate of 52.5 cents per MCF to exceed 50 percent of the

value of the CO_2 in the market place based on SWEPI's existing contract portfolio and delivery mix. The Cortez pipeline tariff rate, which is the actual cost to SWEPI of moving the CO_2 to the marketplace, is no less reasonable now that it exceeds 50 percent of the value of the delivered CO_2 than it was in 1984 when the procedure for calculating the tariff rate was approved by the MMS.

TRANSPORTATION COSTS ARE ACTUAL

The Cortez pipeline tariff rate is the actual cost paid by shippers of CO_2 for transporting CO_2 from the McElmo Dome Unit to the West Texas market. The Cortez pipeline is a common carrier and is the only CO_2 pipeline from the CO_2 source fields in southwestern Colorado to the available markets in West Texas. The Cortez pipeline tariff rate since 1984 has been as follows:

Year	Tariff ¢/MCF
1984	39
1985	39
1986	39
1987	39
1988	39
1989	39
1990	49.3
1991	52.5
1992	52.5

During the period 1988 through 1991, the actual costs of transportation as reported by SWEPI to the MMS on Form MMS-4295 were as follows:

Year	Form 4295 ¢/MCF
1988	65.7762
1989	57.2046
1990	51.2361
1991	

TRANSPORTATION COSTS ARE NECESSARY

The principal and most economically valuable use of CO_2 is in enhanced oil recovery projects. Unfortunately, there are very few enhanced oil recovery projects that can utilize CO_2 produced from the McElmo Dome Unit without transporting the CO_2 through the Cortez pipeline. EOR projects require the commitment of a long term supply of CO_2 before they can be initiated. Such projects are also highly dependant upon the price of crude oil. For these reasons, the value of and the demand for CO_2 has historically been tied to the price of crude oil. The CO_2 sales price is usually redetermined on a quarterly basis and is directly related to the prevailing crude oil

price for such period. Buyers have been unwilling to purchase CO_2 from the McElmo Dome Unit without limitations imposed on the amount they must pay for transportation. Otherwise, SWEPI would sell CO_2 for delivery at the McElmo Dome Unit. In order to increase sales of CO_2 from the McElmo Dome Unit, SWEPI has been willing to absorb some transportation cost risk (i.e., reimbursement of transportation costs being less than the Cortez tariff rate). This action by SWEPI has preserved market share in a competitive business that could otherwise have resulted in lower sales volumes from the McElmo Dome Unit and lower royalties to the MMS. As the price of crude oil declined during the period SWEPI has been producing and selling CO_2 from the Unit (1984-present), the delivered value of the CO_2 also declined to the point where the cost of transportation now exceeds 50 percent of the value of the CO_2 at the point of sale. In such situations, SWEPI has been required under the applicable federal regulations since March 1, 1988 to limit the transportation allowance deduction to 50 percent of the value of the CO_2 at the point of sale. Thus, SWEPI must pay royalty on an amount which includes not only the value of the CO_2 at the Unit, but a portion of the cost of transportation of the CO_2 to the market as well. This additional cost to SWEPI is unfair and, in a market where supply exceeds demand, will further erode the profitability of developing new CO_2 reserves for sale in the future. It is from this situation that SWEPI seeks exception relief.

MMS ROYALTY BASED ON OVERVALUED CO_2

Attachment I hereto sets forth the impact on SWEPI of the 50 percent limitation on transportation allowance deductions. For the period March 1, 1988 through January 31, 1992, SWEPI's calculations reveal that SWEPI has paid the MMS $1,447,493.73 more than it would have paid if SWEPI had been permitted to deduct the actual cost of transportation to get the McElmo Dome CO_2 to the marketplace.

Because the 50 percent limitation on the transportation allowance results in the MMS receiving royalty in excess of the value of the CO_2 at the McElmo Dome Unit, and because the Cortez pipeline tariff calculation procedure produces a reasonable, actual, and necessary transportation charge to move the CO_2 to the market where it has the greatest value, SWEPI respectfully requests the MMS to grant SWEPI an exception to the requirements of 30 CFR § 206.156(c)(1). SWEPI requests that the MMS permit it to use the actual costs of transporting CO_2 produced at the McElmo Dome Unit, including the applicable Cortez pipeline tariff rate and metering charges, as the transportation allowance to be deducted from the CO_2 delivered price in calculating the value of the McElmo Dome Unit CO_2 for payment of royalty to the MMS. SWEPI further requests that such exception relief be made retroactive to March 1, 1988.

The information and data contained in Attachment I hereto is privileged and confidential commercial and financial information from SWEPI's records which is provided to the MMS solely for its use in considering this Request for Exception Relief. The information and data in Attachment I hereto and the references in the text to information and data contained in Attachment I are exempt from disclosure to the public pursuant to the Freedom of Information Act (5 U.S.C. § 552(b)(4).) SWEPI is also submitting to the MMS a non-confidential copy of its Request for Exception Relief. SWEPI requests that it be notified and given an opportunity

to provide written comments in the event a request for SWEPI's Request for Exception Relief is made pursuant to the Freedom of Information Act.

We will be pleased to meet with you to discuss SWEPI's Request for Exception Relief in the event you have any questions.

Yours very truly,

William G. Riddoch

William G. Riddoch
Senior Counsel
On Behalf of Shell Western E&P Inc.
(713) 870-3625

WGR:NC

Attachments

ATTACHMENT I

MSDIFF

MCELMO DOME UNIT
IMPACT OF MMS TRANS ALLOWANCE
ON SWEPI ROYALTY PAYMENTS

PROD MONTH	WEIGHTED AV ROY PRICE W/TRANS ALLOWANCE	WEIGHTED AV ROY PRICE W/ACTUAL TRANS COSTS	ROYALTY PRICE DIFFERENCE @14.65	ROYALTY PRICE DIFFERENCE @14.73	GROSS UNIT VOLUME @14.73	ADDT'L ROYALTY VALUE	SWEPI FEDERAL ROY OBLIGATION*	ROYALTY OVERPAYMENT
3/88	0.3951684	0.3744804	0.0206880	0.0208010	15,200,817	$316,192.19	0.0390621	$12,351.13
4/88	0.3893690	0.3690065	0.0203625	0.0204737	14,666,168	$300,270.72	0.0390621	$11,729.20
5/88	0.3905028	0.3691508	0.0213520	0.0214686	15,005,982	$322,157.43	0.0390621	$12,584.15
6/88	0.3909135	0.3679191	0.0229944	0.0231200	14,718,158	$340,283.81	0.0390621	$13,292.20
7/88	0.3837208	0.3588391	0.0248817	0.0250176	15,053,015	$376,590.31	0.0390621	$14,710.41
8/88	0.3902932	0.3666500	0.0236432	0.0237723	15,915,375	$378,345.07	0.0390621	$14,778.95
9/88	0.3893729	0.3664573	0.0229156	0.0230407	15,221,000	$350,702.49	0.0390621	$13,699.18
10/88	0.3831932	0.3524718	0.0307214	0.0308892	15,512,334	$479,163.59	0.0390621	$18,717.14
11/88	0.3833546	0.3474310	0.0359236	0.0361198	13,654,461	$493,196.40	0.0390621	$19,265.29
12/88	0.3845484	0.3532322	0.0313162	0.0314872	15,478,654	$487,379.47	0.0390621	$19,038.07
TOTAL					150,425,964	$3,844,281.48		$150,165.72

PROD MONTH	WEIGHTED AV ROY PRICE W/TRANS ALLOWANCE	WEIGHTED AV ROY PRICE W/ACTUAL TRANS COSTS	ROYALTY PRICE DIFFERENCE @14.65	ROYALTY PRICE DIFFERENCE @14.73	GROSS UNIT VOLUME @14.73	ADDT'L ROYALTY VALUE	SWEPI FEDERAL ROY OBLIGATION*	ROYALTY OVERPAYMENT
1/89	0.3869663	0.3572341	0.0297322	0.0298946	16,234,645	$485,328.22	0.0390621	$18,957.94
2/89	0.3865611	0.3560738	0.0304873	0.0306538	14,609,054	$447,823.02	0.0390621	$17,492.91
3/89	0.3840632	0.3543033	0.0297599	0.0299224	16,610,268	$497,019.08	0.0390621	$19,414.61
4/89	0.4205056	0.3991551	0.0213505	0.0214671	15,341,427	$329,335.95	0.0390621	$12,864.55
5/89	0.4201139	0.3982700	0.0218439	0.0219632	16,498,363	$362,356.85	0.0390621	$14,154.42
6/89	0.4219899	0.3995509	0.0224390	0.0225615	15,957,756	$360,030.91	0.0390621	$14,063.56
7/89	0.4232107	0.4013955	0.0218152	0.0219343	16,860,211	$369,816.93	0.0390621	$14,445.83
8/89	0.4234880	0.4008069	0.0226811	0.0228050	16,918,468	$385,825.66	0.0390621	$15,071.16
9/89	0.4216822	0.3988029	0.0228793	0.0230042	16,462,666	$378,710.46	0.0390621	$14,793.23
10/89	0.4154910	0.3895001	0.0259909	0.0261328	17,514,871	$457,712.62	0.0390621	$17,879.22
11/89	0.4177141	0.3914972	0.0262169	0.0263601	17,364,734	$457,736.12	0.0390621	$17,880.13
12/89	0.4184185	0.3919770	0.0264415	0.0265859	17,140,092	$455,684.77	0.0390621	$17,800.00
TOTAL					197,512,555	$4,987,380.59		$194,817.56

* DOES NOT INCLUDE SWEPI'S CARRIED WORKING INTEREST ROYALTY BURDEN

ATTACHMENT I

MCELMO DOME UNIT
IMPACT OF MMS TRANS ALLOWANCE
ON SWEPI ROYALTY PAYMENTS

PROD MONTH	WEIGHTED AV ROY PRICE W/TRANS ALLOWANCE	WEIGHTED AV ROY PRICE W/ACTUAL TRANS COSTS	ROYALTY PRICE DIFFERENCE @14.65	ROYALTY PRICE DIFFERENCE @14.73	GROSS UNIT VOLUME @14.73	ADDT'L ROYALTY VALUE	SWEPI FEDERAL ROY OBLIGATION*	ROYALTY OVERPAYMENT
1/90	0.4402296	0.3984667	0.0417629	0.0419910	17,576,883	$738,070.89	0.0390621	$28,830.60
2/90	0.4411087	0.3647996	0.0763091	0.0767258	16,294,046	$1,250,173.71	0.0390621	$48,834.41
3/90	0.4409212	0.3632904	0.0776308	0.0780547	17,887,663	$1,396,216.17	0.0390621	$54,539.14
4/90	0.4306099	0.3462959	0.0843140	0.0847744	17,160,381	$1,454,761.00	0.0390621	$56,826.02
5/90	0.4436723	0.3737360	0.0699363	0.0703182	17,556,874	$1,234,567.78	0.0390621	$48,224.81
6/90	0.4457006	0.3758468	0.0698538	0.0702353	16,667,752	$1,170,664.56	0.0390621	$45,728.62
7/90	0.4301138	0.3459471	0.0841667	0.0846263	17,227,504	$1,457,899.92	0.0390621	$56,948.63
8/90	0.4366781	0.3566424	0.0800357	0.0804728	15,828,885	$1,273,794.70	0.0390621	$49,757.10
9/90	0.4323249	0.3482856	0.0840393	0.0844982	17,203,881	$1,453,696.98	0.0390621	$56,784.46
10/90	0.7158019	0.6969360	0.0188659	0.0189689	17,355,480	$329,214.36	0.0390621	$12,859.80
11/90	0.7563878	0.7390003	0.0173875	0.0174824	16,734,620	$292,561.32	0.0390621	$11,428.06
12/90	0.7591894	0.7424542	0.0167352	0.0168266	16,845,175	$283,447.02	0.0390621	$11,072.04
TOTAL					204,339,144	$12,335,068.41		$481,833.69

PROD MONTH	WEIGHTED AV ROY PRICE W/TRANS ALLOWANCE	WEIGHTED AV ROY PRICE W/ACTUAL TRANS COSTS	ROYALTY PRICE DIFFERENCE @14.65	ROYALTY PRICE DIFFERENCE @14.73	GROSS UNIT VOLUME @14.73	ADDT'L ROYALTY VALUE	SWEPI FEDERAL ROY OBLIGATION*	ROYALTY OVERPAYMENT
1/91					17,425,512			
2/91					15,511,705			
3/91					19,048,440			
4/91					18,521,270			
5/91					17,626,793			
6/91					15,308,072			
7/91					14,905,885			
8/91					15,467,899			
9/91					15,595,970			
10/91					17,524,628			
11/91					19,174,817			
12/91					20,362,700			
TOTAL					206,473,691			

X-4

X-4

* DOES NOT INCLUDE SWEPI'S CARRIED WORKING INTEREST ROYALTY BURDEN

ATTACHMENT I

MCELMO DOME UNIT
IMPACT OF MMS TRANS ALLOWANCE
ON SWEPI ROYALTY PAYMENTS

PROD MONTH	WEIGHTED AV ROY PRICE W/TRANS ALLOWANCE	WEIGHTED AV ROY PRICE W/ACTUAL TRANS COSTS	ROYALTY PRICE DIFFERENCE @14.65	ROYALTY PRICE DIFFERENCE @14.73	GROSS UNIT VOLUME @14.73	ADDT'L ROYALTY VALUE	SWEPI FEDERAL ROY OBLIGATION*	ROYALTY OVERPAYMENT
1/92		X-4			18,843,364		X-4	

GRAND TOTAL (03/01/88 - 01/31/92) X-4

* DOES NOT INCLUDE SWEPI'S CARRIED WORKING INTEREST ROYALTY BURDEN

Shell Oil Company

attach 42

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1992 MAR 30 AM 9:23
ROYALTY VAL. &
STDS. DIV.

March 24, 1992

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. David A. Schuenke, Chief
Division of Appeals
Minerals Management Service (Mail Stop 1300)
Parkway Atrium Building
381 Elden Street
Herndon, Virginia 22070-4817

SUBJECT: APPEAL OF SHELL WESTERN E&P INC.
DOCKET NO. MMS-92-0039-O&G
MC ELMO DOME UNIT
DOLORES AND MONTEZUMA COUNTIES, COLORADO

Dear Mr. Schuenke:

Shell Oil Company, on behalf of its subsidiary Shell Western E&P Inc., (collectively referred to herein as "Shell"), hereby timely files its response to the February 7, 1992 report and recommendations from the Chief, Royalty Valuation and Standards Division ("RVSD"), Minerals Management Service, pertaining to the appeal filed by Shell on December 10, 1990, requesting that Shell be permitted to continue the use of the Cortez tariff calculation procedure as the method for calculating a transportation allowance for sales of CO_2 from the McElmo Dome Unit beyond March 1, 1988.

The recommendation of the RVSD is that the Cortez pipeline tariff calculation procedure for the transportation allowance terminated on April 30, 1990, and effective May 1, 1990, Shell should be required to calculate the transportation allowance in accordance with the regulations at 30 CFR § 206.157(b).

Shell disagrees with the recommendation submitted by the RVSD. Shell submits that there was no termination date placed on the approval of the Cortez pipeline tariff calculation procedure by the RVSD, and that under the applicable regulations (30 CFR § 206.157(c)(2)(v)) the tariff calculation procedure for determining the transportation allowance should continue in effect.

In its letter dated December 9, 1983 (Attachment I), Shell requested that it not be required to pay royalty to the MMS on the CO_2 pipeline tariff. At that time, no tariff had been calculated

although Shell advised the RVSD that the procedure for calculating such tariff was to be on the basis of the 1941 Pipeline Consent Decree methodology.

RVSD acknowledges that its March 29, 1984 approval of the tariff calculation procedure did not specifically address the effective and termination dates for the transportation allowance. However, RVSD now contends that the "intent" of the March 29 decision was to approve the tariff calculation procedure for only the first six contract years. Such "intent" is presumably based on Shell's contractual commitment to limit the Cortez pipeline tariff rate for the first six years.

In order to meet competition and to obtain sales of CO_2 from the McElmo Dome Unit, Shell obligated itself to its customers under the CO_2 Sale and Purchase Contract to base the pipeline tariff rate for the first six contract years on the assumption that the pipeline throughput was 1,000,000 MCF per day. Based on such throughput, which was at that time about three times what the actual throughput was, a tariff rate of 39 cents per MCF was established. This subsidized rate had a six year contractual limitation on it, but there was nothing in Shell's request to the RVSD or in its CO_2 sales contracts that placed a six year limit on the use of the 1941 Pipeline Consent Decree as a tariff calculation procedure.

In its letter dated March 29, 1984 (Attachment II), the RVSD gave its approval to the tariff calculation procedure submitted by Shell, not to a transportation allowance of 39 cents per MCF. The RVSD's March 29, 1984 letter provides in pertinent part as follows:

> The "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by Shell is acceptable....

The RVSD clearly approved the tariff calculation procedure for determining the applicable transportation allowance for purposes of computing royalty owed to the MMS on the CO_2 produced and sold from the McElmo Dome Unit. No limitation on such approval was stated, nor do we believe there was an "intent" by the RVSD to place a limitation on such approval.

As conceded by the RVSD in its report at page 3, MMS approval to use the tariff calculation procedure for the transportation allowance was in effect on March 1, 1988. That tariff calculation procedure is still utilized today in determining the applicable transportation allowance for CO_2 shipped through the Cortez pipeline. Until such tariff calculation procedure is abandoned by the owners of the Cortez pipeline, Shell is entitled, pursuant to the applicable regulations, to continue to use the transportation allowance determined by such tariff calculation procedure as a deduction, subject to the 50 percent limitation rule, in calculating the value of CO_2 at the McElmo Dome Unit for MMS royalty purposes.

Shell agrees with the finding of the RVSD that the filing of Form MMS-4295 was not an election by Shell to terminate the RVSD's March 29, 1984 approval of the tariff calculation procedure.

We appreciate this opportunity to respond to the report and recommendations of the RVSD in this matter. If we can be of further assistance, please advise.

Yours very truly,

William G. Riddoch

William G. Riddoch
Senior Counsel
On behalf of Shell Western E&P Inc.

WGR:NC

Attachments

cc w/o att.: Mr. Milton K. Dial, Chief
Royalty Valuation and Standards Division,
Minerals Management Service
P. O. Box 25165
Denver, Colorado 80225

attach 41

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

MMS-RVS-TP:90-0755
Mail Stop 3530

FEB 19 1992

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated December 4, 1990, Mobil Exploration & Producing U.S. Inc. (Mobil), requested approval of an allowance for transporting carbon dioxide (CO_2) production from the McElmo Dome Unit, located in Dolores and Montezuma Counties, Colorado, to a sales point in Yoakum County, Texas, for the period January 1, 1987, through February 29, 1988. Mobil also requested that the allowance amount exceed 50 percent of the value of the CO_2 for the Accounting Identification (AID) numbers shown on the enclosure.

The Minerals Management Service (MMS) has reviewed the information submitted with Mobil's initial request and the supplemental documentation submitted on October 9, 1991, and determined that the actual transportation costs ranged from 50.3710 (.503710) percent to 61.7381 (.617381) percent of the value of the CO_2 during the period requested. Therefore, Mobil's request to exceed the 50 percent limitation for the period January 1, 1987, through February 29, 1988, is hereby granted for the CO_2 transported from the McElmo Dome Unit to west Texas. The allowance that may be deducted is the actual cost for each specific month during the period requested.

Mobil should make adjustments to its royalty payments on Form MMS-2014, Report of Sales and Royalty Remittance, no later than 90 days from receipt of this letter. The adjustments should be made on your regular monthly reports prior to expiration of this 90-day period and should not comprise a separate report consisting of adjustments only. You may refer to the MMS Oil and Gas Payor Handbook for instructions on reporting adjustments.

If you have any questions, please call Ms. Shirley Keller at (303) 231-3178.

Sincerely,

Thomas J. Blair
Acting Chief, Transportation
and Processing Branch
Royalty Valuation and
Standards Division

Enclosure

bcc: RM File:90-0755
RM Chron/Lakewood
RVS Chron

LMS:RMP:RVSD/TP:MS3530:KELLER:231-3178:1/21/92:ala:TPV:90-0755

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

A.I.D. NUMBER	LEASE NAME	TRACT %	MMS DECIMAL INTEREST
0-005-047930-A-002	TRACT 3-3	0.039490	0.1250000
0-005-047930-A-003	TRACT 3-4	0.078970	0.1250000
0-005-085533-0-002	TRACT 3-5B	0.039490	0.1250000
0-005-085533-0-003	TRACT 3-5A	0.078970	0.1250000
0-005-103715-A-002	TRACT 3-105	0.039490	0.1250000
0-005-120610-b-001	TRACT 3-8	0.039490	0.1250000
0-005-123274-0-002	TRACT 3-106	0.039490	0.1250000
0-005-127321-A-001	TRACT 3-9	0.039490	0.1250000
0-069-000373-A-002	TRACT 4-2	0.078970	0.1250000
0-069-000373-A-003	TRACT 4-1	0.236910	0.1250000
0-069-002653-0-002	TRACT 5-24	0.276400	0.1250000
0-069-002654-A-001	TRACT 2-2	0.157940	0.1250000
0-069-002654-0-001	TRACT 1-4	0.177690	0.1250000
0-069-002751-0-001	TRACT 1-5	0.078970	0.1250000
0-069-003119-0-001	TRACT 2-3	0.517230	0.1250000
0-069-004020-0-001	TRACT 2-4	0.330280	0.1250000
0-069-004042-0-001	TRACT 4-3	0.047630	0.1250000
0-069-004342-0-001	TRACT 4-4	0.138200	0.1250000
0-069-004342-0-002	TRACT 4-5	0.315890	0.1250000
0-069-004408-A-001	TRACT 5-1	0.078870	0.1250000
0-069-004690-0-001	TRACT 2-5	0.078970	0.1250000
0-069-004696-0-001	TRACT 4-7	0.157940	0.1250000
0-069-008343-0-001	TRACT 2-6	0.009550	0.1250000
0-069-009418-0-001	TRACT 4-8	0.078970	0.1250000
0-069-009419-0-001	TRACT 3-13	0.059230	0.1250000
0-069-009975-0-001	TRACT 6-1	0.236910	0.1250000
0-069-009976-A-001	TRACT 4-9	0.047600	0.1250000
0-069-009976-B-001	TRACT 4-10	0.433070	0.1250000
0-069-009980-0-001	TRACT 6-54	0.612030	0.1250000
0-069-009984-A-001	TRACT 5-3	0.274430	0.1250000
0-069-009985-0-001	TRACT 1-6	0.281430	0.1250000
0-069-009986-A-001	TRACT 2-9	0.671260	0.1250000
0-069-009986-0-001	TRACT 2-8	0.197430	0.1250000
0-069-009987-B-001	TRACT 2-12	0.315890	0.1250000
0-069-009987-0-001	TRACT 2-10	0.157940	0.1250000
0-069-009987-0-002	TRACT 2-11	0.157940	0.1250000
0-069-010105-0-001	TRACT 2-14	0.023050	0.1250000
0-069-010110-0-001	TRACT 4-11	0.315890	0.1250000
0-069-010364-A-001	TRACT 4-13	0.157940	0.1250000
0-069-010364-A-002	TRACT 4-14	0.157940	0.1250000
0-069-010364-0-002	TRACT 5-4	0.335250	0.1250000
0-069-010366-0-001	TRACT 6-2	0.631770	0.1250000
0-069-010367-0-001	TRACT 6-3	0.139900	0.1250000
0-069-010368-0-001	TRACT 4-15	0.182790	0.1250000
0-069-010592-0-001	TRACT 6-4	0.790760	0.1250000

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

A.I.D. NUMBER	LEASE NAME	TRACT %	MMS DECIMAL INTEREST
0-069-010593-0-001	TRACT 6-5	0.078970	0.1250000
0-069-010594-0-001	TRACT 6-6	0.138200	0.1250000
0-069-010792-0-001	TRACT 1-7	0.039490	0.1250000
0-069-010925-0-001	TRACT 3-20	0.040340	0.1250000
0-069-011145-0-001	TRACT 4-16	0.158030	0.1250000
0-069-011283-0-001	TRACT 2-15	0.009220	0.1250000
0-069-011511-0-001	TRACT 5-5	0.552330	0.1250000
0-069-011644-A-001	TRACT 5-7	0.315890	0.1250000
0-069-011645-A-001	TRACT 5-9	0.315890	0.1250000
0-069-011646-A-001	TRACT 2-17	0.276400	0.1250000
0-069-011647-0-001	TRACT 4-50	0.648400	0.1250000
0-069-011647-0-002	TRACT 5-10	0.343840	0.1250000
0-069-011651-0-001	TRACT 6-7	0.355370	0.1250000
0-069-011652-0-001	TRACT 6-8	0.315890	0.1250000
0-069-011653-A-001	TRACT 4-18	0.157940	0.1250000
0-069-011653-B-001	TRACT 4-19	0.315890	0.1250000
0-069-011654-A-001	TRACT 4-21	0.078970	0.1250000
0-069-011654-B-001	TRACT 4-22	0.019740	0.1250000
0-069-011654-0-001	TRACT 4-20	0.368040	0.1250000
0-069-011655-A-001	TRACT 4-23	0.084610	0.1250000
0-069-011655-B-001	TRACT 3-22	0.016580	0.1250000
0-069-011656-0-001	TRACT 6-12	0.214680	0.1250000
0-069-011657-0-001	TRACT 4-24	0.118460	0.1250000
0-069-011658-0-001	TRACT 3-23	0.179570	0.1250000
0-069-011659-0-001	TRACT 1-8	0.276400	0.1250000
0-069-011660-0-001	TRACT 1-9	0.315890	0.1250000
0-069-011662-0-001	TRACT 3-25	0.304010	0.1250000
0-069-012034-0-001	TRACT 6-14	0.828670	0.1250000
0-069-012035-0-001	TRACT 6-15	0.316520	0.1250000
0-069-012037-A-001	TRACT 5-12	0.157940	0.1250000
0-069-012039-A-001	TRACT 1-10	0.213370	0.1250000
0-069-012045-0-001	TRACT 6-16	1.073540	0.1250000
0-069-012047-0-001	TRACT 6-17	0.569720	0.1250000
0-069-012049-0-001	TRACT 4-27	0.121640	0.1250000
0-069-012050-0-001	TRACT 3-27	0.167900	0.1250000
0-069-012052-0-001	TRACT 6-55	0.930910	0.1250000
0-069-012062-A-001	TRACT 5-15	0.039490	0.1250000
0-069-012177-0-001	TRACT 5-16	0.522350	0.1250000
0-069-012463-0-001	TRACT 1-11A	0.540380	0.1250000
0-069-012463-0-002	TRACT 1-11B	0.078970	0.1250000
0-069-012463-0-003	TRACT 1-11C	0.086920	0.1250000
0-069-012465-0-001	TRACT 4-28	0.315890	0.1250000
0-069-012605-0-001	TRACT 6-18	0.197430	0.1250000
0-069-012606-0-001	TRACT 6-19	0.296140	0.1250000
0-069-012607-0-001	TRACT 6-20	0.953690	0.1250000

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

A.I.D. NUMBER	LEASE NAME	TRACT %	MMS DECIMAL INTEREST
0-069-013895-0-001	TRACT 3-28	0.039490	0.1250000
0-069-014234-0-001	TRACT 4-30	0.177420	0.1250000
0-069-014235-0-001	TRACT 4-31	0.324170	0.1250000
0-069-014236-0-001	TRACT 3-29	0.081510	0.1250000
0-069-014884-0-001	TRACT 4-32	0.078970	0.1250000
0-069-014885-0-001	TRACT 1-12	0.059230	0.1250000
0-069-015809-0-001	TRACT 6-56	0.205760	0.1250000
0-069-017117-0-001	TRACT 4-33	0.001790	0.1250000
0-069-017617-0-003	TRACT 3-96A	0.078970	0.1250000
0-069-017617-0-004	TRACT 3-96B	0.083680	0.1250000
0-069-017620-A-001	TRACT 3-32	0.157940	0.1250000
0-069-017620-0-001	TRACT 4-34	0.157940	0.1250000
0-069-019348-0-001	TRACT 1-13	0.039490	0.1250000
0-069-019354-0-001	TRACT 4-36	0.315890	0.1250000
0-069-019356-0-001	TRACT 4-38	0.079180	0.1250000
0-069-019664-0-001	TRACT 3-34	0.042030	0.1666667
0-069-019665-0-001	TRACT 3-35	0.078970	0.1666667
0-069-019666-0-001	TRACT 3-36	0.118460	0.1666667
0-069-019738-0-001	TRACT 6-24	0.239820	0.1250000
0-069-020432-A-001	TRACT 2-21	0.009430	0.1250000
0-069-020432-0-001	TRACT 3-37	0.039490	0.1250000
0-069-021139-0-001	TRACT 1-15	0.157940	0.1250000
0-069-021443-0-001	TRACT 3-39	0.081580	0.1250000
0-069-022369-0-001	TRACT 4-40	0.085310	0.1250000
0-069-022370-0-001	TRACT 3-40	0.157940	0.1250000
0-069-022371-0-001	TRACT 4-41	0.008130	0.1250000
0-069-022490-0-001	TRACT 6-26	0.750870	0.1250000
0-069-022712-0-001	TRACT 3-42	0.400580	0.1250000
0-069-022756-0-001	TRACT 1-19	0.137670	0.1250000
0-069-023822-0-001	TRACT 4-43	0.335630	0.1250000
0-069-024213-0-001	TRACT 3-45	0.868680	0.1250000
0-069-024217-0-001	TRACT 4-45	0.473950	0.1250000
0-069-024971-0-001	TRACT 4-46	0.215710	0.1250000
0-069-024972-0-001	TRACT 3-46	0.126310	0.1250000
0-069-024973-0-001	TRACT 3-47	0.078970	0.1250000
0-069-025336-0-001	TRACT 4-47	0.157940	0.1250000
0-069-025338-A-001	TRACT 3-48A	0.019740	0.1250000
0-069-025553-0-001	TRACT 1-16	0.207250	0.1250000
0-069-025554-0-001	TRACT 3-49	0.157940	0.1250000
0-069-026072-0-001	TRACT 2-1	0.217170	0.1250000
0-069-026073-0-001	TRACT 3-53	0.083050	0.1250000
0-069-026074-0-001	TRACT 2-7	0.552800	0.1250000
0-069-026075-0-001	TRACT 3-54	0.047650	0.1250000
0-069-026075-0-002	TRACT 3-55	0.019740	0.1250000
0-069-026076-0-001	TRACT 3-56	0.165070	0.1250000

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

A.I.D. NUMBER	LEASE NAME	TRACT %	MMS DECIMAL INTEREST
0-069-026076-0-002	TRACT 3-57	0.189990	0.1250000
0-069-026077-0-001	TRACT 3-58	0.115800	0.1250000
0-069-026078-0-001	TRACT 2-18	0.449860	0.1250000
0-069-026079-0-001	TRACT 3-59	0.312750	0.1250000
0-069-026080-0-001	TRACT 2-20	0.177690	0.1250000
0-069-026082-0-001	TRACT 3-61	0.396140	0.1250000
0-069-026083-0-001	TRACT 4-48	0.001200	0.1250000
0-069-026084-0-001	TRACT 1-3	0.078970	0.1250000
0-069-026372-0-001	TRACT 5-31	0.019740	0.1250000
0-069-026375-0-001	TRACT 3-18	0.059600	0.1250000
0-069-026376-0-001	TRACT 5-25	0.236910	0.1250000
0-069-026377-0-001	TRACT 3-38	0.343260	0.1250000
0-069-026482-0-001	TRACT 3-62	0.275100	0.1250000
0-069-026490-0-001	TRACT 6-29	0.552800	0.1250000
0-069-026504-0-001	TRACT 3-67	0.281200	0.1250000
0-069-026514-0-001	TRACT 4-49	0.184850	0.1250000
0-069-026967-0-002	TRACT 3-100A	0.081030	0.1250000
0-069-026967-0-003	TRACT 3-100B	0.039490	0.1250000
0-069-026972-0-001	TRACT 4-51	0.299300	0.1250000
0-069-026973-0-001	TRACT 4-52	0.238460	0.1250000
0-069-026974-0-001	TRACT 3-101	0.039490	0.1250000
0-069-026975-0-001	TRACT 4-53	0.404950	0.1250000
0-069-026976-0-001	TRACT 4-54	0.078970	0.1250000
0-069-026977-0-001	TRACT 4-55	0.283310	0.1250000
0-069-027175-0-001	TRACT 4-56	0.006270	0.1250000
0-069-027188-0-001	TRACT 6-10	0.155130	0.1250000
0-069-027189-0-001	TRACT 6-13	0.731220	0.1250000
0-069-027293-A-001	TRACT 4-67	0.019740	0.1250000
0-069-027343-0-001	TRACT 5-32	0.019740	0.1250000
0-069-027343-0-002	TRACT 5-33	0.059230	0.1250000
0-069-027344-0-001	TRACT 5-34	0.118280	0.1250000
0-069-027345-0-001	TRACT 5-35	0.019740	0.1250000
0-069-027358-0-001	TRACT 6-46	0.039490	0.1250000
0-069-027359-0-001	TRACT 6-47	0.394860	0.1250000
0-069-027360-0-001	TRACT 6-48	0.555140	0.1250000
0-069-027361-0-001	TRACT 6-49	0.789710	0.1250000
0-069-027362-0-001	TRACT 6-50	0.552800	0.1250000
0-069-027364-0-001	TRACT 6-51	0.078970	0.1250000
0-069-027365-0-001	TRACT 6-52	0.078970	0.1250000
0-069-027369-0-001	TRACT 6-53	0.158450	0.1250000
0-069-030166-0-001	TRACT 2-84	0.059230	0.1250000
0-069-030167-0-001	TRACT 2-77	0.019740	0.1250000
0-069-033296-0-001	TRACT 2-79	0.018830	0.1666667
0-069-033296-0-002	TRACT 2-83	0.226690	0.1666667
0-069-033297-0-001	TRACT 2-80	0.039490	0.1666667

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

A.I.D. NUMBER	LEASE NAME	TRACT %	MMS DECIMAL INTEREST
0-069-033297-0-002	TRACT 2-81	0.039490	0.1666667
0-069-033298-0-001	TRACT 2-78B	0.315890	0.1666667
0-069-033299-0-001	TRACT 2-78A	0.295810	0.1666667
0-069-033300-0-001	TRACT 4-61A	0.135390	0.1666667
0-069-033301-0-001	TRACT 4-60	0.157940	0.1666667
0-069-033301-0-002	TRACT 4-61B	0.157940	0.1666667
0-069-033302-0-001	TRACT 4-59B	0.131030	0.1666667
0-069-033303-0-001	TRACT 4-59A	0.184570	0.1666667
0-069-033304-0-001	TRACT 3-64	0.078970	0.1666667
0-069-033304-0-002	TRACT 3-65	0.054420	0.1666667
0-069-033304-0-003	TRACT 3-66	0.090600	0.1666667
0-069-033306-0-001	TRACT 3-108B	0.039490	0.1666667
0-069-033306-0-002	TRACT 3-109B	0.112830	0.1666667
0-069-033307-0-001	TRACT 3-108A	0.059230	0.1666667
0-069-033307-0-002	TRACT 3-109A	0.078970	0.1666667
0-069-033307-0-003	TRACT 3-110C	0.138200	0.1666667
0-069-033308-0-001	TRACT 3-107	0.078970	0.1666667
0-069-033308-0-002	TRACT 3-110B	0.177690	0.1666667
0-069-033309-0-001	TRACT 3-110A	0.098710	0.1666667
0-069-033310-0-001	TRACT 3-63	0.039490	0.1666667
0-069-035914-0-001	TRACT 2-85	0.019740	0.1666667
0-069-035915-0-001	TRACT 2-82	0.098710	0.1666667
0-069-035915-0-002	TRACT 2-86	0.177690	0.1666667
0-069-035916-0-001	TRACT 3-111	0.078970	0.1666667
0-069-035916-0-002	TRACT 3-112	0.039490	0.1666667
0-069-037436-0-001	TRACT 4-61C	0.019740	0.1666667
0-069-037437-0-001	TRACT 4-62	0.039490	0.1666667
0-069-037438-0-001	TRACT 4-63	0.078970	0.1666667
0-069-037439-0-001	TRACT 6-31	0.015790	0.1666667
0-069-037440-0-001	TRACT 6-59	0.133960	0.1666667
0-077-058420-0-001	TRACT 3-1	0.126860	0.1250000
0-077-060887-0-002	TRACT 3-2	0.084040	0.1250000

Mobil Exploration & Producing U.S. Inc.

MINERALS MANAGEMENT SERVICE
ROYALTY VAL. & STDS. DIV.
OCT 10 1991
RECEIVED
DENVER, COLORADO

P.O. BOX 650232
DALLAS, TEXAS 75265-0232

October 9, 1991

Ms. Shirley Keller
Minerals Management Service
Royalty Valuation and Standard Division
P. O. Box 25165, Mail Stop 3530
Denver, CO 80225-0165

In reply to: MMS-RVS-TP:90-0755

1.25 Transportation Allowance
McElmo Dome CO2
January 1987 - February 1988

Dear Ms. Keller:

Per your request, attached is documentation depicting the value of CO2 sold during January 1987 through February 1988.

Attachment A reflects quarterly pricing sheets for the period January 1987 through February 1988 for the H. O. Mahoney and Denver Unit II in-kind supply contracts and for the Denver Unit II Exchange contract.

Attachment B exhibits pricing and other pertinent information from the Mahoney and Denver II in-kind supply contracts. The Denver Unit II exchange contract pricing is per the in-kind supply contract.

Your specific request indicated "that sales invoices or other third party documentation showing the value of CO2 sold ..." during the period would be required before the MMS can proceed with Mobil's request. Sales pertaining to the contracts mentioned above are the only ones in question regarding the 50 percent limitation issue. These sales are intracompany and therefore the pricing information may be referenced only from the contracts.

Please contact Beverly Ward at (214)951-4004 should you have questions regarding this matter.

Very truly yours,

R. R. Bates

R. R. Bates, Manager
Royalty Compliance

BBWard
Attachments

Attachment A

October 7, 1991

M E M O R A N D U M

TO: Beverly Ward

FROM: Forrest D. Dermid

RE: Quarterly Prices for 50% Limitation Rule

Per our October 7, 1991 phone conversation, below are the quarterly laydown price/MCF for the period January through June 1987.

January - March 1987		
Denver Unit II Exchange	C-4338	.7698000
H.O. Mahoney		.6280660
Denver Unit II In-Kind	C-4362	.7698000
April - June 1987		
Denver Unit II Exchange	C-4338	.7698000
H.O. Mahoney		.6562621
Denver Unit II In-Kind	C-4362	.7698000

Mobil Exploration & Producing U.S. Inc.

attach 39

October 1, 1991

PHONE (214) 951-3350
FACSIMILE (214) 951-2029

Mr. Stanley J. Brown
Minerals Management Service
Chief, Transportation and
Processing Valuation Branch
Royalty Valuation and Standards Division
Royalty Management Program
P. O. Box 25165, Mail Stop 3530
Denver, Colorado 80225

Transportation Allowance for
Federal Oil and Gas Leases
Within the McElmo Dome Unit

Dear Mr. Dial:

Mobil Exploration & Producing U.S. Inc. on behalf of itself and its affiliated companies (collectively "Mobil") submits to the Minerals Management Service ("MMS") amended forms 4295 for the periods January through December 1989, January through December 1990 and January through December 1991. The amended forms reflect Mobil's intention to use the Cortez Pipeline Tariff ("Tariff") as the transportation allowance for royalty purposes applicable to production from the federal leases ("Leases") within the McElmo Dome Unit ("Unit").[1]

Mobil respectfully requests that the MMS approve Mobil's use of the Tariff as the proper transportation allowance on the Leases for these and for future periods, including appro-

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1 There are 212 A.I.D. numbers for the Leases within the Unit on which Mobil pays royalties. A complete list is attached as Exhibit A.

val to exceed the fifty percent limitation on transportation allowances where necessary. The MMS has approved Mobil's use of the Tariff for past periods.[2]

STATEMENT OF FACTS

Mobil produces large quantities of carbon dioxide (CO_2) from Leases within the Unit located in Dolores and Montezuma Counties, Colorado. Because the primary market for CO_2 is in West Texas & Eastern New Mexico, Mobil, Shell Oil Company (the Unit Operator) ("Shell"), and others formed the Cortez Pipeline Company, which built a 500-mile pipeline ("Pipeline")[3] to transport CO_2 from Colorado to West Texas to enhance oil recovery

The Pipeline was completed in 1983 and first sales of CO_2 began in April 1984. The Pipeline is a common carrier pipe-

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2 The MMS has approved Mobil's use of the Tariff for the 1984 through 1986 periods. Mobil's application for a transportation allowance based upon the Tariff for the January 1987 through February 1988 period is still pending before the MMS. The MMS' initial approval of the Tariff for the 1986 period excluded costs pertaining to federal and state income taxes which are a component of the Tariff. That decision was overturned by the Interior Board of Land Appeals in 1990. See Shell Western E&P Inc., 112 IBLA 394, 400 (January 23, 1990) ("Shell"); Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, 178 (June 28, 1990)("Mobil"). By letter dated October 24, 1990, the MMS approved Mobil's use of the full Tariff for 1986, including instances where the Tariff exceeded the fifty percent transportation allowance limitation. See MMS October 24, 1990 Letter, attached as Exhibit B.

3 The Cortez Pipeline Company is presently owned fifty percent by Shell, thirty-seven percent by Mobil, and thirteen percent the Vickers Group. The Vickers Group is a non-shipping party that does not own leasehold CO_2 transported through the Pipeline.

line[4] and neither the Interstate Commerce Commission nor the Federal Energy Regulatory Commission ("FERC") assumed jurisdiction over the transportation of the CO_2. In addition to Mobil's and Shell's production, the Pipeline transports CO_2 produced by third parties such as Chevron U.S.A. Inc. ("Chevron") which do not own an interest in the Pipeline. Notwithstanding the refusal by the agencies to exercise jurisdiction over the Pipeline, Cortez Pipeline Company elected to publish a tariff that is consistent with the tariff methodology historically used by pipeline companies under the 1941 Consent Decree in the case of United States v. Atlantic Refining Co. See United States v. Atlantic Refining Co., attached as Exhibit C.

As set out in the May 18, 1982 Partnership Agreement for the Cortez Pipeline Company ("Agreement"), calculation of the Tariff conforms to the 1941 Consent Decree permitting no more than a seven percent return on investment to the Pipeline owners.

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4 CO_2 pipeline rights-of-way for transporting CO_2 from federal oil and gas leases are governed by Section 28 of the Mineral Leasing Act, 30 U.S.C. § 185 (1988). See Exxon Corp. v. Lujan, 730 F. Supp. 1535 (D. Wyo. 1990), appeal filed, No. 90-8036 (10th. Cir. argued May 9, 1991). Such pipelines are statutorily required to operate as common carriers. Id. As a common carrier, the Pipeline is required (i) to nondiscriminatorily permit third parties to ship CO_2 up to available capacities; (ii) to treat all shippers alike, an (iii) to not charge excessive rates. See generally Reed, The New Carbon Dioxide Pipelines: Revival of the Common Carrier at Common law, 12 Okla. City. U. L. Rev. 103 (1987).

See Agreement, appended as Exhibit D, pp. 34-35.[5] Because transportation costs for the CO_2 are very high the Agreement provides that for the first six years of operation, while Shell and Mobil production volumes increased and third-party shippers were sought, a ceiling would be placed on the Tariff. Consequently, during the start-up phase of the Pipeline from 1983-1989, the Tariff was calculated on a minimum projected throughput of 1,000 MCF/day instead of actual throughput which was substantially lower. Under the terms of the Agreement, this artificially induced ceiling on the Tariff amount terminated after 1989 and actual throughput volumes must be used.[6] The Tariff rate of approximately $.39/MCF in place for the years 1983-1989 substantially increased in 1990 when actual throughput volumes were substituted for the 1,000 MCF/day limit because actual throughput volumes were much lower (543 MCF/day in 1990 and a projected 550 MCF/day in 1991). Though the Pipeline is used by third-party

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5 The Consent Decree is discussed in Hearings, Antitrust Subcommittee of the House Committee on the Judiciary, 85th. Cong., 1st Sess., Part 1. See United States v. Atlantic Refining Co., 360 U.S. 19, 20 n. 1, 79 S. Ct. 944, 945 n. 1 (1959)(upholding the propriety of the companies' interpretation of the Consent Decree).

6 Although Mobil and Shell sought to extend use of the minimum projected throughput of 1,000 MCF/day to subsequent years, the agreement provides that changes to the Tariff rate-making methodology must be approved by unanimous vote of the Pipeline owners. See Agreement, pp. 11-12. To date, Mobil and Shell have been unable to obtain such unanimous consent required for such change.

shippers of CO_2 such as Chevron, it does not yet transport sufficient CO_2 to near capacity volumes. As a result, the Tariff rate was $.493/MCF for 1990 and $.525/MCF for 1991.

REQUEST

In 1988 the MMS promulgated new regulations which amended the Department of the Interior's ("Department") gas valuation procedures for royalty purposes, including transportation allowances. Unprocessed gas transported non-arm's-length by the lessee/producer is subject to the provisions of 30 C.F.R. §§ 206.152 and 206.157, which require that the transportation allowance be based upon the producer's "reasonable actual costs." See 30 C.F.R. § 206.157(b). Producers possessing a FERC or state-approved pipeline tariff may use that tariff in lieu of calculating actual costs. See 30 C.F.R. § 206.157(b)(5) (1990). Because the Tariff is subject to a regulated method in an essentially equivalent manner as traditionally regulated pipelines, Mobil requests that the MMS exercise its discretionary authority under 30 C.F.R. §§ 206.152 and 206.157 (1990) and approve Mobil's use of the Tariff for Unit production from January 1989 to the present, and in future years, for the following reasons:

1. The MMS has approved Mobil's use of the Tariff for past periods. The MMS has reviewed, documented, and approved Mobil's use of the Tariff for past periods as proper. See, e.g., MMS

October 24, 1990 Letter, Exhibit B. The MMS determined that the Tariff represents Mobil's reasonable actual costs for transporting CO_2. Id.[7] The facts and circumstances surrounding transportation of Mobil's CO_2 for 1989 through 1991 and subsequent periods remain the same. The Tariff represents Mobil's reasonable actual costs for those periods. As the MMS is well aware, the administrative burdens for Mobil to calculate a transportation allowance based upon actual costs, and for the MMS to review and approve those calculations, are great. The MMS has acknowledged that computing actual, reasonable costs where a previously approved allowance exists is "unnecessarily burdensome and duplicative." See 53 Fed. Reg. 1230, 1261 (January 15, 1988).

2. Sufficient safeguards exist in the Tariff rate methodology to protect the interests of the MMS. The Agreement requires that the Pipeline tariff rate be determined by using the methodology historically used by pipeline companies which are parties to the 1941 Consent Decree. See United States v. Atlantic Refinery Co., Exhibit C. The 1941 Consent Decree utilizes a tariff rate setting methodology that entitles pipeline owners to no more than a seven percent return on investment.

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7 The MMS has likewise approved Shell's use of the Tariff as an acceptable transportation allowance for the period April 15, 1984 through February 29, 1988. See MMS November 5, 1990 Letter to Shell. Shell is currently appealing from those portions of the letter that deny Shell the right to continue using the full Tariff for subsequent periods. See MMS 90-0662-O&G.

These safeguards are identical to those for regulated pipelines and prevent costs from exceeding "fair and reasonable" rates. See Agreement, Exhibit D, pp. 34-35.

Calculation of the Tariff is in effect arm's-length because only unanimous vote of the Cortez Pipeline Company owners can amend rate setting criteria and the Vickers Group does not own or ship CO_2 through the Pipeline. Id. Since Mobil cannot rescind or alter the Agreement's terms unilaterally, there is no "potential for abuse resulting from expense manipulation" in this instance. See Shell, 112 IBLA at 400. Moreover, because the Pipeline's capacity exceeds Mobil and Shell's total production, it requires third-party gas to meet volume throughput requirements. Third parties such as Chevron, are charged the exact same transportation tariff as Mobil and Shell. Raising Tariff rates above the 1941 Consent Decree limits is not only inconsistent with the methodology underlying the Agreement, it would be unsound economically since to do so would deter third parties from using the Pipeline.

3. Mobil's use of the Tariff is consistent with the current regulations. The preamble to the Department's recently promulgated regulations states that the transportation allowance regulations being adopted "are consistent with past practices" and "policy" of the Department. See 53 Fed. Reg. 1230, 1257 (January 15, 1988). The regulations provide that previously-approved transportation allowances will continue in effect after

implementation of the new regulations. See 30 C.F.R. § 206.150(c)(v) (1990). Approval of Mobil's use of the Tariff for 1989 through 1991 and future periods is consistent with these provisions.

As MMS is fully aware, CO_2 transportation is unusual and unique. See MMS October 24, 1990 Letter, Exhibit B, p. 7. The preamble acknowledges that these unusual circumstances may exist and states that the current regulations are "sufficiently flexible to apply to different types of gas transportation arrangements that may arise." See 53 Fed. Reg. at 1258. In order to accommodate the atypical nature of CO_2 the MMS must construe Departmental regulations, including the exception from calculating actual costs, consistent with these facts and circumstances. See, e.g., Exxon Corp., 118 IBLA 221, 256 (1991). This requires the MMS to exercise its discretion to determine transportation allowance values by a "creative approach, rather than resort to an ill-fitting model." Id. See also California Co. v. Seaton, 187 F. Supp. 445, 449 n.1 (D.C. Cir. 1960). While the very nature of CO_2 removes it from the jurisdiction of certain regulatory agencies, in practice the Tariff rate methodology accomplishes the same purpose and contains the same safeguards present in FERC or state-approved tariffs. See Exxon, 118 IBLA at 240-241. Consequently, there is every reason to flexibly apply the exception from calculating reasonable actual costs in this instance.

4. To deny Mobil's use of the Tariff while permitting its use by third parties unlawfully discriminates against Mobil. Third-party transporters such as Chevron are permitted to use the Tariff for transportation allowance purposes. See 30 C.F.R. § 206.157(a) (1990). It is undisputed that the Tariff likewise represents Mobil's reasonable actual costs of transporting CO_2. To deny Mobil's use of the Tariff solely on the basis that it is affiliated with a Pipeline owner is unlawful. See Shell at 399; Mobil at 178. Moreover, the Interior Board of Land Appeals expressly held that it was arbitrary and capricious for the MMS to permit third parties to deduct federal and state taxes included within the Tariff while prohibiting Mobil from doing likewise. Id. That holding effectively limits the provisions of the current regulation prohibiting deduction of federal and state taxes when calculating actual costs for non-arm's-length transportation allowances. See 30 C.F.R. § 206.157(b)(2)(iii) (1990). It would be incongruous for the MMS to allow third parties to use the Tariff as a transportation allowance while prohibiting Mobil from doing the same. See Shell at 399; Mobil at 178.

5. MMS approval of the Tariff in excess of the fifty percent limitation is appropriate in this instance. The regulations provide that transportation allowances may exceed fifty percent of the gas value upon approval of the MMS. See 30 C.F.R. § 206.156(c)(3) (1990). That approval will be granted upon the producers' demonstration that the transportation costs are

"reasonable, actual and necessary." Id. The Tariff satisfies that standard. Exploration and production of CO_2 is a development that became commercially feasible only within the past decade. Markets for large volumes of CO_2 are rare and so far have only been found great distances from CO_2 production fields. Transportation costs for the Unit are very high because no useable pipeline existed nearby and the Pipeline had to be constructed and financed in order to market Unit gas. The Cortez Pipeline Company expended approximately —— X-4 —— dollars building the Pipeline between the Unit in Southwestern Colorado and the Denver Unit in West Texas. When approving Mobil's past use of the Tariff, MMS agreed that the "unusual circumstances, including the high transportation costs to transport CO_2 from the McElmo Dome Unit to West Texas, warranted relief from the fifty percent limitation." See MMS October 24, 1990 Letter, Exhibit B, p. 7. The MMS determined that Mobil's costs were demonstrably reasonable, actual, and necessary. Id. These facts remain true for the 1989 and subsequent periods as well.[8]

For these reasons, Mobil requests that its continued use of the Tariff for 1989 and subsequent periods be approved by the MMS, as well as accepting the attached amended filings. Mobil

---

8 Approval to exceed the 50% threshold is requested for the period March, 1988 through December, 1988 as well, since Mobil has previously filed for use of the full Cortez tariff during that period.

DAVIS, GRAHAM & STUBB
ATTORNEYS AT LAW

WASHINGTON D.C. OFFICE
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1200 NINETEENTH STREET, N.W.
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60 EAST SOUTH TEMPLE
SALT LAKE CITY, UTAH 84111-1006
TELEPHONE 801-328-6000

June 26, 1992

Via Hand Delivery

Mr. Milton K. Dial
Chief, Royalty Valuation and
Standards Division
Minerals Management Service
Denver Federal Center
6th and Kipling Streets
Building 41, Room 288
Denver, Colorado 80225

ROYALTY VAL. & STDS. DIV.
1992 JUN 26 PM 2:39

Re: May 28, 1992 Demand Letter

Dear Mr. Dial:

Mobil Exploration & Producing U.S. Inc. ("Mobil") appeals pursuant to 30 C.F.R. § 290 (1991) from the May 28, 1992 Minerals Management Service Demand Letter regarding use of the Cortez Pipeline Tariff rate for determination of transportation allowances. The Demand Letter is attached as Exhibit 1.

Mobil also requests an extension of time through and including July 31, 1992 for filing a statement of reasons in support of its appeal.

Very truly yours,

Charles L. Kaiser
Mark D. Bingham
for
DAVIS, GRAHAM & STUBBS

/jz
Enclosure
cc: Robert A. Luettgen, Esq. - Mobil

Shell Oil Comp attach 43

March 31, 1992

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

CONFIDENTIAL: CONTAINS PROPRIETARY COMMERCIAL INFORMATION

Mr. John L. Price
Chief, Oil and Gas Valuation Branch
Royalty Valuation and Standards Division
Minerals Management Service
P. O. Box 25165, DFC
Denver, Colorado 80225-0165

RECEIVED
D.O.I. - MMS
1992 APR -6 PM 12:52
ROYALTY VAL. &
ROYALTY VAL. &
STD. DIV.

SUBJECT: REQUEST FOR EXCEPTION RELIEF
LIMITATION ON TRANSPORTATION ALLOWANCE DEDUCTION

Dear Mr. Price:

Shell Western E&P Inc. ("SWEPI") hereby submits its Request for Exception Relief from the requirements of 30 C.F.R. § 206.156(c)(1), which provides that the transportation allowance deduction shall not exceed 50 percent of the value of the unprocessed gas. This Request for Exception Relief is submitted pursuant to 30 C.F.R. § 206.156(c)(3).

FACTS

SWEPI is the Operator of the McElmo Dome (Leadville) Unit ("Unit") located in Dolores and Montezuma Counties, Colorado. The Unit contains about 203,234 acres, of which approximately 154,639 acres are federal lands, 2,440 acres are State lands, and 46,155 acres are fee lands. The Unit Agreement was approved by the U.S. Department of Interior, Bureau of Land Management on March 29, 1983, effective April 1, 1983.

Carbon dioxide ("CO_2") is produced as a unitized substance from the Unit and is transported by the Cortez Pipeline Company to various sales points in Texas where the CO_2 is used as an injectant in connection with enhanced oil recovery projects.

The Cortez Pipeline Company, a general partnership composed of Shell Cortez Pipeline Company (50 percent), Mobil Cortez Pipeline Company, (37 percent) and Cortez Vickers Pipeline Company (13 percent), owns the 500 mile, 30 inch CO_2 pipeline which transports the CO_2 from the Unit to Texas. The Cortez pipeline is operated by Shell Pipe Line Corporation

stands ready to provide any additional documentation the MMS may require and would be happy to meet with MMS representatives to discuss this matter further.

Very truly yours,

Robert A. Luettgen

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 3530

TAKE PRIDE IN AMERICA

IN REPLY
REFER TO:

MMS-RVS-TP:90-0755

AUG 16 1991

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. R. R. Bates
Manager, Royalty Accounting
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated December 4, 1990, Mobil Exploration & Producing U.S. Inc. (Mobil) requested an exception to the 50-percent limitation for transporting carbon dioxide (CO_2) production removed from the McElmo Dome Unit to the sales points remote from the leases for the period January 1, 1987, through February 29, 1988.

The Minerals Management Service (MMS) reviewed the information submitted with Mobil's request. The following information will be required before MMS can proceed with your request:

- Sales invoices or other third party documentation showing the value of CO_2 sold during the period requested to determine if the transportation costs exceed 50 percent of the value of CO_2 sold from the McElmo Dome Unit.

It is our policy to retain projects requiring additional information for 60 days. After this 60-day period, the project file is closed if the requested information has not been received in this office. Please submit the requested data within 60 days from the date of this letter to:

Ms. Shirley Keller
Minerals Management Service
Royalty Valuation and Standards Division
P.O. Box 25165, Mail Stop 3530
Denver, Colorado 80225-0165

If the information is not received within 60 days, your application for an exception to the 50-percent limitation for transporting CO_2 from McElmo Dome Unit will be returned unapproved.

If you are unable to meet the 60-day requirement, you must submit a request, with sufficient justification, to obtain an MMS-approved extension.

Please refer to Project No. 90-0755 when submitting the requested information. If there are any questions, please call Ms. Keller at (303) 231-3178.

Sincerely,

Stanley J. Brown
Chief, Transportation and
Processing Branch
Royalty Valuation and
Standards Division

attach 38

Shell Oil Company

December 10, 1990

DEC 11 1990

VIA EXPRESS DELIVERY

Mr. Milton K. Dial, Chief
Royalty Valuation and Standards Division
Minerals Management Service
P.O. Box 25165, MS 3500
Denver, CO 80225

Subject: Notice of Appeal
MMS-RVS-OG: 90-0662

Dear Mr. Dial:

Shell Oil Company, on behalf of its operating subsidiary Shell Western E&P Inc. ("SWEPI"), hereby timely files its Notice of Appeal, pursuant to 30 CFR Part 290 (1988), of the November 5, 1990 letter from the Minerals Management Service ("MMS"), which was received by SWEPI on November 12, 1990, pertaining to the transportation allowance for the sale of carbon dioxide gas ("CO_2") from the McElmo Dome Unit for the period commencing March 1, 1988.

Background

SWEPI is the Operator of a multi-company project engaged in the production of CO_2 from the McElmo Dome (Leadville) Unit source field located in Dolores and Montezuma Counties, Colorado. There is no market for the CO_2 in Colorado. However, CO_2 can be utilized in enhanced oil recovery projects in West Texas to recover oil that cannot be economically produced in any other manner. In order to transport the CO_2 from the source field in Southwestern Colorado to the oil fields of West Texas, a 500-mile pipeline was built by Cortez Pipeline Company ("Cortez"). Cortez is jointly owned by an affiliate of SWEPI and other companies and is operated as a common law, common carrier pipeline. The pipeline was completed in 1983 and first sales of CO_2 from the McElmo Dome Unit to the Denver Unit in West Texas began in April 1984.

In October 1983, SWEPI made a proposal to the MMS regarding royalty payments for CO_2 to be produced from federal leases in the McElmo Dome Unit that would permit SWEPI to deduct the total Cortez tariff as a transportation allowance.

By letter dated March 29, 1984, the MMS advised SWEPI that the Cortez tariff calculation procedure to arrive at a value deduction for transportation costs is acceptable, with the exception that, for royalty purposes, federal and state income tax are not to be considered in computing transportation costs. The MMS also advised that if and when its proposed rulemaking procedure with respect to transportation allowances becomes effective, SWEPI may request that such procedure be applied to the Cortez tariff.

On May 1, 1984, SWEPI appealed the decision of the MMS to exclude federal and state income taxes from the Cortez tariff calculation. By Decision dated August 6, 1986, the Director of the MMS affirmed the decision not to allow federal and state income taxes as elements of the transportation allowance. On September 9, 1986, SWEPI filed its Notice of Appeal to the Director's decision to the Interior Board of Land Appeals ("IBLA"). By Decision dated January 23, 1990, the IBLA set aside the decision of the MMS with respect to the exclusion of federal and state income taxes from the Cortez tariff calculation. (112 IBLA 394.) The IBLA held that MMS' denial of a transportation allowance for income taxes solely on the basis that SWEPI is an affiliate of the Cortez pipeline operator was improper.

Subsequently, by letter dated November 5, 1990, the MMS advised SWEPI that for the period April 15, 1984 through February 29, 1988, the Cortez tariff was acceptable as a transportation allowance. However, by such letter the MMS also stated that SWEPI, by filing Form MMS-4295, had elected to come under the federal royalty regulations pertaining to transportation allowances beginning March 1, 1988.

SWEPI's interpretation of the November 5, 1990 letter is that the MMS will not permit SWEPI to deduct the Cortez tariff as the applicable transportation allowance for the period commencing March 1, 1988. It is from such interpretation that SWEPI appeals.

Applicable Regulations

The transportation allowance procedures proposed by MMS became effective March 1, 1988. Section 206.156(a) of Title 30 of the Code of Federal Regulations provides that where the value of gas has been determined pursuant to Section 206.152 at a point off the lease, MMS shall allow a deduction for the reasonable actual costs incurred by the lessee to transport unprocessed gas to the sales point off the lease. The regulations further provide that, with respect to non-arm's length contract based transportation allowances, which are in effect on March 1, 1988, such allowances will be allowed to continue until such allowance terminates. 30 CFR § 206.157(c)(2)(v)(1988).

Argument

SWEPI believes that Section 206.157(c)(2)(v) is applicable to SWEPI's continued use of the Cortez tariff subsequent to March 1, 1988 as the

approved transportation allowance with respect to SWEPI's sales of CO_2 from the McElmo Dome Unit.

In its March 29, 1984 letter to SWEPI, the MMS stated the following:

> The "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by [SWEPI] is acceptable, with the exception that, for royalty purposes, Federal and State income tax are not to be considered in computing transportation costs. Accordingly, Federal and State income tax should be eliminated before transportation costs are computed.

The exception to the Cortez tariff approval imposed by the MMS, relating to federal and state income tax, has now been set aside by the January 23, 1990 decision of the IBLA, supra.

SWEPI submits that based on both the March 29, 1984 acceptance of the Cortez tariff procedure by the MMS, and the recent IBLA decision setting aside the MMS' only objections to the Cortez tariff, the Cortez tariff falls squarely within the parameters of Section 206.157(c)(2)(v) and should be approved by the MMS as the transportation allowance for SWEPI's sales of CO_2 from the McElmo Dome Unit.

The MMS' November 5, 1990 letter states that because SWEPI submitted Form MMS-4295, Gas Transportation Allowance Report, for the period March 1, 1988 through December 31, 1988, SWEPI elected to come under the new regulations that became effective March 1, 1988.

Effective with the new federal royalty regulations, lessees were required to submit to the MMS an initial Form MMS-4295 which would be effective for the remainder of the calendar year or until the transportation under the non-arm's length contract terminates, whichever is earlier. An exception to such reporting requirement was made for transportation allowances which were in effect at the time the regulations became effective, and which had been approved by the MMS in writing.

At the time SWEPI filed its Form MMS-4295 for the remainder of calendar year 1988, SWEPI had appealed the MMS' decision not to allow federal or state income taxes as part of the Cortez tariff calculation and no decision had yet been rendered by the IBLA with respect to such appeal. This was also the situation when SWEPI filed Form MMS-4295 for 1989.

Since the MMS had approved the Cortez tariff procedure except for the inclusion of federal and state income taxes, perhaps SWEPI should not have filed Form MMS-4295 for 1988 and 1989, but should have relied instead on the exception to such reporting requirement set forth in 206.157(c)(2)(v). However, SWEPI did file Form MMS-4295 on June 28, 1988 and on April 28, 1989 with the following caveat:

Notwithstanding the foregoing, to protect a producer's rights to challenge the validity of the recently promulgated royalty regulations, be advised that this filing of Form MMS-4295 does not constitute a basis for estoppel or waiver of a producer's position as to how royalty is to be calculated.

After the January 23, 1990 IBLA decision was issued, SWEPI met with representatives of the MMS on March 23, 1990 to discuss the impact of such decision on SWEPI's approved transportation allowance for CO_2 sold from the McElmo Dome Unit. The MMS advised that it had not determined whether to seek reconsideration of the IBLA decision, and that it may be required to calculate actual cost information from Cortez for the 1984-88 period. As a result of the inconclusive nature of such meeting, SWEPI again filed Form MMS-4295 for 1990 by letter dated June 28, 1990. Once again, SWEPI submitted its filing subject to the above caveat. It was not until receipt of the November 5, 1990 letter that SWEPI realized that MMS was not going to allow the Cortez tariff as the approved transportation allowance for the post March 1, 1988 period.

SWEPI submits that its intent in filing Form MMS-4295 was to comply with what it considered its reporting requirements to be for non-arm's length transportation contracts, but such filing was not meant to preclude SWEPI from using the MMS approved Cortez tariff as its transportation allowance once such tariff, with all of its components, was no longer subject to appeal. It would be clearly discriminatory to deny SWEPI the right to use the Cortez tariff as the approved transportation allowance while permitting federal lessees who are not Cortez owners to use the Cortez tariff as a transportation allowance.

Based on the foregoing, SWEPI respectfully requests the MMS to permit SWEPI to continue to use, subsequent to March 1, 1988, the Cortez tariff as its approved transportation allowance for sales of CO_2 from its McElmo Dome Unit.

Yours very truly,

William G. Riddoch

William G. Riddoch
Senior Counsel
On behalf of Shell Western E&P Inc.

WGR:MT/NC

Attach - 37

MOBIL EXPLORATION & PRODUCING U.S. INC.

P. O. Box 650232
Dallas, Texas 75265-0232

RECEIVED
DENVER, COLORADO

December 4, 1990

Mr. Milton K. Dial
Minerals Management Service
Royalty Management Program
P. O. Box 25165, Mail Stop 3520
Denver, Colorado 80225

1.25 TRANSPORTATION ALLOWANCE
MCELMO DOME CO2
JANUARY 1987 - FEBRUARY 1988

Dear Mr. Dial:

As of December 4, 1990, Mobil has not received approval for the attached transportation allowance for the period January 1987 through February 1988.

Since the transportation allowance exceeds the MMS' general 50 percent ceiling on transportation for some of the months and leases, Mobil requests that the Secretary grant relief from this limitation.

Mobil asserts circumstances warranting relief from the limitation do exist. CO2 markets are scarce, leading to higher transportation costs as sales point distances increase from the McElmo Dome Unit field. Large, expensive CO2 pipelines are a necessity to market reserves which otherwise would never be developed, and few companies other than CO2 producers are willing to invest in these lines. It is interesting to note that Exxon's La Barge project has, and may still be flaring, over 100 MMCFD of CO2 because its planned market cannot afford the tariff necessary to justify a pipeline into the Dakotas and Canada. Obviously, transportation costs are a large part of the CO2 laydown price.

Mobil requests that MMS acknowledge CO2 markets warrant an exception from the 50 percent ceiling on transportation allowances. In the alternative, Mobil requests relief from the limitation because of circumstances beyond Mobil's control which adversely impact Mobil's CO2 sales from the McElmo Dome Unit field.

If you have any questions, please contact J. G. Anderson at (214) 951-4004.

Very truly yours,

JGAnderson

for R. R. Bates
Manager, Royalty Compliance

JGAnderson
Attachment

cc: B. A. Phillips
Mobil Oil Corporation
P. O. Box 900
Dallas, TX 75221

R. A. Luettgen - 16

attach. 36

United States Department of the Inte

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

Mail Stop 3520

MMS-RVS-OG:90-0662

NOV 5 1990

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. William Riddock
Senior Counsel
Shell Western E&P Inc.
P.O. Box 576
Houston, Texas 77001

Dear Mr. Riddock:

The Interior Board of Land Appeals (IBLA) decision No. 87-47 dated January 23, 1990, set aside and remanded the portion of the Minerals Management Service (MMS) decision (MMS-84-0013-MISC) which disallowed State and Federal income taxes as elements of transportation costs in calculating royalties on carbon dioxide (CO_2) produced from the McElmo Dome Unit. The IBLA concluded that MMS ". . . unfairly discriminates against a CO_2 lessee in denying a deduction for that component of a pipeline tariff relating to State and Federal income taxes solely on the basis that such lessee is an affiliate of the pipeline operator."

As a result of IBLA decision No. 87-47, State and Federal income taxes will be included in the calculation procedure for the Cortez Pipeline transportation allowance. The MMS determined that the "Cortez Pipeline Company Letter Tariff," dated April 15, 1984, that charges Shell Western E&P Inc. (SWEPI) $0.39/Mcf to transport CO_2 to the delivery points in west Texas included State and Federal income taxes as a component in the 1941 Pipeline Consent Decree tariff calculation procedure. Therefore, the tariff of $0.39/Mcf, including State and Federal income taxes, is acceptable as a transportation allowance for the Cortez Pipeline from April 15, 1984 through February 29, 1988.

New transportation allowance regulations became effective March 1, 1988. Our records indicate that SWEPI submitted Form MMS-4295, "Gas Transportation Allowance Report," for the period March 1, 1988, through December 31, 1988. Because new allowance forms were submitted to MMS for the McElmo Dome Unit, SWEPI elected to come under the new regulations effective March 1, 1988.

You have the right to appeal MMS's decision in accordance with 30 CFR 290 (1990). The appeals procedure is outlined on the enclosed Appeals Procedure page. If you have any questions, please contact Ms. Theresa Walsh Bayani at (303) 231-3395.

Sincerely,

Milton K. Dial
Chief, Royalty Valuation and
Standards Division

Enclosure

cc: Division of Appeals
Parkway Atrium Building
381 Elden Street
Herndon, VA 22070-4817

Enclosure

Appeals Procedure

You have the right to appeal in accordance with the provisions of 30 CFR 290 (1990). Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed within 30 days from the date of receipt of this letter with:

Minerals Management Service
Attention: Mr. Milton K. Dial
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS 3500
Denver, Colorado 80225
Telephone: (303) 231-3184

You should be aware that compliance with the orders and directives contained in this letter shall not be suspended by reason of an appeal unless authorized in writing pursuant to 30 CFR § 243.2 (1990).

attach 35

Mail Stop 3520

MMS-RVS-OG:90-0029

OCT 24 1990

ENCLOSURE 1 CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC.

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated January 5, 1990, Mobil Exploration & Producing U.S. Inc. (Mobil) requested approval of a transportation allowance for carbon dioxide (CO_2) production removed from the McElmo Dome Unit during Calendar Year 1986 in an amount that exceeds 50 percent of the value of the CO_2.

The Minerals Management Service (MMS) reviewed the information submitted with your request and determined that the actual transportation costs exceed 50 percent of the value of the CO_2 for the 1986 period. Mobil's request to exceed 50 percent of the value of the CO_2 for the 1986 period is hereby approved for the CO_2 transported from the McElmo Dome Unit to west Texas. The allowance that may be deducted will be the sum of the approved 1986 transportation allowances for the pipeline segments to the delivery point but may not exceed 68 percent of the value of CO_2 transported from the McElmo Dome Unit to west Texas.

You have the right to appeal MMS's decision in accordance with 30 CFR 290 (1989). The appeals procedure is outlined on the enclosed Appeals Procedure page. If you have any questions, please contact Ms. Theresa Walsh Bayani at (303) 231-3395.

Sincerely,

Original signed by
Milton K. Dial

Milton K. Dial
Chief, Royalty Valuation and
Standards Division

2 Enclosures

Enclosure 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION

Findings and Conclusions

on

McElmo Dome CO_2
Transportation Allowance

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado. Mobil Producing Texas and New Mexico Inc. (MPTM) is a working interest owner in the McElmo Dome Unit.

By letter dated January 5, 1990, Mobil Exploration & Producing U.S. Inc. (Mobil) requested approval of a transportation allowance for the CO_2 produced from the McElmo Dome Unit during Calendar Year (CY) 1986 in excess of 50 percent of the value of the CO_2.

By letter dated March 2, 1990, the Minerals Management Service (MMS) requested that Mobil submit additional information regarding the actual cost data for the Cortez Pipeline. By letters dated April 17, April 19, and May 31, 1990, Mobil submitted the data and requested that MMS approve the "Cortez Pipeline Company Letter Tariff" that charges Mobil $0.39/Mcf to transport CO_2 to the delivery points in west Texas.

FINDINGS

- By letter dated December 9, 1983, Shell Western E&P Inc. (SWEPI) requested that MMS approve a tariff calculation procedure based upon the 1941 Pipeline Consent Decree methodology for the Cortez Pipeline. In the December 9 letter, SWEPI stated that it ". . . has obligated itself by the CO_2 Sale and Purchase Contract to base such pipeline tariff for the first six contract years on the assumption that the Cortez CO_2 pipeline throughput is 1,000,000 Mcf per day. . . ." The SWEPI also submitted to MMS an example of the tariff calculation procedure using numbers for illustrative purposes only.

- By decision dated March 29, 1984, issued to SWEPI, MMS approved a tariff calculation procedure for the Cortez Pipeline with the exception that for royalty purposes State and Federal income taxes are not to be considered in

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royalty purposes State and Federal income taxes are not to be considered in computing the transportation costs. In the March 29 decision, MMS also stated that "Documentation such as billings, invoices, or similar evidence which support claimed costs shall be maintained in your accounting office for future audit. . . ."

° By decision dated December 31, 1986, issued to MPTM, MMS also approved the tariff calculation procedure for the Cortez Pipeline. The December 31 decision stated that the ". . . Cortez Pipeline 'tariff calculation' procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable, with the exception that, for royalty purposes, State and Federal income taxes are not to be considered in computing transportation costs." The approved "tariff calculation" procedure allowed certain transportation charges assessed by Cortez Pipeline Company (Cortez) in accordance with a 1941 Pipeline Consent Decree. Cortez is a general partnership composed of SWEPI, Mobil, and Conoco Inc. The SWEPI and Mobil appealed the issue regarding the exclusion of income taxes.

° Mobil's appeal addressed the following additional issues in which it contends that MMS was in error in its December 31 decision: the rate of return on investment for the MPTM pipeline segment; the disallowance of compression expenses for the MPTM pipeline segment; and the transportation allowance ceiling limitation of 50 percent of the value of CO_2.

° The MMS Director's decision dated October 30, 1987, was issued in response to Mobil's appeal. The October 30 decision remanded the issue concerning the rate of return applicable to the transportation allowance to the Royalty Valuation and Standards Division (RVSD) for recalculation; however, the issue regarding the exclusion of income taxes was upheld. The October 30 decision was also rendered without prejudice to the right of Mobil to seek relief from the 50 percent ceiling on transportation allowances by submitting a request for such relief to RVSD.

° By memorandum dated January 26, 1988, RVSD requested that the Director reconsider the issue regarding the recalculation of the rate of return because RVSD believed it had correctly applied MMS policy when calculating Mobil's transportation allowance. It had always been MMS policy to use the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS. By memorandum dated May 5, 1988, the Director reconsidered the October 30 decision and approved MMS's historic practice of using the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS.

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- Mobil further appealed the Director's decision to the Interior Board of Land Appeals (IBLA). Mobil appealed the rate of return issue along with the other issues discussed above.

- In response to Mobil's appeal regarding the McElmo Dome Unit, IBLA decision No. 88-158 dated June 28, 1990, affirmed as modified in part, set aside and remanded in part to MMS the December 31, 1986, MMS decision issued to Mobil. The IBLA decision No. 88-158 concluded the following:

  (1) The MMS determination ". . . limiting operating expenses to 10 percent of the undepreciated capital investment is remanded to MMS for review of reasonableness of the costs reported by Mobil, and based on its review, a determination of the appropriate operating expenses to be included in calculating the transportation allowances."

  (2) Application of a rate of return based on the prime interest rate at the time of the initial period for which the transportation allowance is calculated will be upheld as reasonable.

  (3) During the period of stay granted by IBLA in Mobil's appeal, MMS reconsidered its decision regarding compression costs and concluded ". . . that the costs of compression may be allowed as a deduction when computing royalty value when those costs are shown to be related to the cost of transporting the CO_2 from the field to the nearest available market." Thus, IBLA's No. 88-158 decision set aside and remanded that portion of the decision regarding compression costs.

  (4) The IBLA No. 88-158 decision did not decide on the issue regarding the 50-percent transportation allowance limitation because Mobil could seek relief from the 50-percent limitation by submitting a request to RVSD. Thus, the IBLA No. 88-158 decision concluded that it would not decide the issue regarding the 50-percent limitation because ". . . it is not ripe for review."

  (5) The IBLA No. 88-158 decision set aside and remanded to MMS the issue regarding disallowing State and Federal income taxes as elements of transportation costs in calculating royalties on CO_2 transported by the Cortez Pipeline. The IBLA No. 88-158 decision concluded that in the related

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decision IBLA No. 87-47 regarding SWEPI's appeal of the issue regarding the exclusion of income taxes, "It is clear that the decision [IBLA No. 87-47] on appeal in that case was based on the same policy and rationale as in the present case." Thus, the IBLA No. 87-47 decision is controlling this case.

° In response to SWEPI's appeal regarding the issue of disallowing State and Federal income taxes as elements of transportation costs in calculating royalties on CO_2 transported by the Cortez Pipeline, IBLA decision No. 87-47 dated January 23, 1990, set aside and remanded to MMS an August 6, 1986, MMS decision issued to SWEPI. The IBLA decision No. 87-47 concluded that MMS ". . . unfairly discriminates against a CO_2 lessee in denying a deduction for that component of a pipeline tariff relating to state and Federal income taxes solely on the basis that such lessee is an affiliate of the pipeline operator."

The Cortez Pipeline

° The partners of Cortez elected to calculate the CO_2 pipeline tariff on the basis of the 1941 Pipeline Consent Decree methodology which provides, in essence, that the pipeline tariff is established to provide a 7 percent return to the owners. The "Cortez Pipeline Company Letter Tariff" charges Mobil $0.39/Mcf to transport CO_2 to the delivery points in west Texas.

° By letter dated May 31, 1990, Mobil provided MMS with a copy of the tariff calculation procedure used by the Cortez partners to determine the tariff of $0.39/Mcf. Based on this information, MMS determined that the tariff of $0.39/Mcf for the Cortez Pipeline included State and Federal income taxes as a component in the 1941 Pipeline Consent Decree tariff calculation procedure.

° The Cortez partners elected to use the 1941 Pipeline Consent Decree methodology and to calculate the tariff based on the capacity of the Cortez Pipeline (1,000,000 Mcf per day) rather than on the actual throughput. Based on the information contained in Mobil's May 31, 1990, submittal and various other documents submitted by SWEPI, MMS verified that the tariff calculation procedure for the Cortez Pipeline was based upon the capacity of 1,000,000 Mcf per day.

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- The MMS reviewed the actual cost data for each of the items approved by MMS for inclusion in the 1941 Pipeline Consent Decree tariff calculation procedure and determined that the tariff of $0.39/Mcf, including allowance for State and Federal income taxes, is acceptable as a 1986 transportation allowance for the Cortez Pipeline.

The MPTM Pipeline Segment

- By letter dated July 1, 1987, MMS approved 1986 transportation allowances for the MPTM pipeline segment. The actual costs for the MPTM pipeline segment submitted by Mobil at the time of approval did not specifically identify any costs as compression costs. However, in the July 1 decision, MMS disallowed compression costs in the computation of the 1986 transportation allowance for the MPTM pipeline segment.

- In follow-up discussions with Mobil and from documentation contained in the January 5, 1990, request, Mobil confirmed that the costs for the MPTM pipeline segment included compression that occurred along MPTM's Pipeline in order to get CO_2 into the higher pressured Sheep Mountain Pipeline.

- Compression costs to place the product in marketable condition have not been allowed as a deduction when calculating Federal royalty, but compression costs critical to transporting the production along the pipeline are allowable.

- Compression performed after initial delivery in the field that is critical to transporting CO_2 along the MPTM Pipeline is allowable in the computation of the transportation allowance. The cost of compressors located along the transportation route on the MPTM pipeline segment where the primary function is to keep production moving through the pipeline could clearly be construed as allowable transportation costs because the compression is at all points along the pipeline.

- Compression performed where the primary function is to get production from one pipeline into another pipeline (after initial delivery from the field) is also allowable in the computation of the transportation allowance because the compression is necessary to move the production into another pipeline leading to the sales point.

- All compression costs regarding the MPTM Pipeline are identified as transportation costs. Because all costs previously submitted by Mobil regarding the transportation allowance for the MPTM Pipeline were considered MMS-acceptable costs at the time of approval, it was not necessary to recalculate the 1986 transportation allowance for the MPTM pipeline segment.

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° At the time of initial approval of the MPTM pipeline segment, Mobil's operating costs, including overhead and ad valorem taxes, did not exceed 10 percent of the undepreciated capital investment at the beginning of the year for which the transportation allowance is computed. Therefore, in light of the IBLA decision No. 88-158, it was not necessary for MMS to recalculate the trasportation allowance for the MPTM pipeline segment for the 1986 period.

° The following 1986 transportation allowances approved in the July 1, 1987, decision are acceptable allowances for the MPTM pipeline segment: $0.084723/Mcf for CO_2 transported to the Denver City Station and $0.011480/Mcf for CO_2 transported to the Wellman and Mahoney units. (See Exhibit 1.)

Mobil's Proposal To Exceed the 50 Percent Limitation

° The Conservation Division Manual (CDM), U.S. Geological Survey, a procedural guide used by the predecessor to MMS, section 647.5.3E., states that under no circumstances should the transportation costs exceed 50 percent of the product's fair market value at the market competitive sales point.

° The imposition of a limitation on transportation allowances to 50 percent of the value of the products is a proper exercise of the Secretary of the Interior's discretion to establish minimum royalty value. The Secretary also has discretion to grant relief from the 50 percent limitation in those cases in which unusual circumstances warrant such action.

° Mobil's request for approval of a 1986 transportation allowance in excess of 50 percent of the value of CO_2 production included the following information: the leases to which the transportation allowances would apply, the actual cost data for the MPTM pipeline segment, the actual cost data for the Cortez Pipeline, and the circumstances warranting relief from the 50 percent limitation.

° Mobil asserts that CO_2 markets are scarce leading to higher transportation costs as the sales point distances increase from the McElmo Dome Unit. Mobil contends that large, expensive CO_2 pipelines are a necessity to market reserves which otherwise would never be developed. Mobil further states that few companies other than CO_2 producers are willing to invest in CO_2 pipelines.

° In the letter dated January 5, 1990, Mobil calculated the sum of the transportation allowances for the pipeline segments to each delivery point. Mobil determined that during CY 1986, the allowances exceeded the

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50 percent limitation for CO_2 transported to the following delivery points: Seminole San Andres Unit, Denver Unit, Dollarhide Unit, South Wasson Clearfork Unit, and Mahoney Unit. However, Mobil used the calculation procedure contained in the CDM rather than the MMS-approved tariff calculation procedure to calculate the transportation allowance for the Cortez Pipeline.

The MMS Analysis

° The MMS calculated the sum of the approved 1986 transportation allowances for the pipeline segments to each delivery point using the tariff of $0.39/Mcf for the Cortez Pipeline (including State and Federal income taxes) and the 1986 transportation allowances approved in the July 1, 1987, decision for the MPTM Pipeline, Sheep Mountain Pipeline, and West Texas Pipeline.

° The MMS determined that during CY 1986, the approved allowances exceed 50 percent of the value of the CO_2 transported to west Texas. Exhibits 2, 3, 4, and 5 provide a summary of the MMS-approved transportation allowances and the percentage of the sales value of the CO_2 at the sales point.

° The unusual circumstances including the high transportation costs to transport CO_2 from the McElmo Dome Unit to west Texas warrant relief from the 50 percent limitation.

CONCLUSIONS

The Cortez Pipeline

° As a result of IBLA decision No. 87-47, State and Federal income taxes will be included in the calculation procedure for the Cortez Pipeline transportation allowance for CY 1986. The MMS determined that the tariff of $0.39/Mcf charged to Mobil included State and Federal income taxes as a component in the 1941 Pipeline Consent Decree tariff calculation procedure. Therefore, Mobil's proposal to use the tariff of $0.39/Mcf as a transportation allowance is acceptable.

The MPTM Pipeline Segment

° Exhibit 1 details the costs allowed by MMS for the MPTM Pipeline. The 1986 transportation allowances for the MPTM Pipeline are $0.084723/Mcf for CO_2 transported to the Denver City Station and $0.011480/Mcf for CO_2 transported to the Wellman and Mahoney Units.

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MOBIL EXPLORATION & PRODUCING U.S. INC.

Transportation Allowance Limitation

° The MMS reviewed the documentation submitted with Mobil's request and determined that the maximum 1986 actual transportation costs were approximately 68 percent of the value of CO_2 transported to west Texas. Therefore, the actual transportation costs exceed the 50 percent limitation for CY 1986. Mobil's request to exceed the 50 percent limitation for the 1986 period is hereby granted for the CO_2 transported from the McElmo Dome Unit to west Texas. The allowance that may be deducted will be the sum of the approved 1986 transportation allowances for the pipeline segments to the delivery point but may not exceed 68 percent of the value of CO_2 transported from the McElmo Dome Unit to west Texas. (See Exhibits 3, 4, and 5.)

° Mobil should make adjustments to royalty payments on Form MMS-2014, Report of Sales and Royalty Remittance, no later than 90 days from receipt of this decision. The adjustments should be made in your regular monthly reports prior to expiration of this 90-day period and should not comprise a separate report consisting of adjustments only. You may refer to the MMS Oil and Gas Payor Handbook for instructions on reporting adjustments.

Enclosure 2

Appeals Procedure

You have the right to appeal in accordance with the provisions of 30 CFR 290 (1989). Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed within 30 days from the date of receipt of this letter with:

Minerals Management Service
Attention: Mr. Milton K. Dial
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS 3500
Denver, Colorado 80225
Telephone: (303) 231-3184

You should be aware that compliance with the orders and directives contained in this letter shall not be suspended by reason of an appeal unless authorized in writing pursuant to 30 CFR § 243.2 (1989).

attach. 34

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 3520

IN REPLY
REFER TO:

MMS-RVS-OG:89-1012

OCT 24 1990

ENCLOSURE 1 CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC.

CERTIFIED MAIL--
RETURN RECEIPT REQUESTED

Mr. R. R. Bates
Manager, Royalty Compliance
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Bates:

By letter dated December 21, 1989, Mobil Exploration & Producing U.S. Inc. (Mobil) requested approval of a transportation allowance for carbon dioxide (CO_2) production removed from the McElmo Dome Unit during Calendar Year 1985 in an amount that exceeds 50 percent of the value of the CO_2.

The Minerals Management Service (MMS) reviewed the information submitted with your request and determined that the actual transportation costs do not exceed 50 percent of the value of the CO_2 for the 1985 period. Therefore, Mobil's request to exceed the 50 percent limitation for the 1985 period is hereby denied.

Mobil also provided MMS with additional information regarding the operating costs for the Mobil Producing Texas and New Mexico Inc. (MPTM) pipeline segment and the Cortez Pipeline. The MMS recalculated the 1985 transportation allowances for the MPTM pipeline segment as outlined in Exhibit 1 of the enclosed "Findings and Conclusions."

By letter dated January 5, 1990, Mobil requested approval of a transportation allowance in excess of 50 percent of the value of the CO_2 production for the 1986 period. You will be provided a separate response addressing that request.

You have the right to appeal MMS's decision in accordance with 30 CFR 290 (1989). The appeals procedure is outlined on the enclosed Appeals Procedure page. If you have any questions, please contact Ms. Theresa Walsh Bayani at (303) 231-3395.

Sincerely,

Milton K. Dial
Chief, Royalty Valuation and
Standards Division

2 Enclosures

Enclosure 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION

Findings and Conclusions

on

McElmo Dome CO_2
Transporation Allowance

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado. Mobil Producing Texas and New Mexico Inc. (MPTM) is a working interest owner in the McElmo Dome Unit.

By letter dated December 21, 1989, Mobil Exploration & Producing U.S. Inc. (Mobil) requested approval of a transportation allowance for the CO_2 produced from the McElmo Dome Unit during Calendar Year (CY) 1985 in excess of 50 percent of the value of CO_2.

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FINDINGS

° By letter dated December 9, 1983, Shell Western E&P Inc. (SWEPI) requested that MMS approve a tariff calculation procedure based upon the 1941 Pipeline Consent Decree methodology for the Cortez Pipeline. In the December 9 letter, SWEPI stated that it ". . . has obligated itself by the CO_2 Sale and Purchase Contract to base such pipeline tariff for the first six contract years on the assumption that the Cortez CO_2 pipeline throughput is 1,000,000 Mcf per day. . . ." The SWEPI also submitted to MMS an example of the tariff calculation procedure using numbers for illustrative purposes only.

° By decision dated March 29, 1984, issued to SWEPI, MMS approved the tariff calculation procedure for the Cortez Pipeline with the exception that for

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royalty purposes State and Federal income taxes are not to be considered in computing the transportation costs. In the March 29 decision, MMS also stated that "Documentation such as billings, invoices, or similar evidence which support claimed costs shall be maintained in your accounting office for future audit. . . ."

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° Mobil's appeal addressed the following additional issues in which it contends that MMS was in error in its December 31 decision: the rate of return on investment for the MPTM pipeline segment; the disallowance of compression expenses for the MPTM pipeline segment; and the transportation allowance ceiling limitation of 50 percent of the value of CO_2.

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° By memorandum dated January 26, 1988, RVSD requested that the Director reconsider the issue regarding the recalculation of the rate of return because RVSD believed it had correctly applied MMS policy when calculating Mobil's transportation allowance. It had always been MMS policy to use the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS. By memorandum dated May 5, 1988, the Director reconsidered the October 30 decision and approved MMS's historic practice of using the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS.

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° Mobil further appealed the Director's decision to the Interior Board of Land Appeals (IBLA). Mobil appealed the rate of return issue along with the other issues discussed above.

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(1) The MMS determination ". . . limiting operating expenses to 10 percent of the undepreciated capital investment is remanded to MMS for review of reasonableness of the costs reported by Mobil, and based on its review, a determination of the appropriate operating expenses to be included in calculating the transportation allowances."

(2) Application of a rate of return based on the prime interest rate at the time of the initial period for which the transportation allowance is calculated will be upheld as reasonable.

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(4) The IBLA No. 88-158 decision did not decide on the issue regarding the 50-percent transportation allowance limitation because Mobil could seek relief from the 50-percent limitation by submitting a request to RVSD. Thus, the IBLA No. 88-158 decision concluded that it would not decide the issue regarding the 50-percent limitation because ". . . it is not ripe for review."

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The Cortez Pipeline

° The partners of Cortez elected to calculate the CO_2 pipeline tariff on the basis of the 1941 Pipeline Consent Decree methodology which provides, in essence, that the pipeline tariff is established to provide a 7 percent return to the owners. The "Cortez Pipeline Company Letter Tariff" charges Mobil $0.39/Mcf to transport CO_2 to the delivery points in west Texas.

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° The MMS reviewed the cost data for each of the items approved by MMS for inclusion in the 1941 Pipeline Consent Decree tariff calculation procedure and determined that the tariff of $0.39/Mcf, including allowance for State and Federal income taxes, is acceptable as a 1985 transportation allowance for the Cortez Pipeline.

The MPTM Pipeline Segment

° By letter dated October 31, 1986, MMS approved 1985 transportation allowances for the MPTM pipeline segment. The actual costs for the MPTM pipeline segment submitted by Mobil at the time of approval did not specifically identify any costs as compression costs. However, in the October 31 decision, MMS disallowed compression costs in the computation of the 1985 transportation allowance for the MPTM pipeline segment.

° In follow-up discussions with Mobil and from the documentation contained in the December 21, 1989, request, Mobil confirmed that the costs for the MPTM pipeline segment included compression that occurred along MPTM's Pipeline in order to get CO_2 into the higher pressured Sheep Mountain Pipeline.

° Compression costs to place the product in marketable condition have not been allowed as a deduction when calculating Federal royalty, but compression costs critical to transporting the production along the pipeline are allowable.

° Compression performed after initial delivery in the field that is critical to transporting CO_2 along the MPTM Pipeline is allowable in the computation of the transportation allowance. The cost of compressors located along the transportation route on the MPTM pipeline segment where the primary function is to keep production moving through the pipeline could clearly be construed as allowable transportation costs because the compression is at all points along the pipeline.

° Compression performed where the primary function is to get production from one pipeline into another pipeline (after initial delivery from the field) is also allowable in the computation of the transportation allowance because the compression is necessary to move the production into another pipeline leading to the sales point.

° By letter dated December 21, 1989, Mobil submitted a revised 1985 transportation allowance for the MPTM pipeline segment. At the time of initial approval, Mobil included ad valorem taxes that were not attributable to the MPTM pipeline segment for inclusion in the computation of the 1985 transportation allowance. Therefore, MMS excluded ad valorem taxes and recalculated the 1985 transportation allowance for the MPTM pipeline segment.

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° At the time of initjal approval of the MPTM pipeline segment, Mobil's operating costs, including overhead and ad valorem taxes, exceeded 10 percent of the undepreciated capital investment at the beginning of the year for which the transportation allowance is computed. Therefore, Mobil's operating costs were limited to 10 percent of the undepreciated investment. However, because Mobil had erroneously included ad valorem taxes for the 1985 period, the exclusion of the ad valorem taxes results in the operating costs not exceeding the 10 percent limitation. In light of the IBLA decision No. 88-158, MMS recalculated the allowable costs excluding ad valorem taxes and determined that Mobil's operating costs do not exceed the 10 percent limitation.

Calculation of MPTM Pipeline Transportation Allowance

° Exhibit 1 provides a summary of the revised MMS-allowable costs excluding ad valorem taxes that are not attributable to the MPTM Pipeline. The approved operating costs include compression costs performed after initial delivery in the field that is critical to transporting CO_2 along the MPTM Pipeline.

° In accordance with MMS's practice and policy, the revised 1985 transportation allowances for the MPTM Pipeline are $0.046176/Mcf for CO_2 transported to the Denver City Station and $0.010452/Mcf for CO_2 transported to the Wellman Unit.

Mobil's Proposal To Exceed the 50 Percent Limitation

° The Conservation Division Manual (CDM), U.S. Geological Survey, a procedural guide used by the predecessor to MMS, section 647.5.3E., states that under no circumstances should the transportation costs exceed 50 percent of the product's fair market value at the market competitive sales point.

° The imposition of a limitation on transportation allowances to 50 percent of the value of the products is a proper exercise of the Secretary of the Interior's discretion to establish minimum royalty value. The Secretary also has discretion to grant relief from the 50 percent limitation in those cases in which unusual circumstances warrant such action.

° Mobil's request for approval of a 1985 transportation allowance in excess of 50 percent of the value of CO_2 production included the following information: the leases to which the transportation allowances would apply, proposed transportation allowance rates, a revised 1985 transportation allowance for the MPTM pipeline segment, the actual cost data for the Cortez Pipeline, and the circumstances warranting relief from the 50 percent limitation.

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° Mobil asserts that CO_2 markets are scarce leading to higher transportation costs as the sales point distances increase from the McElmo Dome Unit. Mobil contends that large, expensive CO_2 pipelines are a necessity to market reserves which otherwise would never be developed. Mobil further states that few companies other than CO_2 producers are willing to invest in CO_2 pipelines.

° In the letter dated December 21, 1989, Mobil calculated the sum of the transportation allowances for the pipeline segments to each delivery point. Mobil determined that during CY 1985, the allowances exceeded the 50 percent limitation for CO_2 transported to the East Vacuum Unit and the Seminole San Andres Unit. However, Mobil used the calculation procedure contained in the CDM rather than the MMS-approved tariff calculation procedure to determine the transportation allowance for the Cortez Pipeline.

The MMS Analysis

° The MMS calculated the sum of the approved 1985 transportation allowances for the pipeline segments to each delivery point using the tariff of $0.39/Mcf for the Cortez Pipeline (including State and Federal income taxes), the 1985 revised transportation allowance for the MPTM Pipeline, and the 1985 transportation allowance for the Sheep Mountain Pipeline (previously approved by letter dated December 31, 1986).

° The MMS determined that during CY 1985, the approved allowances did not exceed 50 percent of the value of CO_2 production from the McElmo Dome Unit. Exhibits 3 and 4 provide a summary of the MMS-approved transportation allowances and the percentages of the sales value of the CO_2 at the sales point(s).

CONCLUSIONS

The Cortez Pipeline

° As a result of the IBLA decision No. 87-47, the State and Federal income taxes will be included in the calculation procedure for the Cortez Pipeline transportation allowance for CY 1985. The MMS determined that the tariff of $0.39/Mcf charged to Mobil included State and Federal income taxes as a component in the 1941 Pipeline Consent Decree tariff calculation procedure. Therefore, Mobil's proposal to use the tariff of $0.39/Mcf as a transportation allowance is acceptable.

The MPTM Pipeline Segment

° The MMS revised the transportation allowance for the MPTM Pipeline to reflect the exclusion of ad valorem taxes not attributable to the pipeline for the 1985 period.

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° Exhibit 1 details the costs allowed by MMS for the MPTM Pipeline. The revised 1985 transportation allowances for the MPTM Pipeline are $0.046176/Mcf for CO_2 transported to the Denver City Station and $0.010452/Mcf for CO_2 transported to the Wellman Unit.

Transportation Allowance Limitation

° The MMS reviewed the documentation submitted with Mobil's request and determined that the actual transportation costs do not exceed the 50 percent limitation for CY 1985. Therefore, Mobil's request to exceed the 50 percent limitation is denied for CY 1985.

° To determine the transportation allowance for each delivery point, Mobil should calculate the sum of the approved transportation allowances for the pipeline segments to each delivery point.

° The 1985 transportation allowance which Mobil may deduct will be the MMS-approved transportation allowance (the sum of the approved transportation allowances for the pipeline segments to each delivery point). Exhibit 2 summarizes the 1985 approved allowances for CO_2 transported from the McElmo Dome Unit to west Texas.

° Mobil should make adjustments to royalty payments on Form MMS-2014, Report of Sales and Royalty Remittance, no later than 90 days from receipt of this decision. The adjustments should be made in your regular monthly reports prior to expiration of this 90-day period and should not comprise a separate report consisting of adjustments only. You may refer to the MMS Oil and Gas Payor Handbook for instructions on reporting adjustments.

Enclosure 2

Appeals Procedure

You have the right to appeal in accordance with the provisions of 30 CFR 290 (1989). Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed within 30 days from the date of receipt of this letter with:

Minerals Management Service
Attention: Mr. Milton K. Dial
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS 3500
Denver, Colorado 80225
Telephone: (303) 231-3184

You should be aware that compliance with the orders and directives contained in this letter shall not be suspended by reason of an appeal unless authorized in writing pursuant to 30 CFR § 243.2 (1989).

Exhibit 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

MCELMO DOME CO2 PROJECT
MPTM PIPELINE
REVISED 1985 TRANSPORTATION ALLOWANCE

COSTS	ALLOWABLE COSTS PREVIOUSLY APPROVED BY MMS	REVISED ALLOWABLE COSTS APPROVED BY MMS
OPERATING EXPENSES	$185,777.00	$159,941.55
RETURN ON INVESTMENT	X-4	X-4
DEPRECIATION		

X-4

THROUGHPUT FOR DENVER CITY STATION 7,840,214 MCF

THROUGHPUT FOR WELLMAN UNIT 8,659,034 MCF

ALLRED STATION TO DENVER CITY DELIVERY STATION X-4 /7,840,214 = $ X-4

ALLRED STATION TO WELLMAN UNIT X-4 /8,659,034 = X-4

1
MOBIL'S SUBMITTAL DATED DECEMBER 21, 1989, CONTAINED NEW INFORMATION REGARDING THE OPERATING COSTS FOR MPTM PIPELINE. MOBIL ERRONEOUSLY INCLUDED AD VALOREM TAX IN THE ORIGINAL REQUEST FOR THE 1985 TRANSPORTATION ALLOWANCE. THEREFORE, MMS RECALCULATED THE 1985 TRANSPORTATION ALLOWANCE FOR MPTM PIPELINE SEGMENT.

2
MOBIL SUBMITTED A BREAKDOWN OF COSTS WHICH INCLUDED 80 PERCENT APPLIED TO THE SEMINOLE SAN ANDREAS UNIT (DENVER CITY STATION) AND 20 PERCENT APPLIED TO THE WELLMAN UNIT.

Exhibit 2

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

THE MCELMO DOME CO2 PROJECT
MMS-APPROVED 1985 TRANSPORTATION ALLOWANCE

SEGMENT	DENVER UNIT ($/MCF)	SEMINOLE-SAN ANDRES UNIT ($/MCF)	WELLMAN UNIT ($/MCF)
MCELMO DOME UNIT TO DENVER UNIT/ALLRED STATION (CORTEZ PIPELINE)	$0.390000	$0.390000	$0.390000
ALLRED STATION TO DENVER CITY DELIVERY STATION (MPTM PIPELINE)	---	$0.046176	---
ALLRED STATION TO WELLMAN UNIT (MPTM PIPELINE)	---	---	$0.010452
DENVER CITY DELIVERY STATION TO SEMINOLE SAN ANDRES UNIT (SHEEP MTN. PIPELINE)	---	$0.035000	---
TOTAL	$0.390000	$0.471176	$0.400452

attach 32

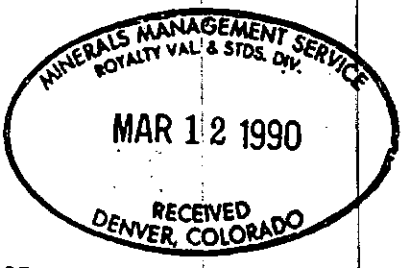
United States Department of the Inter

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

-47

85-0120

FEB. 13, 1990



Memorandum

To: [ ] Chief, Fiscal Accounting Division

[ ] Chief, Production Accounting Division

[ ] Chief, Royalty Compliance Division

[X] Chief, Royalty Valuation and Standards Division

From: Chief, Division of Appeals

Subject: Interior Board of Land Appeals (IBLA) Decision
112 IBLA 394
MMS- 84-0013 -Misc.

We are forwarding a copy of a decision by the IBLA for your information and appropriate action.

Please provide the Division of Appeals with a copy of any documents implementing the IBLA directive.

David A. Schuenke

Attachment

cc: Appeals Case File

United States Department of the Interior

OFFICE OF HEARINGS AND APPEALS
INTERIOR BOARD OF LAND APPEALS
4015 WILSON BOULEVARD
ARLINGTON, VIRGINIA 22203

IN REPLY REFER TO:

SHELL WESTERN E & P, INC.

IBLA 87-47 Decided January 23, 1990

Appeal from a decision of the Director, Minerals Management Service, affirming an order of the Royalty Valuation and Standards Division disallowing Federal and state income taxes as elements of transportation costs in calculating royalties on carbon dioxide transported by pipeline. MMS-84-0013-MISC.

Set aside and remanded.

1. Oil and Gas Leases: Royalties: Generally

MMS unfairly discriminates against a CO_2 lessee in denying a deduction for that component of a pipeline tariff relating to Federal and state income taxes solely on the basis that such lessee is an affiliate of the pipeline operator.

APPEARANCES: William G. Riddoch, Esq., Houston, Texas, for appellant; Peter J. Schaumberg, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE FRAZIER

Shell Western E & P, Inc. (SWEPI), has appealed from the August 6, 1986, decision of the Director, Minerals Management Service (MMS), affirming an order of the Chief, Royalty Valuation and Standards Division, MMS, disallowing Federal and state income taxes as elements of transportation costs in calculating royalties on carbon dioxide (CO_2) produced from the McElmo Dome (Leadville) Unit, 1/ located in Dolores and Montezuma Counties,

1/ McElmo Dome is a consolidation of several previous units into a single unit covering a subsurface unitized formation known as the Mississippian Leadville Formation underlying lands in Ts. 36, 37, 38, 39 N., and Rs. 17, 18, 19, and 20 W., New Mexico Principal Meridian. Unitized substances in McElmo Dome are all oil and gas within or produced from the unitized formation. The term "gas" specifically and expressly includes carbon dioxide. Robert D. Lanier, 90 IBLA 293, 93 I.D. 66 (1986) (carbon dioxide produced from McElmo Dome under Federal oil and gas leases).

Colorado, and transported via a pipeline owned by the Cortez Pipeline Company (Cortez) 2/ over 500 miles to the Denver Unit CO_2 project in western Texas.

SWEPI, the successor in interest to Shell Oil Company (Shell), is the operator of the McElmo Dome Unit. On October 25, 1983, representatives of Shell met with representatives of MMS to provide an overview of and a status report on Shell's McElmo Dome/Denver Unit CO_2 Project. At the meeting, MMS requested information concerning the tariff to be charged to Shell by Cortez for transportation of Shell's share of CO_2 produced from McElmo Dome and sold by Shell to the Denver Unit, via the 500-mile pipeline then under construction from southwestern Colorado to the Wasson Field in West Texas where the Denver Unit is located.

By letter dated December 9, 1983, Shell advised MMS of certain information provided by Cortez concerning the tariff to be established for transportation of CO_2 from McElmo Dome to the Denver Unit. In the letter, Shell proposed that the Cortez tariff be allowed as a transportation deduction from the proceeds received by Shell for the sale of CO_2, and that Shell not be required to pay royalty under the Federal leases on that amount.

By letter dated March 29, 1984, MMS advised SWEPI that the Cortez tariff calculation procedure was acceptable to MMS, with the exception that Federal and state income taxes should not be considered in computing transportation costs. MMS explained that "Federal and State income tax should be eliminated before transportation costs are computed. Should they be retained in the computation, royalty must be paid on that portion of the pipeline tariff represented by the Federal and State income taxes" (Letter from MMS to SWEPI dated Mar. 29, 1984, at 2).

By letter dated May 1, 1984, SWEPI appealed the March 29, 1984, decision to the Chief, Royalty Valuation and Standards Division, MMS, arguing as follows:

> There currently is no market for CO_2 produced from the McElmo Dome (Leadville) Unit except for CO_2 purchased by the Denver Unit. The actual cost of transporting CO_2 through the Cortez pipeline from Southwestern Colorado to West Texas is a marketing cost which must be assumed by the royalty owner as well as the working interest owners. These actual costs of transportation, which will in the future include payment of both Federal and State income taxes, constitute the Cortez tariff and are incurred by the Federal lessee who transports CO_2 to the Denver Unit for sale. SWEPI, as a Federal lessee transporting CO_2 to the Denver Unit for sale, is entitled to be reimbursed by the purchaser of CO_2 for the tariff charged for transporting such CO_2, subject to certain limitations as set forth in the Denver Unit CO_2 Sale and

2/ Cortez is a general partnership owned by Shell Cortez Pipeline Company, Mobil Cortez Pipeline Company, and Continental Resources Cortez Pipeline Company.

> Purchase Contract. Since the Sale of CO_2 to the Denver Unit was the first such sale of CO_2 from the McElmo Dome (Leadville) Unit - and is still the only such sale - it was necessary to agree with the Denver Unit working interest owners that they would not bear the full cost of the Cortez pipeline tariff.
>
> Thus, any actual costs of transportation borne by SWEPI which are not reimbursed by the Denver Unit were agreed to through negotiation with the Denver Unit working interest owners. The MMS, however, by its determination not to permit deduction of all the actual transportation charges (the tariff) incurred by SWEPI has arbitrarily and without justification imposed a penalty on SWEPI which was neither negotiated nor anticipated. The full tariff paid by SWEPI should be permitted to be deducted from the price received for CO_2 sales by SWEPI for royalty payment purposes to the MMS.

(Letter dated May 1, 1984, from SWEPI to MMS, at 3-4).

By memorandum dated September 10, 1984, the Chief, Royalty Valuation and Standards Division (RVSD), recommended to the Chief, Division of Appeals, Office of Program Review, that the March 29, 1984, decision be upheld, providing the following rationale for its position:

> The RVSD upholds its previous position with regard to income taxes. In William and Meyers Oil and Gas Law, Vol. 3, § 604.6(b) clearly defines which costs may be considered as a cost of operation; "the current cost of operation has been held to include taxes (other than income taxes) payable by the owner of the working interests." In addition, in Matzen v. Hugeton Production Co., (321 P.2d 576), the Supreme Court of Kansas upheld evidence which established that "from an accounting standpoint, income tax is a sharing of profits, not a cost; that in cost accounting, income tax is never used as a factor in determining cost of operation, cost of sales, nor of any other item." [Emphasis in original.]

By letter to the Chief, Division of Appeals, Office of Payment Review, MMS, dated February 7, 1985, SWEPI registered its disagreement with RSVD's September 10, 1984, memorandum. SWEPI argued that RSVD's reliance upon the definition of "cost of operation" from Williams and Myers was misplaced, stating that "[i]t is a partial quote from Section 604.6(b) * * * taken out of context, which relates to a subject completely different from transportation costs which are allowed as a deduction from the value of royalties" (Letter dated Feb. 7, 1985, from SWEPI to the Chief, Division of Appeals, Office of Payment Review, MMS, at 7). According to SWEPI, "[t]he entire scope of the discussion in this part of the treatise is limited to costs of 'paying production', within the overall construction of a habendum clause in an oil and gas lease for purposes of determining the duration of the lease,"

and that "[t]his section of the treatise has no relevance at all to costs incurred in the transportation of a product, in this case, CO_2, or computation of royalty payments." Id. SWEPI argued as follows:

> The issue under appeal here is not the identification of which costs of production are to be assessed against the non-operator-lessor's usual royalty interest, but is instead the identification of "costs subsequent to production" which are usually borne proportionately by the operating and the non-operating interests. 3 R. Williams, Oil and Gas Law Sections 645.1-.2 (1981). Indeed, the quoted definition itself clearly identifies the party whose income taxes are not to be included in the current cost of operations, i.e., "the owner of the working interest," and not a common carrier pipeline.

(Letter dated Sept. 7, 1985, at 8).

In addition, SWEPI maintained that RSVD "misses the mark" by placing its reliance upon Matzen v. Hugoton Production Co., 321 P.2d 576 (Kas. 1958). SWEPI conceded that the "Matzen court properly determined that an operator-lessee and a non-operator-lessor must bear the burden of their own income tax without contribution from the other party" (Sept. 11, 1985, letter (emphasis in original)). SWEPI contended, however, that Matzen "does not stand for the proposition that income taxes of a common carrier pipeline carrier must be borne exclusively out of the operator lessee's interest." Id. at 9. SWEPI reasons as follows:

> What distinguishes the holding of Matzen from the issue in the SWEPI Appeal is the fact that the court disallowed deduction of the lessee's income taxes from the lessor-landowners' royalty. Whereas in the MMS Decision, pipeline owners' income taxes which are included in a pipeline tariff and passed on as a cost to a shipper-lessee as an overall transportation charge are disallowed as deductible costs for the purpose of computing the transportation allowance for royalty purposes. Stated simply, the Matzen case involved income taxes of a lessee, and the instant appeal involves income taxes of a common carrier pipeline. The former is not, and the latter is, a proper component of transportation expense deductible from lessor royalty. [Emphasis in original.]

(Letter dated Feb. 7, 1985, at 10).

By memorandum dated May 6, 1985, from the Chief, RVSD, to the Chief, Division of Appeals, Office of Program Review, the Chief, RVSD, responded to SWEPI's arguments. RVSD explained that its decision to disallow Federal and state income taxes as transportation costs was based upon the Conservation Division Manual (CDM 647.5), which "provides standard guidelines for determining allowable pipeline transportation deductions for royalty purposes for Federal and Indian onshore lands" (Memorandum dated May 6, 1985, at 2). The CDM specifies transportation allowances for (1) producer-owned and operated pipelines (CDM 647.5A); (2) producer-owned (by production payments) pipelines which are not operated by the lessee (CDM 647.5B); and (3) pipelines

owned by parties other than the lessee (CDM 647.5C). RVSD determined that because SWEPI "owns a major interest of the Cortez Pipeline Company through its subsidiary, Shell Cortez Pipeline Company * * * the CDM guidelines under 'producer-owned and operated pipelines,' 647.5A, are most applicable in this case" (Memorandum dated May 6, 1985, at 3). These guidelines provide as follows:

> Intangible and direct costs in the following or like categories which can be shown to the satisfaction of the Supervisor to be part of the operating costs: Insurance (hazard, liability, workman's compensation, etc.); Taxes (Social Security, property taxes assessed on the pipeline and other equipment approved as pipeline investment items, etc. However, corporate income taxes are not an allowable deduction) * * *. [Emphasis added].

RVSD explained that its policy is to deny Federal and state income taxes as transportation costs when the "pipeline is producer-owned and transporting that producer's production only to a sales point" (Memorandum dated May 6, 1985, at 3). By contrast, RVSD noted that "[i]n situations where a third-party pipeline, generally a common carrier, imposes a tariff on a producer under arm's-length conditions, MMS will approve the entire tariff, regardless of how such tariff is derived, as the producer's actual cost of transportation that may be deducted from Federal royalty." Id. Further, "[i]f a pipeline is a common carrier, and carries both affiliated and nonaffiliated production, it is MMS policy to accept a published tariff for the nonaffiliated production, but to require actual cost data to justify an allowance for affiliated production." Id. at 3.

By letter to the Division of Appeals, Office of Program Review, MMS, dated September 9, 1985, SWEPI maintained that other producers not related to the pipeline company would be able to deduct the entire pipeline tariff, whereas it would only be allowed to deduct less than that amount since the portion of the tariff attributable to Federal and income taxes will not be recognized as a transportation cost. SWEPI concluded that this application of the CDM was arbitrary, resulting in "undue discrimination against the producer-owners of the Cortez CO_2 pipeline, a common carrier" (Letter dated Sept. 9, 1985, at 6). SWEPI asserts:

> The producer-owners are subject to liability for a higher royalty payment to the MMS than are other producers of CO_2 from the McElmo Dome (Leadville) Unit or from other CO_2 sources who transport CO_2 through the Cortez CO_2 pipeline, but who do not own an interest in the Cortez CO_2 pipeline, solely because the transportation of CO_2 is not regulated.

Id.

By decision dated August 6, 1986, the Director, MMS, denied SWEPI's appeal, and affirmed the order of the RSVD, explaining its policy of denying the deduction of Federal and state income taxes as transportation costs on the following basis:

> This policy is premised on the impossibility of accurately allocating the correct tax burden to the pipeline, as well as the other activities of the pipeline/producer. An inflated pipeline tariff in those circumstances would benefit the lessee in providing for a greater reduction from royalty (and thereby depriving the lessor of its full royalty entitlement). The MMS adopted the policy of limiting the transportation allowance to actual costs exclusive of income tax. The MMS policy is a reasonable measure intended to eliminate the potential for abuse that could result from expense manipulation between pipelines and production facilities not wholly independent of each other.

(Decision dated Aug. 6, 1986, at 6).

[1] As noted by appellant, MMS relied upon Matzen to support its decision to deny a deduction for incomes taxes as transportation costs. However, the record demonstrates that despite its application of Matzen against SWEPI, MMS does not follow Matzen as a general rule. MMS appears untroubled by the general concept of allowing a lessee to include income taxes paid by a pipeline as an element of transportation costs, since it allows such a deduction if there is a published tariff for a common carrier which includes income taxes as transportation costs. 3/ When there is no published tariff, as in the instant case, only lessees who are affiliates of pipeline owners are not allowed to deduct income taxes as transportation costs from the value upon which royalty is calculated. MMS' application of the Matzen rule only when the lessee is an affiliate of the pipeline owner is untenable.

In Getty Oil Co., 51 IBLA 47 (1980), the Director, Geological Survey (GS), affirmed an order of the Acting Oil and Gas Supervisor, Gulf of Mexico Area, GS, requiring Getty to pay additional royalties for gas sold to its "wholly controlled" subsidiary in accordance with a contract between Getty and the subsidiary. GS contended that since Getty had the right to rescind the contract, and thus sell the gas at higher interstate prices, the Area Supervisor should properly value the gas for royalty purposes as if Getty had sold it at the highest price obtainable on the interstate market.

The Board stated that "[e]ssential to Getty's appeal is the validity of its agreement for the sale of gas to [its subsidiary]." 51 IBLA at 49. The Board's analysis of this issue is relevant to the issue of whether MMS should have denied SWEPI the income tax deduction on the basis that it wanted to "eliminate the potential for abuse that could result from expense

---

3/ The Board has held that section 28 of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 185 (1982), provides the authoirity for issuance of a right-of-way for a carbon dioxide pipeline for transportation of production from Federal oil and gas leases. Exxon Corp., 97 IBLA 45, 94 I.D. 139 (1987). Such pipelines are required by statute to be operated as "common carriers." 30 U.S.C. § 185(r)(1) (1982).

manipulation between pipelines and production facilities not wholly independent of each other" (Decision by Director, MMS, dated Aug. 6, 1986, at 6). The Board stated:

> We agree with appellant that a parent corporation and its wholly owned subsidiary may enter into a valid contract. In United States v. Weissman, 219 F.2d 837 (2nd Cir. 1955), Judge Learned Hand wrote: "It is true that there can be legal transactions between two corporations all of whose shares are owned by a single individual, and that the same obligations will arise out of them as would arise, had they been between either corporation and a third person." It is the general rule that courts will not, because of stock ownership or interlocking directorates, disregard the separate legal identities of corporations, unless such relationship is used to defeat public convenience, justify wrongs (e.g., violation of antitrust laws), protect fraud, or defend crime. Norton v. Integral Corp., 584 S.W.2d 932, 935 (1979).

51 IBLA at 50.

MMS proceeds on the assumption that when the lessee is an affiliate of the pipeline operator, the income tax burden of the operator may somehow be shifted to the lessee, thereby reducing the amount upon which Federal royalty on the CO_2 is calculated. MMS' policy, while "intended to preclude abuse and overcome audit burdens," unfairly discriminates against lessees who are affiliates of pipeline operators. In the absence of some manifestation that affiliated companies are using their corporate relationship to defeat MMS royalty collection efforts, the general rule recognized in Getty Oil Co. applies. 4/ MMS does not allege, and there is nothing in the record to suggest, that Cortez is not transporting SWEPI's CO_2 at a price equal to that obtainable under an arms-length contract. MMS' denial of a transportation allowance for income taxes in this case solely on the basis that SWEPI is an affiliate of the pipeline operator was improper.

4/ Moreover, the factual predicates of the MMS decision are substantially undermined by the fact that SWEPI owns only a 50-percent interest in the Cortez pipeline. While the Board has, indeed, recognized that economic incentives exist which might impel producers to shift profits to wholly owned subsidiaries as a means of decreasing royalty obligations (see Transco Exploration Co., 110 IBLA 282, 96 I.D. 367 (1989)), the economic viability of such a strategy declines where, as here, outside interests in the subsidiary are substantial. Thus, while a parent corporation might well desire to have profits transferred form one corporationn to another in an attempt to lessen royalty payments of 12.5 percent on the value of production, the incentive to do so when the parent corporation owns only 50 percent of the second corporation evaporates, since such a procedure results in the net loss of 37.5 percent. Similarly, it is difficult to see how the manipulation of allocation of income taxes works effectively where the parent corporation owns only 50 percent of one of the entities involved, particularly where the expressed fears of MMS can only be realized by increasing the tax burden of the partially-owned entity.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director, MMS, is set aside and remanded for action consistent with this opinion.

Gail M. Frazier
Administrative Judge

I concur:

James L. Burski
Administrative Judge

from C

attach. 33

United States Department of the I

OFFICE OF HEARINGS AND APPEALS
INTERIOR BOARD OF LAND APPEALS
4015 WILSON BOULEVARD
ARLINGTON, VIRGINIA 22203

IN REPLY REFER TO:

MOBIL PRODUCING TEXAS & NEW MEXICO, INC.

IBLA 88-158

Decided June 28, 1990

Appeal from a decision of the Director, Minerals Management Service, upholding in part and setting aside in part findings and conclusions of the Royalty Valuation and Standards Division establishing transportation allowances for conveying carbon dioxide. MMS-87-0194-O&G.

Affirmed as modified in part, set aside and remanded in part.

1. Administrative Procedure: Administrative Procedure Act

Although rulemaking procedures at 5 U.S.C. § 553 (1982) do not apply to interpretive rules, 5 U.S.C. § 552 (1982) requires publication in the Federal Register of statements of general policy and interpretations of general applicability.

2. Administrative Authority: Generally—Administrative Procedure: Administrative Review—Minerals Management Service: Generally

The Conservation Division Manual is an administrative manual which governed the internal operations of the Conservation Division, Geological Survey. It does not have the force of law and its provisions are guidelines, rather than rules which are binding on the Board of Land Appeals. Review is not limited to determining whether its provisions were correctly applied and the Board may consider whether application of the provisions is arbitrary, capricious, an abuse of discretion, or contrary to law.

3. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Mineral Leasing Act: Royalties—Oil and Gas Leases: Royalties: Generally

Ordinarily royalty is computed on the value of the gas removed or sold from the lease. Where gas must be transported from the field to the point of first sale, the deduction of reasonable transportation costs is allowed. The Secretary of the Interior's authority to

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determine the value of production upon which royalty payments are made extends to determining the factors used in computing transportation allowances for royalty purposes.

4. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Mineral Leasing Act: Royalties—Oil and Gas Leases: Royalties: Generally

Operating expenses are a proper component of a transportation allowance for a CO_2 pipeline which is required to transport production to market. A decision limiting operating costs to 10 percent of undepreciated investment when calculating the relevant transportation allowance may be set aside and remanded where the effect is to eliminate a substantial percentage of operating costs and no rational basis for such a limitation is given in the decision or contained in the record.

5. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Mineral Leasing Act: Royalties—Oil and Gas Leases: Royalties: Generally

The allowance of a reasonable rate of return on depreciated assets has been upheld in computing a transportation allowance for production for which there is no market in the field or at the wellhead. Application of a rate of return based on the prime interest rate at the time of the initial period for which the transportation allowance is calculated will be upheld as reasonable.

APPEARANCES: Robert T. Brousseau, Esq., Kenneth F. Plifka, Esq., Dallas, Texas, for Mobil Producing Texas & New Mexico, Inc.; Christina K. Navarro, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Mobil Producing Texas and New Mexico, Inc. (Mobil, MPTM), has appealed a decision of the Director of the Minerals Management Service (MMS) dated October 30, 1987, which upheld in part and set aside and remanded in part a decision of the Royalty Management Program (RMP), Royalty Valuation and Standards Division (RVSD), approving transportation allowances. 1/ The transportation allowances apply to carbon dioxide (CO_2) produced from Federal oil and gas leases and transported by pipeline from the McElmo Dome Unit in Montezuma County, Colorado, to three areas in west Texas where it

1/ The RVSD decision was embraced in a document entitled "Findings and Conclusions on McElmo Dome Unit CO_2 Transportation Allowances" (Findings and Conclusions) attached to a cover letter addressed to appellant.

is used for enhanced oil recovery. 2/ The RVSD established transportation allowances for three segments of the pipeline: (1) the Cortez Pipeline which delivers CO_2 from Colorado to the Allred Station and the Denver Unit, (2) the MPTM Pipeline which transports CO_2 from the Allred Station to the Denver City Delivery Station on the Sheep Mountain Pipeline and which also delivers CO_2 to the Wellman Unit, and (3) the Sheep Mountain Pipeline which conveys CO_2 from the Denver City Delivery Station to the Seminole-San Andreas Unit.

On appeal Mobil challenges five determinations in the RVSD findings and conclusions which affected the calculation of the transportation allowances. Mobil argues that RVSD's decision on these matters was unreasonable, arbitrary, and capricious. Mobil also attacks the decision on the ground it was based on policies and guidelines set forth in the Geological Survey's Conservation Division Manual (CDM). 3/ Mobil argues that "[t]he CDM, which takes the form of a legislative rule having the force of law, is not lawfully in effect since the CDM was not promulgated and published in compliance with Section 552 of the Administrative Procedure Act (the 'APA')" (Statement of Reasons (SOR) at 2).

Mobil argued similarly before the Director that the CDM "which takes the form of a directive and materially modifies existing regulations * * * was not promulgated and published in compliance with 5 U.S.C. § 552 (1982)" and that "the policy guidelines therein, to the extent adverse to Mobil, should be deemed void" (SOR to Director at 2). Among other matters, section 552 requires an agency to publish in the Federal Register "substantive rules of general applicability * * * and statements of general policy or interpretations of general applicability formulated and adopted by the agency." 5 U.S.C. § 552(a)(1)(D) (1982). The Director's decision, however, described Mobil's argument as a claim that the CDM "guidelines were not published in accordance with the notice and comment requirements of the Administrative Procedure Act (APA), 5 U.S.C. § 552(a) (1982)" (Decision at 4). This statement failed to distinguish the notice and comment procedure required by section 553 from section 552 which Mobil had cited. 4/

2/ Title to CO_2, a nonhydrocarbon gas produced from a gas well as a component of the naturally formed gases indigenous to the underlying reservoir, has been held to be in the United States by virtue of the reservation of gas in the patent of the land under sec. 1 of the Act of July 17, 1914, as amended, 30 U.S.C. § 121 (1982). Robert D. Lanier, 90 IBLA 293, 93 I.D. 66 (1986) (involving title to CO_2 developed under Federal leases in the McElmo Dome field), aff'd, Aulston v. United States, No. 87-F-1144 (D. Colo. Aug. 4, 1988), appeal filed, No. 88-2349 (10th Cir.).

3/ MMS was created by Secretarial Order No. 3071 (Jan. 19, 1982). 47 FR 4751 (Feb. 2, 1982). Matters relating to royalty and mineral revenue management were subsequently transferred to MMS under Secretarial Order No. 3087 (Dec. 3, 1982). 48 FR 8983 (Mar. 2, 1983). The provisions of the CDM at issue in this appeal have subsequently been replaced by regulations. 30 CFR Part 206, Subpart D, 53 FR 1272 (Jan. 15, 1988).

4/ Section 553 requires that "[g]eneral notice of proposed rule making" be published in the Federal Register and that the agency "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral

Stating that "the requirements of the APA pertain only to legislative rules and are inapplicable to interpretive rules," the decision concluded that "(t)he CDM guidelines * * * are interpretive rules" and, therefore, "the advance notice and comment provisions of the APA (5 U.S.C. § 553, 1982) are inapplicable." Id.

The briefs before the Board do not clarify the matter. Mobil continues to assert that "the CDM was not promulgated and published in compliance with Section 552," but its brief responds to the decision's conclusion that the CDM guidelines are interpretive rules. Mobil argues that, because the CDM was issued exercising a legislatively delegated power and has a substantial impact upon oil and gas producers, "the notice and comment provisions of the APA apply" (SOR at 4-5). Despite this argument, however, appellant concludes that the CDM's policy guidelines "to the extent adverse to Mobil, should be vacated and deemed void" due to failure to comply with section 552 (SOR at 5). Similarly, MMS responds to Mobil's SOR, contending that the CDM is not legislative but rather "its provisions are guidelines, also referred to as interpretive rules, which clarify or construe an existing law or regulation" (Answer at 7-8), but does not discuss section 552. 5/

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fn. 4 (continued)
presentation." 5 U.S.C. § 553 (1982). It excepts from these requirements "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice." Following receipt of comments, section 553 requires "consideration of the relevant matter presented" and that the agency "incorporate in the rules adopted a concise general statement of their basis and purpose." It also provides that the "required publication or service of a substantive rule shall be made not less than 30 days before its effective date." Publication of substantive rules in the Federal Register is required by 5 U.S.C. § 552(a)(1)(D) (1982).

5/ MMS relies on Quitman Refining Co., 57 IBLA 53 (1981), as requiring rejection of Mobil's argument. Although the decision concerns an unpublished method for making a calculation, it is not dispositive of issues pertaining to section 552. A notice had been published in the Federal Register for small refiners to apply to purchase royalty oil. Quitman applied and was found ineligible. On appeal the company argued that the 2-month "runs to stills" figures used by Geological Survey for calculating excess refining capacity departed from the requirement of both the notice and the regulation at 30 CFR 225a.6(f) (1979) that applicants submit production figures for 12 months. Id. at 57. The Board found that the notice neither specified the method of calculation nor indicated that the 12-month figures would be used. Id. at 58. By inference, neither did the regulation which was the source of the wording of the notice. See 30 CFR 225a.6(f) (1979). Thus, Quitman's arguments were flawed because they were based on an incorrect assertion that the use of figures for 2 months was a change from the published notice and the regulations.

The decision also noted that the Wyoming District Court had held that the published notice either did not promulgate a new rule or regulation or, if it did, the rule was not substantive requiring compliance with section 553. Id. at 58. Accordingly, the Board rejected Quitman's argument that the method of calculation required rulemaking under section 553.

The CDM was prepared by the Geological Survey to provide consistent instructions for its personnel to follow in determining transportation allowances and performing other tasks. Its provisions set forth both general guidelines and detailed procedures. Thus, it is best characterized as an administrative manual governing internal operations. It is possible, of course, that individual provisions overreach the CDM's general function and establish rules which purport to affect substantive rights and are subject to promulgation under section 553 or set forth matters of general policy or interpretations of general applicability subject to publication in the Federal Register. See Nguyen v. United States, 824 F.2d 697, 700 (9th Cir. 1987). On the other hand, individual provisions may be simply "statements of policy and interpretations" which must be made "available for public inspection and copying." 5 U.S.C. § 552(a)(2) (1982); see Caruano v. National Transportation Safety Board, 843 F.2d 56 (1st Cir. 1988).

[1] The Director's decision contains one misstatement regarding the APA which should be rectified. While it correctly states that section 553 does not apply to interpretive rules, see 5 U.S.C. § 553(b)(3)(A) (1982), it incorrectly states that the APA applies only to legislative rules. As quoted above, section 552 requires publication of not only substantive rules but also "statements of general policy or interpretations of general applicability."

We find, however, that no ground for reversal of the MMS decision on the basis of the APA has been shown by appellant. Although Mobil asserted in its appeal to the Director that the CDM materially modifies "existing regulations," it cited neither specific provisions of the CDM nor the regulations which it believed to be modified. Furthermore, although Mobil both argues that the CDM contains "legislative rules" subject to section 553 rulemaking and characterizes the provisions as "policy guidelines" subject to publication under section 552, it fails to provide any analysis based on precedent that specific provisions should be regarded as establishing either rules or policy. Proper application of the APA has been the subject of extensive litigation. Mobil fails to offer any specific basis for the violations of the APA it alleges. 6/ Accordingly, we find appellant has failed to establish reversible error on the basis of violation of the APA.

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fn. 5 (continued)
Finally, the Board upheld the use of the standard because it concluded that use of the 2-month figures to calculate Quitman's excess capacity was neither unfair nor arbitrary because the same method had been used for all applicants. Id. at 59.

6/ We note that Mobil also misstates the consequence of failure to comply with the APA. While compliance with section 553 would be necessary for the provisions of the CDM to have the force and effect of law, the absence of such compliance does not require that we declare it void. Rather, the absence of compliance with section 553 means simply that the provisions do not, as MMS correctly states, have the force of law. See Chrysler Corp. v. Brown, 441 U.S. 281, 301-03 (1979). Similarly, the failure to publish statements of general policy or interpretations of general applicability in the Federal Register as required by section 552 does not make them invalid.

[2] Our basis for reviewing the issues concerning the CDM provisions Mobil has challenged is much simpler. Consistent with the administrative nature of the CDM, MMS states that it "does not contend that the CDM has the force of law" (Answer at 5). Because the CDM is not law, its provisions are not binding on the Board, as regulations would be, and our review is not limited to determining whether they were correctly applied. See Conoco Inc., 110 IBLA 232, 242-43 (1989); Dugan Production Corp., 107 IBLA 91, 94 (1989); Pamela S. Crocker-Davis, 94 IBLA 328, 332 (1986). As characterized by the CDM itself, the provisions are guidelines and, as Mobil contends, they are subject to attack and review as to whether they are arbitrary, capricious, an abuse of discretion, or contrary to law under 5 U.S.C. § 706(2)(A) (1982). See, e.g., Phillips Petroleum Co., 109 IBLA 4, 9 (1989). While MMS correctly asserts that the Secretary possesses considerable discretion in determining the value of production for royalty purposes, its exercise is tempered by the standard of reasonableness. Conoco Inc., supra at 240. Mobil, however, bears the burden of showing error. See Mobil Oil Corp., 108 IBLA 216, 219-20 (1989).

On appeal Mobil also repeats a statement made to the Director that the company "acknowledges that agency decisions are generally entitled to substantial deference," but in this case, due to MMS' failure to consider all relevant factors, its decision "should not be afforded any deference, substantial or otherwise" (SOR at 15-16; SOR to Director at 9). Our review, however, is not concerned with the principle of deference. As correctly stated in the MMS answer, deference "is more appropriate to judicial review of agency decisions than to IBLA's review of MMS decisions" (Answer at 20).

The reason, of course, is that both MMS and this Board are components of the Department of the Interior. In reviewing the decisions of his subordinates, the Director of MMS has no obligation to defer to their determinations. To the contrary, the Secretary has delegated to the Director various responsibilities and duties, as well as the authority to carry them out, and he is obligated to assure himself that the decisions of those he supervises conform to the law and follow proper administrative procedures. Similarly, in reviewing appeals of decisions by the Director o MMS, as well as appeals from decisions by other divisions of the Department the Board exercises the authority to decide appeals which has been delegate by the Secretary. 43 CFR 4.1. In addition, when deference is accorded by the courts, it is not to the decision of an agency but its interpretation o the laws it administers. See 5 Stein, Mitchell & Mezines, Administrative Law § 51.01[1] (1988).

We turn next to the specific issues raised by Mobil concerning calculation of the transportation allowances. The formula used by MMS established the allowances for the pipeline segments by dividing the sum o depreciation, operating expenses, and return on investment by the volume o

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fn. 6 (continued)
Rather, the consequence is that "[e]xcept to the extent that a person has actual and timely notice of the terms thereof, a person may not in any manner be required to resort to or be adversely affected by" the policy or interpretation. 5 U.S.C. § 552(a)(1) (1982).

"throughput" (Findings and Conclusions, Attachment 3). Specifically, Mobil challenges: (1) the limitation of operating expenses to the lesser of actual operating costs or 10 percent of the undepreciated capital investment; (2) the rate of return allowed on investment; (3) the disallowance of compression expenses as an operating expense; (4) the limitation of transportation allowances to a maximum of 50 percent of the CO_2's value at the point of sale; and (5) the disallowance of Federal and state income taxes as components of operating expenses.

[3] The Mineral Leasing Act requires the payment of royalty based on the "amount or value of the production removed or sold from the lease." 30 U.S.C. § 226(b) and (c) (1982). The Secretary of the Interior "is authorized to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes" of the Act. 30 U.S.C. § 189 (1982). Under these provisions the Secretary has authority to determine the value of production upon which royalty payments are made. Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1378-79 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir. 1986), cert. denied, 480 U.S. 940 (1987); California Co. v. Udall, 296 F.2d 384, 388 (D.C. Cir. 1961); see United States v. Ohio Oil Co., 163 F.2d 633, 638-41 (10th Cir. 1947), cert. denied, 333 U.S. 833, reh'g denied, 333 U.S. 865 (1948). For many years, and at the time of the MMS decision at issue here, Departmental regulations provided:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary.

30 CFR 206.103 (1987). 7/

7/ The provision was classified to 30 CFR 221.47 when promulgated in 1942. 7 FR 4132, 4137 (June 2, 1942). After the creation of MMS (47 FR 4751 (Feb. 2, 1982)), minor modifications were made to reflect the change of administrative authority (47 FR 28368 (June 30, 1982)) and the provision was reassigned to 30 CFR 221.110 (47 FR 47758, 47774 (Oct. 27, 1982)). After MMS acquired authority over matters relating to royalty and mineral revenue management (48 FR 8983 (Mar. 2, 1983)), MMS reassigned the provisi to 30 CFR 206.103 (48 FR 35639, 35641 (Aug. 5, 1983)). Effective Mar. 1, 1988, it was removed and a detailed approach to royalty valuation established at 30 CFR part 206. 53 FR 1184, 1218 (Jan. 15, 1988). However, th substance of the provision was adopted by Congress as part of the Notice t Lessees Numbered 5 Gas Royalty Act of 1987. 101 Stat. 1719, 1720 (1988).

Normally gas is sold and valued for royalty purposes at the wellhead. When not sold at the wellhead, the common practice is to deduct a transportation allowance from the sales value of the product in order to determine its value at the wellhead. The Department has followed this practice, allowing the deduction of transportation costs when minerals must be transported from the field to the first point of sale. Petro Lewis Corp., 108 IBLA 20, 35-36, 96 I.D. 127, 135 (1989); Kerr-McGee Corp., 22 IBLA 124, 127-28 (1975); see JFD, Inc., 49 IBLA 337 (1980); Shell Oil Co., 70 I.D. 393, 395 n.6 (1963). The Secretary's authority extends to determining the factors used in computing transportation allowances for royalty purposes. Shell Oil Co., 52 IBLA 15, 20, 88 I.D. 1, 4 (1981); Shell Oil Co., 70 I.D. at 396.

Mobil first challenges the determination in the RVSD findings and conclusions limiting operating expense to 10 percent of the undepreciated capital investment. This determination was based on CDM section 647.5A.3B which states in part:

> Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which the operating costs are being computed.

Mobil argues that the 10-percent limitation is discriminatory because it does not apply to arm's-length transactions by producers who are not owners of CO_2 pipelines (SOR at 6). 8/ Mobil also objects to including ad valorem taxes as an operating cost because they are not "required to operate and maintain the pipeline system" as described in the CDM provision and contends that they should be deductible as a separate expense because they are neither established nor controlled by Mobil (SOR at 7). MMS argues that Mobil fails to show error in the method of calculation and fails to show how the inclusion of ad valorem taxes as an operating expense, which was intended to benefit producers, works to its detriment (Answer at 11-12). 9/

Review of the RVSD findings and conclusions discloses that the detriment does not arise directly from inclusion of the tax in operating expenses, but indirectly from application of the 10 percent cap to all operating expenses including ad valorem taxes. Thus, Mobil's operation and maintenance expenses, including overhead, were not in excess of the 10-percent limit, but the addition of the ad valorem tax caused Mobil's total operating expenses to exceed the limit. The ad valorem tax by itself exceeds not only the operation and maintenance expenses, including overhead,

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8/ Section 647.5A of the CDM expressly applies to calculation of transportation expenses when the pipeline is owned by the producer.

9/ It should be noted that many taxes such as production or severance taxes, reclamation fees, and black lung taxes are properly considered to be a cost of production and may not be subtracted from gross value for computation of the Federal royalty. See Black Butte Coal Co., 103 IBLA 145, 95 I.D. 89 (1988).

but also the 10-percent limitation. Thus, while treatment of the ad valorem tax as an operating expense can be viewed as providing Mobil a partial benefit (the difference between the other expenses and the 10-percent limit), its inclusion can also be viewed as excluding from allowable transportation costs a substantial component of the costs of actually operating and maintaining the pipeline.

The real issue is not whether ad valorem taxes paid by the pipeline operator are allowed as a separate expense, but rather whether operating expenses including ad valorem taxes are properly limited to 10 percent of the undepreciated capital investment at the beginning of the year for which the transportation allowance is computed. The Director's decision and the MMS brief on appeal describe the 10-percent limitation as a longstanding policy but do not explain the rationale for the limitation.

[4] A transportation allowance recognizes that the price received for a product at a distance from the point of production is not the value of the product at the point of production because the costs incurred in transporting the product have added value to it. In Kerr-McGee Corp., supra, the Board set aside a decision denying a transportation allowance for costs associated with a pipeline conveying oil from the leasehold to the point of the first available market. In reaching this result we noted that if the Government took its royalty in kind (as it had a right to do), rather than in value, it would bear the expense of transporting the oil to market. We found it would produce "an anomalous result if the Government royalty interest was, in effect, chargeable with transportation when taken in kind, but not when taken in value." 22 IBLA at 128. We think the same principle is applicable in this case. Review of the RVSD Findings and Conclusions at Attachment 2 discloses that limiting operating expenses to 10 percent of undepreciated investment has the effect of restricting appellant's deduction for 1985 to approximately 50 percent of actual operating expenses incurred. Whichever way the numbers are viewed, it is clear that either the operating expenses must be unusual, so as not to reflect the value added by transporting the product, or the 10-percent limitation does not reasonably represent the value transportation adds to the product and its application defeats the reason for giving a transportation allowance. 10/

We are unable to determine on the basis of the record before us which is the case. The record does not contain the information as to expenses Mobil submitted to MMS. The inclusion of ad valorem taxes as an operating expense within the 10-percent limitation suggests that such taxes are normally a relatively small portion of total operating expenses. In this case the tax is not and we are unable to ascertain why. The amount is equal to more than 10 percent of Mobil's capital investment in the pipeline indicating that it may be unusually large. There is, however, no information in the record as to the nature or origin of the tax or whether the

10/ In reviewing the reasonableness of the limitation of operating costs to 10 percent of undepreciated investment, we note that over the 20-year depreciation schedule the undepreciated investment is reduced to zero (Findings and Conclusions, Attachment 1).

amount includes one or several taxes paid by Mobil. If compression costs are included in operating expenses, the percentage of actual operation and maintenance costs Mobil is allowed under the 10-percent limitation will be further reduced, making it even less likely that the limit reasonably represents the cost of transportation to the market. The CDM itself suggests one reason it may not. Consistent with the scope of Part 647 of the CDM, the 10-percent limitation appears to have been developed by the Geological Survey in relation to pipelines conveying oil and hydrocarbon gas, the more commonly marketed components of Federal oil and gas production. It may have accurately represented a reasonable maximum amount which the costs of transportation added to the value of those substances, but the same may not be true for the transportation of CO_2 produced from Federal oil and gas leases. 11/ If it is not, the 10-percent limitation would not be improper per se but its application to a CO_2 pipeline would be unreasonable and arbitrary.

Because the record is inadequate to establish a rationale basis for this aspect of the decision, we set aside the MMS determination limiting operating expenses to 10 percent of the undepreciated capital investment and remand the matter to MMS for review of the reasonableness of the costs reported by Mobil and, based on its review, a determination of the appropriate operating expenses to be included in calculating the transportation allowances.

The second issue raised by Mobil concerns the rate of return on investment. The RVSD Findings and Conclusions established the rate based on section 647.5A.3A of the CDM which states in part that "[u]nless otherwise justified, the prime interest rate in effect at the time of initial allowance approval should be used as a rate of allowable return on the depreciated investment." The Findings and Conclusions further stated that MMS' policy is "to use the prime interest rate, as published in the Wall Street Journal, in effect at the beginning of the year for which the initial allowance is granted." Following this procedure, the RVSD determined that the rate on January 8, 1985, was 10.75 percent.

On appeal to the Director, Mobil argued that if MMS policy had been followed, the rate published in the Wall Street Journal on January 2, 1985, should have been used. This rate, Mobil stated, was 11.25 percent. Mobil also argued that the standard was improper because the prime interest rate "reflects the short-term cost of money to the bank's most favored customers and can fluctuate greatly within a year" (SOR to Director at 5). RVSD's response disagreed with Mobil as to both the date of publication to be used and the rate. The RVSD contended that the rate published on January 2, 1985, was 10.75 percent rather than 11.25 percent but that this was not the proper date to use because it was the rate in effect for December 31, 1984.

11/ A right-of-way for a pipeline to transport CO_2 produced from Federal oil and gas leases is properly issued pursuant to the pipeline right-of-way provisions of section 28 of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 185 (1982). Exxon Corp., 97 IBLA 45, 94 I.D. 139 (1987), aff'd, Exxon Corp. v. Lujan, 730 F. Supp. 1535 (D. Wyo. 1990).

The rate in effect on January 2, 1985, the RVSD stated, was published on January 3, 1985. This rate, however, was also asserted by RVSD to be 10.75 percent. 12/

The Director's decision noted that the CDM calls for using the prime rate in effect at the time of the initial allowance approval and concluded that "[s]ince Mobil's transportation allowance was approved on December 31, 1986, it appears that RVSD erred in using the prime rate in effect on January 1, 1985" (Decision at 10). The decision remanded the matter to the RVSD for recalculation of the rate of return. It also rejected Mobil's arguments as to the method for establishing the rate because Mobil had not "provided a convincing factual basis which would support a finding that the 10.75 percent rate utilized by RMP was or is unreasonable or that a different rate would be more reasonable." Id.

On appeal Mobil argues that the Director's decision is contrary to the statement in the RVSD decision that MMS policy is to use the prime interest rate in effect at the beginning of the year for which the initial allowance is granted. Mobil also argues that using the rate in effect on the date a transportation allowance is granted allows MMS to delay approval awaiting a reduction in the rate. Mobil renews its argument that use of the prime rate is unreasonable, arbitrary, and capricious because it represents the short-term cost of money to a bank's most favored customers, can fluctuate greatly within a year, and does not reflect the risks of constructing a CO_2 transportation facility (SOR at 8). It proposes an alternative method for establishing a rate.

Subsequent to the filing of this appeal, MMS has submitted a copy of a memorandum dated May 5, 1988, from the Associate Director for Royalty Management to the Director of MMS which addresses the decision on appeal. It states:

> It has always been our policy to use the prime interest rate in effect at the beginning of the period for which the allowance will apply to calculate the allowance rate. The date of actual approval, which may occur after the period for which the allowance will apply, should not be a consideration in determining the appropriate rate of return to use in calculating an allowance.
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> * * * * * * *
>
> With this memorandum I am requesting that you approve our historic [sic] practice of using the prime interest rate in effect on the first day of the first deduction period, which is defined as any 12-month period for which the allowance will be effective. The CDM may be somewhat ambiguous, but this has been our

12/ Photocopies of relevant pages of the Wall Street Journal published on Jan. 2, 1985 (rate effective Dec. 31, 1984) and Jan. 3, 1985 (rate effective Jan. 2, 1985) appear in the case file and verify a prime rate of 10.75 percent.

> consistent policy in determining transportation and processing allowances for the period prior to March 1, 1988, * * *.

The memorandum states that "the rate of return at the beginning of the allowance period was 10.75 percent." The memorandum was approved by the Acting Director of MMS. In its Answer, MMS indicates that the appropriate rate is the one described in the memorandum and requests that the Board modify the Director's decision to allow a rate of return of 10.75 percent as "the prime rate in effect on January 1, 1985, the first day of the deduction period for which the allowance has been approved" (Answer at 15).

[5] When there is no market for production at the wellhead or in the field where production is obtained, the net-back or net-realization method of valuation for royalty purposes has been used to compute value at the point of production. Allowance of a return on capital investment has been recognized as an element of costs to be considered in using this method. United States v. General Petroleum Corp. of California, 73 F. Supp. 225, 247 (S.D. Cal.), aff'd, Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950). In General Petroleum Corp., the Department had allowed depreciation on capital investment in addition to the actual cost of operating the gathering system, but had refused to allow any return on capital investment, asserting that it was not allowable under the net-realization analysis. The court held that a "return on the lessees' depreciated investment in the wet-gas gathering system at Kettleman Hills should have been allowed." 73 F. Supp. at 257. Consistent with its finding that the rate of interest prevailing in the community for amounts involved in the judgment at the time in question was approximately 4 percent and that interest at that rate established "just compensation," the court allowed a 4-percent rate of return on capital investment. 73 F. Supp. at 264.

This Board has previously had occasion to examine the issue of the reasonableness of a rate of return on depreciated assets in computing an allowance for transportation costs. In Shell Oil Co., 52 IBLA 15, 88 I.D. 1 (1981), a case involving a transportation allowance for offshore production, we found that "a fair rate of return depends greatly on the economic conditions and other circumstances of the case at the time involved." 52 IBLA at 26, 88 I.D. at 6. In that case we upheld an allowance based on a 6-percent rate of return. In Black Butte Coal Co., 111 IBLA 275 (1989), involving an allowance for transportation and processing of coal produced under a Federal lease, the Board affirmed a transportation allowance in which the deduction for return on undepreciated investment was based on the prime rate of interest. 13/ Although there may be other measures of

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13/ In Phillips Petroleum Co., 109 IBLA 4 (1989), the Board remanded a case involving a transportation allowance calculated on the prime interest rate in effect on Jan. 1, 1975, for an audit period from 1976 through 1982. We specifically noted that the prime rate chosen was in effect at a time other than the relevant time and found compelling the emphasis in Shell Oil Co., supra, on the economic conditions at the time involved. Phillips Petroleum Co., supra at 15. We find Phillips to be distinguishable because the prime interest rate at issue here was the rate in effect for the initia period of the transportation allowance.

interest rate prevailing in the community at the relevant time, 14/ the prime rate of interest is clearly one reasonable measure of prevailing interest rates at the relevant time. Accordingly, finding no error has been established by appellant in use of the prime interest rate to compute return on undepreciated investment, Hence, the decision of the Director is affirmed as modified to allow a rate of return at the prime rate in effect on the first day of the deduction period for which the allowance has been approved.

The third issue raised by Mobil concerns compression expenses, which the RVSD did not allow Mobil to include in its operating expenses (Findings and Conclusions at 6). On appeal to the Director, Mobil argued that compression expenses should be allowed because no market exists for the CO_2 at the field and compression is necessary to transport it (SOR to Director at 6). Mobil also argued that disallowing compression expenses was unreasonable because they comprised 80 percent of the actual operating expenses and, under the circumstances, would be recognized as part of the costs of production under standard accounting practices. Id. The Director's decision upheld the RVSD determination based on the obligation of operators to put production into marketable condition, citing the decisions in Placid Oil Co., 70 I.D. 438 (1963); The California Co., 66 I.D. 54 (1954), aff'd sub nom. California Co. v. Seaton, 187 F. Supp. 445 (D.C.D.C. 1960), aff'd sub nom. California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961); and The Texas Co., 64 I.D. 76 (1957).

Mobil's SOR renews its arguments and analyzes the cases cited by the Director to show that they support Mobil's position. After Mobil filed its SOR, MMS requested and received several extensions of time to file an answer. Subsequently MMS requested and received a 6-month stay because discussions had been initiated between the parties. Upon further requests the stay was extended for an additional 6 months.

In its answer MMS states:

> During the period of the stay granted by this Board in this appeal, MMS reconsidered its decision regarding compression costs. It has concluded that the costs of compression may be allowed as a deduction when computing royalty value when those costs are shown to be related to the cost of transporting the CO_2 from the field to the nearest available market. This position is consistent with the IBLA [Departmental] decisions cited above as MMS continues the policy of disallowing deductions for the costs

14/ The new Federal gas valuation regulations at 43 CFR Subpart D, 53 FR 1272 (Jan. 15, 1988), provide with respect to transportation allowances that the "rate of return shall be the industrial rate associated with Standard and Poor's BBB rating. The rate of return shall be the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the reporting period for which the allowance is applicable and shall be effective during the reporting period." 30 CFR 206.157(b)(2)(v), 53 FR 1280.

of compression when those are costs of marketing the production, rather than costs of transporting it.

(Answer at 16). The answer further states that "MMS intends to allow Mobil's costs of compression which it can show are costs of transportation" and requests that the Board remand the issue to MMS to determine which costs are attributable to transportation (Answer at 17).

We grant the MMS request and set aside and remand that portion of the decision. Cf. Phillips Petroleum Co., 109 IBLA 4, 10-13 (1989) (expenses of moving wet gas from the field to the processing plant in order to extract natural gas liquid products and, thereafter, market the production allowable as a transportation cost).

We next consider the 50-percent transportation allowance limitation. The RVSD decision stated: "The 1985 allowances which MPTM may deduct will be the lesser of the approved allowance (the sum of the approved transportation allowances for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point." (Emphasis in original.) This determination was based on CDM section 647.5.3E which states: "Under no circumstances should transported costs exceed 50 percent of the product's fair market value at the market competitive sales point."

On appeal Mobil argues, as it did before the Director, that the 50-percent limitation was established in 1974 at a time when product prices were high and has subsequently become unreasonable, arbitrary, and capricious due to a considerable decline in the price of CO_2 at a time when operating costs have increased (SOR at 14). Mobil contends that, due to the distance between the McElmo Dome field and the Texas units, transportation costs are likely to be more than 50 percent of the sales price. MMS defends the limitation as a proper exercise of the Secretary's authority and argues that Mobil has failed to show it is unreasonable. MMS further notes that the Director's decision stated that Mobil could seek relief from the limitation by submitting a request with the RVSD but that Mobil has not done so.

We do not decide the issue because it is not ripe for review. Neither the value of the CO_2 sold nor the amount of deductible operating expenses have been established. The RVSD Findings and Conclusions states that MMS had requested Mobil "to submit a proposed valuation procedure for the establishment of value(s) for royalty purposes, of CO_2 disposed under any contracts" and that MMS will establish a royalty valuation procedure for the CO_2 pending receipt of Mobil's proposed procedure (Findings and Conclusions at 1). Absent a valuation of the CO_2, the question whether Mobil's expenses will exceed 50 percent of its value is speculative and the issue whether the limitation is reasonable and appropriate is hypothetical. Likewise, the amount of the deductible operating expense has not been established and, until it has, it is speculative whether it will exceed 50 percent of the value of the CO_2.

Until these facts have been determined, it is not clear that appellant has been adversely affected by a decision on this issue. Until such a decision has been made there is no case or controversy for us to decide and any ruling we might make would be advisory. The Board does not issue advisory

opinions. Tennessee Consolidated Coal Co. v. OSMRE, 99 IBLA 274 (1987); State of Alaska, 85 IBLA 170, 172 (1985); see also Conoco, Inc., 96 IBLA 384 (1987); Fred D. Zerfoss, 81 IBLA 14 (1984); Soderberg Rawhide Ranch Co., 63 IBLA 260 (1982). Accordingly, we conclude this issue is not properly before us at the present time. We note, however, that as the announced willingness of MMS to consider a waiver of the 50-percent limitation suggests, any decision on remand applying such a limitation to operating costs must establish a rational basis therefor.

The final issue raised by Mobil concerns RVSD's acceptance of the tariff submitted for the Cortez Pipeline as the basis for its transportation allowance except for the inclusion of state and Federal income taxes (Findings and Conclusions at 2, 6). In its appeal to the Director, Mobil submitted and relied upon an SOR which had been filed by Shell Western Exploration & Producing, Inc. (SWEPI), in a related appeal (IBLA 87-47). A decision on that appeal has been recently issued. Shell Western E & P, Inc., 112 IBLA 394 (1990). It is clear that the decision on appeal in that case was based on the same policy and rationale as in the present case. See CDM § 647.5A.3B(5) (allowable transportation costs for producer-owned pipelines include taxes other than income taxes). For reasons stated in the opinion, we found that the "denial of a transportation allowance for income taxes * * * solely on the basis that SWEPI is an affiliate of the pipeline operator was improper." Id. at 400. The decision is controlling in this case. Accordingly, we set aside the decision as to this matter and remand it to MMS.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director, Minerals Management Service, dated October 30, 1987, is affirmed in part as modified and set aside and remanded in part.

C. Randall Grant, Jr.
Administrative Judge

I concur:

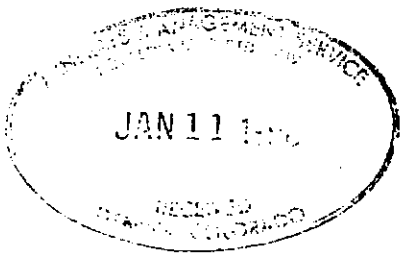
Wm. Philip Horton
Chief Administrative Judge

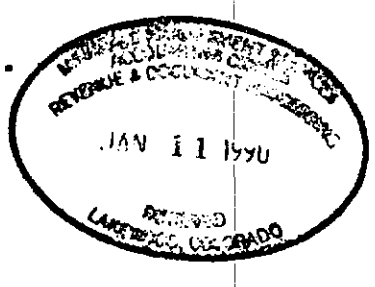
MOBIL EXPLORATION & PRODUCING U.S. INC.
P. O. Box 650232
Dallas, Texas 75265-0232

Attach 31

January 5, 1990

Minerals Management Service
Attn: Mr. Stan Brown
Royalty Management Program
P O Box 25165, Mail Stop 653
Denver CO 80225





1.96.01 TRANSPORTATION ALLOWANCES
MCELMO DOME CO2
REVISED TRANSPORTATION
FILINGS - 1986

Enclosed is a revised transportation allowance filing for 1986 for the McElmo Dome Unit. As stated in the Minerals Management Service's answer to Mobil's IBLA Appeal 88-158, the "...MMS intends to allow Mobil's costs of compression which it can show are costs of transportation...." The attached filing includes Mobil's compression expenses incurred in transporting the CO2. In addition, instead of using the Cortez Letter Tariff, we have computed actual costs on this segment.

Since the transportation allowance exceeds the MMS' general 50 percent ceiling on transportation allowances for the months listed on attachments I-1 through I-4, Mobil requests that the Secretary grant relief from this limitation. Attachment II lists the leases involved.

Attachment A reflects Mobil's revised transportation allowance request. For your convenience, attachment B shows the allowance which MMS previously approved for the McElmo Dome Unit. Enclosures C - F apply to the Cortez Pipeline segment; G - J show costs related to the Allred Station. A schematic drawing, labeled K, illustrates the pipeline disposition points.

Mobil asserts circumstances warranting relief from the limitation do exist. CO2 markets are scarce, leading to higher transportation costs as sales point distances increase from the McElmo Dome Unit field. Large, expensive CO2 pipelines are a necessity to market reserves which otherwise would never be developed, and few companies other than CO2 producers are willing to invest in these lines. It is interesting to note that Exxon's La Barge project has, and may still be flaring, over 100 MMCFD of CO2 because its planned market cannot afford the tariff necessary to justify a pipeline into the Dakotas and Canada. Obviously, transportation costs are a large part of the CO2 laydown price.

Mobil requests that MMS acknowledge CO2 markets warrant an exception from the 50 percent ceiling on transportation allowances. In the alternative, Mobil requests relief from the limitation because of circumstances beyond Mobil's control which adversely impact Mobil's CO2 sales from the McElmo Dome Unit field.

Questions concerning this matter should be directed to J. G. Anderson at (214) 951-4004.

Very truly yours,

R. D. Lee

for R. R. Bates
Manager, Royalty Compliance

JGAnderson
Attachments

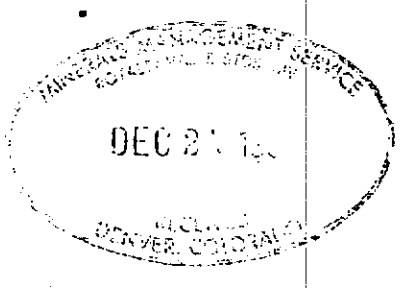
cc: B. A. Phillips - 15
R. A. Luettgen - 16

MOBIL EXPLORATION & PRODUCING U.S. INC.
P. O. Box 650232
Dallas, Texas 75265-0232

attach 30

December 21, 1989

Minerals Management Service
Attn: Mr. Stan Brown
Royalty Management Program
P O Box 25165, Mail Stop 653
Denver CO 80225



1.96.01 TRANSPORTATION ALLOWANCES
MCELMO DOME CO2
REVISED TRANSPORTATION
FILINGS - 1985

Enclosed is a revised transportation allowance filing for 1985 for the McElmo Dome Unit. As stated in the Minerals Management Service's answer to Mobil's IBLA Appeal 88-158, the "...MMS intends to allow Mobil's costs of compression which it can show are costs of transportation...." The attached filings include Mobil's compression expenses incurred in transporting the CO2. In addition, instead of using the Cortez Letter Tariff, we have computed actual costs on this segment.

Since the transportation allowance exceeds the MMS' general 50 percent ceiling on transportation allowances for the months listed on attachments I-1 through I-4, Mobil requests that the Secretary grant relief from this limitation. Attachment II lists the leases involved.

Attachment A reflects Mobil's revised transportation allowance request. For your convenience, attachment B shows the allowance which MMS previously approved for the McElmo Dome Unit. Enclosures C - E apply to the Cortez Pipeline segment; G - J show costs related to the Allred Station. A schematic drawing, labeled K, illustrates the pipeline disposition points.

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Mobil requests that MMS acknowledge CO2 markets warrant an exception from the 50 percent ceiling on transportation allowances. In the alternative, Mobil requests relief from the limitation because of circumstances beyond Mobil's control which adversely impact Mobil's CO2 sales from the McElmo Dome Unit field.

Questions concerning this matter should be directed to J. G. Anderson at (214) 951-4004.

Very truly yours,

R. D. Lee

for R. R. Bates
Manager, Royalty Compliance

JGAnderson
Attachments

cc: B. A. Phillips - 15
R. A. Luettgen - 16

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATIO I-1
1985 TRANSPORTATION ALLOWANCE

CO2 TO WELLMAN UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
			MMS .401049		
JAN	1.5225	0.7612500	0.598828	0	39
FEB	1.5225	0.7612500	0.598828	0	39
MAR	1.5225	0.7612500	0.598828	0	39
APR	1.4475	0.7237500	0.598828	0	41
MAY	1.4460	0.7230000	0.598828	0	41
JUN	1.4456	0.7230000	0.598828	0	41
JUL	1.4370	0.7228000	0.598828	0	41
AUG	1.4379	0.7185000	0.598828	0	42
SEP	1.4379	0.7189500	0.598828	0	42
OCT	1.4533	0.7189500	0.598828	0	42
NOV	1.4533	0.7266500	0.598828	0	41
DEC	1.4533	0.7266500	0.598828	0	41

22%

attach 29

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY REFER TO:

MMS-RVS-OG:88-0453

ENCLOSURE CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC.

Mr. L. R. Amsberry
Accounting Specialist
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

JUN 2 6 1989

Dear Mr. Amsberry:

By letter dated May 13, 1988, Mobil Producing Texas and New Mexico Inc. (MPTM) requested approval of transportation allowances pertaining to carbon dioxide (CO_2) production transported from the McElmo Dome Unit in southwestern Colorado through the Cortez Pipeline, MPTM's pipeline, West Texas Pipeline, and Sheep Mountain Pipeline. Mobil also requested approval of allowances for gathering and measuring CO_2 from the McElmo Dome Unit.

The Minerals Management Service (MMS) reviewed the information you submitted, and we have approved, subject to future audit, transportation allowances for the period January 1, 1988, through February 29, 1988, as outlined in the enclosed Findings and Conclusions.

New transportation allowance regulations became effective on March 1, 1988. Since you elected to come under the new regulations as of the effective date, a Form MMS-4295 was submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

You have the right to appeal this decision in accordance with 30 CFR 290 (1988). Please refer to the appeals procedure enclosure.

If there are any questions, please call Ms. Theresa Walsh Bayani at (303) 231-3395.

Sincerely,

Milton K. Dial
Chief, Royalty Valuation and Standards Division

2 Enclosures

Enclosure 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION
Findings and Conclusions
on
McElmo Dome Transportation Allowances

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado. Shell Western E&P Inc. (SWEPI) is the operator of the unit. Mobil Producing Texas & New Mexico Inc. (MPTM) is a working interest owner in the McElmo Dome Unit.

By letter dated May 13, 1988, MPTM requested approval of transportation allowances for the period January 1, 1988, through February 29, 1988, pertaining to CO_2 production transported from the McElmo Dome Unit to the following delivery points: McElmo Creek Unit; East Vacuum Unit; Central Basin Pipeline; Seminole-San Andres Unit; Willard Unit; Denver Unit; South Wasson Clearfork Unit; Mahoney Unit; Wellman Unit; and Dollarhide Unit. The transportation allowances are discussed by pipeline segments which include the following: The Cortez Pipeline; MPTM's pipeline; West Texas Pipeline; and Sheep Mountain Pipeline. The MPTM also requested approval of allowances for gathering and measuring CO_2 from the McElmo Dome Unit.

FINDINGS

Cortez Pipeline

° The MPTM requested a transportation allowance for the period January 1, 1988, through February 29, 1988, for CO_2 transported through the Cortez Pipeline from the McElmo Dome Unit to various units in west Texas. The Cortez Pipeline is owned by the Cortez Pipeline Company, of which MPTM, SWEPI, and Conoco Inc. are parent owners. The "Cortez Pipeline Company Letter Tariff" charges MPTM $0.39/Mcf for CO_2 transported through the Cortez Pipeline.

° The Minerals Management Service's (MMS) decisions dated March 29, 1984, December 31, 1986, and July 1, 1987, approved the costs incurred in the Cortez Pipeline Tariff, with the exception of income tax, as a transportation allowance for the shipment of CO_2. The approved "tariff calculation" procedure allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 pipeline consent decree. All components of the tariff were allowed to be deducted from the value of

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CO_2 with the exception of State and Federal income taxes. The SWEPI and MPTM are appealing the issue regarding the income taxes.

The MPTM's Pipeline

° Deliveries to the Seminole-San Andres, Willard, Wellman, and Mahoney Units are via the Cortez Pipeline and MPTM's pipeline segment. A pipeline segment and pump connecting the Cortez Pipeline and Sheep Mountain Pipeline are operated by MPTM. The MPTM's pipeline segment extends from the Allred Station, located near the Cortez Pipeline, to the Denver City Delivery Station, located on the Sheep Mountain Pipeline. The MPTM provided actual cost data for the period January 1, 1988, through February 29, 1988, regarding the transportation allowance for CO_2 transported to the Seminole-San Andres, Wellman, Mahoney, and Willard Units. Therefore, an allowance will be approved for this period.

° The transportation information submitted by MPTM for its pipeline segment is broken into four major components: depreciation, expenses, interest, and throughput. By letter dated July 1, 1987, MMS approved a 1986 allowance for MPTM's pipeline. The "Pipeline Capital Investment Depreciation Schedule" contained in the December 31, 1986, approval was utilized in the allowance calculation for the period January 1, 1988, through February 29, 1988. (See attachment 1.)

° The MPTM used a 10 percent salvage value in calculating depreciation. The Conservation Division Manual (CDM) states ". . . unless otherwise justified by the lessee, a salvage value of 10 percent should be applied to tangible items when determining the depreciable investment cost to be used in allowance calculation. . . ." The MMS bases all allowable depreciation on the actual, out-of-pocket costs incurred for real property and equipment integral to the pipeline.

° Compression performed after initial delivery in the field that is critical to transporting CO_2 along MPTM's pipeline is allowable in the computation of the transportation allowance for MPTM's pipeline. The cost of compressors located along the transportation route on MPTM's pipeline where the primary function is to keep production moving through the pipeline could clearly be construed as allowable transportation costs since the compression is performed to maintain the pressure at all points along the pipeline. Compression performed where the primary function is to get production from one pipeline into another pipeline (after initial delivery from the field) is also allowable in the computation of the transportation allowance since the compression is necessary to move the production into another pipeline

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leading to the sales point. All the cost categories represent MMS-acceptable pipeline capital expenditures.

° The MPTM's submittal details the costs MPTM considers to be pertinent to the expense item of the transportation allowance calculation.

° The transportation allowance costs submitted by MPTM are broken into eight major groups: operating labor; maintenance labor; operating supplies, utilities, and fuel; services purchased; maintenance supplies; other direct expenses; overhead; and indirect expenses.

° The MMS's policy is to allow actual overhead costs limited to 10 percent of operating costs. The MPTM's overhead costs exceeded 10 percent of the allowable operating costs. Therefore, MPTM's overhead costs are limited to $1,676.84. (See attachment 2.)

° The MPTM's category descriptions for operating and maintenance costs and indirect expense items represent MMS-acceptable pipeline expenses. The services purchased are within MMS-acceptable operation costs.

° The CDM allows certain operating expenses in the calculation of a transportation allowance. Section 647.5A.3B states in part:

> Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lessor of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which the operating costs are being computed.

° Taxes (except income taxes) are allowed by MMS as an expense item. Only those taxes attributive to the pipeline will be allowed.

° The MPTM submittal provided actual throughput for January 1, 1988, through February 29, 1988. These figures represent CO_2 transported in MPTM's pipeline segment to the Seminole-San Andres, Willard, Wellman, and Mahoney Units.

Sheep Mountain Pipeline

° A portion of MPTM's McElmo Dome CO_2 production is transported to the Seminole-San Andres Unit via the Cortez Pipeline, MPTM's pipeline segment, and Sheep Mountain Pipeline. The MPTM requested a transportation allowance for CO_2 production transported through the Sheep Mountain Pipeline.

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- Amerada Hess Corporation (AHC) is an undivided interest owner of 30 percent of the southern segment of the Sheep Mountain Pipeline system which begins in New Mexico and extends to the Seminole-San Andres Unit, Gaines County, Texas. The arm's-length "Carbon Dioxide Transportation Agreement" was negotiated between MPTM and AHC on February 13, 1984, to transport MPTM's portion of CO_2 production from the Denver City Delivery Station, located on the Sheep Mountain Pipeline, to the Seminole-San Andres Unit. The MPTM is charged a transportation fee of $0.035/Mcf of CO_2 measured at the delivery station on the Sheep Mountain Pipeline.

West Texas Pipeline

- The MPTM requested a transportation allowance for CO_2 transported through the West Texas Pipeline for the period January 1, 1988, through February 29, 1988. The arm's-length "Carbon Dioxide Transportation Contract" was negotiated between MPTM and Big Three Industries, Inc., on April 18, 1986, to transport MPTM's portion of CO_2 production from the Denver City CO_2 Delivery Station, located on the Cortez Pipeline, to the South Wasson Clearfork Unit. The MPTM is charged a transportation fee of $4,300 per month. The monthly charge is adjusted by an adjustment multiplier as detailed in section 6.2 of the transportation agreement.

- The MPTM requested a transportation allowance of $0.11/Mcf for CO_2 transported to the Dollarhide Unit through the West Texas Pipeline. The arm's-length transportation agreement was negotiated on September 9, 1985, between MPTM and Big Three Industries, Inc.

- The CDM section 647.5C.3 states in part:

  > Allowances will be granted to cover transportation costs incurred in moving production through pipelines owned by parties other than the lessee. The allowance will be limited to . . . actual charges to the lessee for transporting production, pursuant to an arm's-length contract.

- The CDM section 647.5.3C states in part:

  > Generally, if the lessee/operator is transporting production under an arm's-length agreement by the only mode available to him, then these costs may be allowed even though they may be higher than other modes of transportation.

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Cortez Tariff No. 2

° The MPTM requested an allowance for the period January 1, 1988, through February 29, 1988, for a transfer charge for the movement of CO_2 through a gathering system from the Yellow Jacket Junction to the junction of Cortez Gathering System and the Hovenweep Central Facility Pipeline. The "Cortez Pipeline Company Letter Tariff No. 2" charges MPTM $0.05/Mcf for the movement of CO_2 from non-Hovenweep Facility sources through the gathering system located within the McElmo Dome Unit boundary.

Metering Facility Agreements

° The MPTM requested an allowance for a metering charge to measure CO_2 from the McElmo Dome Unit to the McElmo Creek Unit Pipeline. The MPTM submitted a copy of the "McElmo Creek Facility Lease Agreement" between Shell Western Pipelines Inc. (SWPI) and MPTM that charges MPTM $5,000 per month to measure CO_2 at the metering facility that is located within the McElmo Dome Unit. The SWPI is the owner of the metering facility.

° The MPTM also requested an allowance for a metering charge to measure CO_2 at the Tatum Metering Facility. The MPTM submitted a copy of the "Tatum Facility Lease Agreement" between SWPI and MPTM that charges MPTM $3,000 per month to measure CO_2 at the metering facility that is located in Lea County, New Mexico.

° At 43 CFR § 3162.7-1 (1987), "Measurement, disposition and protection of production," section (a) reads as follows:

> The lessee shall put into marketable condition, if economically feasible, all oil, other hydrocarbons, gas and sulphur produced from the leased land.

° Section 647.3A of COM states in part:

> The lessee is obligated to place lease production in marketable condition without deduction of costs for measuring, compressing or otherwise conditioning the gas market. Under no circumstances will royalty be computed on less than the gross proceeds accruing to the lessee from the sale of leasehold production.

° Notice to Lessees and Operators No. 1 (NTL-1), "Procedures for Reporting and Accounting for Royalties," under section III, "Gas and Associated Liquids Production, Sales, and Royalty Requirements," states:

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> Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursements and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. Likewise, no deduction will be allowed for the cost which an operator incurs by reason of placing the gas in a marketable condition as an operator is obligated to do so at no cost to the lessor.

° The preceding statement is primarily concerned with gross proceeds. However, in defining the term, gathering gas is considered part of the activities for which the operator is responsible, at no cost to the lessor.

° The new oil and gas valuation regulations provide that transportation allowances approved in writing by MMS before March 1, 1988, will be allowed to continue until such allowances terminate. Since MPTM elected to come under the new regulations effective March 1, 1988, a Form MMS-4295 was submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

CONCLUSIONS

Cortez Pipeline

° The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable with the exception that for royalty purposes State and Federal income taxes are not to be considered in computing transportation costs. Accordingly, State and Federal income taxes should be eliminated before transportation costs are computed.

The MPTM's Pipeline

° The MPTM's pipeline transportation allowance is computed annually based on actual allowable costs, consistent with MMS's established policy.

° The pipeline operating and maintenance costs represent MMS-acceptable operating costs. All compression critical to transporting CO_2 along MPTM's pipeline will be allowed.

° The MMS's policy is to allow actual overhead costs (not to exceed 10 percent of the allowable costs) in computing a transportation allowance. The MPTM's

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overhead costs exceeded 10 percent of the allowable costs. Therefore, MPTM's overhead costs are limited to $1,676.84.

° Attachments 1 and 2 detail all costs allowed by MMS for MPTM's pipeline. Attachment 1 is a copy of the depreciation schedule for MPTM's pipeline approved by letter dated December 31, 1986. Attachment 3 details the allowable costs for MPTM's pipeline for the period January 1, 1988, through February 29, 1988.

Sheep Mountain Pipeline

° The MMS's policy is to grant transportation allowances to cover transportation costs incurred in moving production through pipelines not owned by the lessee. Therefore, the transportation fee of $0.035/Mcf charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the Sheep Mountain Pipeline is an acceptable cost in the computation of the transportation allowance.

West Texas Pipeline

° The transportation fee of $4,300 per month adjusted by an adjustment multiplier charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the West Texas Pipeline to the South Wasson Clearfork Unit is an acceptable cost in the computation of the transportation allowance. The approved costs are for January 1, 1988, through February 29, 1988, and are the actual monthly charges.

° The transportation fee of $0.11/Mcf charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the West Texas Pipeline to the Dollarhide Unit is an acceptable cost in the computation of the transportation allowance. For this pipeline segment, the approved cost will be used for the period January 1, 1988, through February 29, 1988.

Cortez Tariff No. 2, McElmo Creek Facility Lease Agreement, and Tatum Metering Facility

° Pertinent regulations and NTL-1 state that the lease operator has the responsibility and obligation to place the gas in marketable condition. At least one court decision has upheld the principle that the lease operator is obligated to perform necessary field measuring and gathering operations and that the gas conditioning processes are not deductible in computing Federal royalty.

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° The MPTM's request for approval of measuring and gathering charges as a transportation allowance should be denied. Gathering and measuring costs are not an allowable deduction from Federal royalty.

Limitation of Transportation Allowances

° To determine the transportation allowance for each delivery point, MPTM should calculate the sum of the approved transportation costs for the pipeline segments to each delivery point.

° The allowance for the period January 1, 1988, through February 29, 1988, which MPTM may deduct will be the lesser of the approved allowance (the sum of the approved transportation costs for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point.

° The new oil and gas valuation regulations became effective March 1, 1988. Since MPTM elected to come under the new regulations effective March 1, 1988, Forms MMS-4295 were submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

Attachment 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

Mobil CO_2 Transportation Allowance
Pipeline Capital Investment Depreciation Schedule

(1) Allowance Year	(2) Capital Invest.	(3) Undep. Invst. Beg. of Year	(4) Depreciation	(5) Undep. Invst. End of Year	(6) Return on Invest.
1985					
1986					
1987					
1988					
1989					
1990					
1991					
1992					
1993					
1994					
1995					
1996					
1997					
1998					
1999					
2000					
2001					
2002					
2003					
2004					
2005					

X - 4

---

(1) 20-year, straight-line depreciation, 10 percent salvage value.

(2) Allowable pipeline capital investment.

(3) Remaining undepreciated investment at beginning of year.

(4) Annual depreciation (X · 4 ÷ 20).

(5) Undepreciated investment, beginning of year minus annual depreciation.

(6) Undepreciated investment, beginning of year times prime interest rate of 10.75 percent.

Attachment 2

THIS DOCUMENT CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC.

January 1, 1988, Through February 29, 1988
Operating Expenses, MPTM CO_2 Pipeline

Actual Operating Costs[1]	$16,768.39
Overhead[2] (limited to 10% allowable operating costs)	$1,676.84
Total Operating Expenses[3]	$18,445.23
Undepreciated Investment Beginning of Year		
Total MMS-Allowable Operating Expenses (limited to lesser of actual operating expenses or 10% of undepreciated investment)	X .4

---

[1]Operating figures from MPTM's submittal dated May 13, 1988.

[2]The MPTM's overhead expenses exceeded 10 percent of allowable operating costs.

[3]The MPTM's actual operating expenses did not exceed 10 percent of undepreciated investment.

Attachment 3

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

Transportation Allowance Calculation, MPTM CO_2 (pipeline) - January 1, 1988, Through February 29, 1988

$$\text{Transportation Allowance} = \frac{\text{Depreciation(D)}^1 + \text{Operating Expenses(E)}^2}{\text{Throughput}} + \text{Return on Investment(I)}$$

$$\times \frac{1}{1}$$

Seminole-San Andres Unit

$$\times \frac{1}{1}$$

Willard, Wellman, and Mahoney Units

---

[1]Depreciation and return on investment figures from attachment 1.

[2]Operating expenses from attachment 2.

[3]The MPTM submitted a breakdown of costs which includes 80 percent applied to the Seminole-San Andres Unit and 20 percent to the Willard, Wellman, and Mahoney Units.

MOBIL EXPLORATION & PRODUCING US INC
AS AGENT FOR MOBIL PROD TX & NM INC
MMS A.I.D. NUMBER LISTING
MCELMO DOME UNIT
UNIT NUMBER 9102117600

	LEASE NAME		TRACT %
0-005-047930-A-002	TRACT	3-3	0.039490
0-005-047930-A-003	TRACT	3-4	0.078970
0-005-085533-0-002	TRACT	3-5B	0.039490
0-005-085533-0-003	TRACT	3-5A	0.078970
0-005-103715-A-002	TRACT	3-105	0.039490
0-005-120610-b-001	TRACT	3-8	0.039490
0-005-123274-0-002	TRACT	3-106	0.039490
0-005-127321-A-001	TRACT	3-9	0.039490
0-069-000373-A-002	TRACT	4-2	0.078970
0-069-000373-A-003	TRACT	4-1	0.236910
0-069-002653-0-002	TRACT	5-24	0.276400
0-069-002654-A-001	TRACT	2-2	0.157940
0-069-002654-0-001	TRACT	1-4	0.177690
0-069-002751-0-001	TRACT	1-5	0.078970
0-069-003119-0-001	TRACT	2-3	0.517230
0-069-004020-0-001	TRACT	2-4	0.330280
0-069-004042-0-001	TRACT	4-3	0.047630
0-069-004342-0-001	TRACT	4-4	0.138200
0-069-004342-0-002	TRACT	4-5	0.315890
0-069-004408-A-001	TRACT	5-1	0.078870
0-069-004690-0-001	TRACT	2-5	0.078970
0-069-004696-0-001	TRACT	4-7	0.157940
0-069-008343-0-001	TRACT	2-6	0.009550
0-069-009418-0-001	TRACT	4-8	0.078970
0-069-009419-0-001	TRACT	3-13	0.059230
0-069-009975-0-001	TRACT	6-1	0.236910
0-069-009976-A-001	TRACT	4-9	0.047600
0-069-009976-B-001	TRACT	4-10	0.433070
0-069-009980-0-001	TRACT	6-54	0.612030
0-069-009984-A-001	TRACT	5-3	0.274430
0-069-009985-0-001	TRACT	1-6	0.281430
0-069-009986-A-001	TRACT	2-9	0.671260
0-069-009986-0-001	TRACT	2-8	0.197430
0-069-009987-B-001	TRACT	2-12	0.315890
0-069-009987-0-001	TRACT	2-10	0.157940
0-069-009987-0-002	TRACT	2-11	0.157940
0-069-010105-0-001	TRACT	2-14	0.023050
0-069-010110-0-001	TRACT	4-11	0.315890
0-069-010364-A-001	TRACT	4-13	0.157940
0-069-010364-A-002	TRACT	4-14	0.157940
0-069-010364-0-002	TRACT	5-4	0.335250
0-069-010366-0-001	TRACT	6-2	0.631770
0-069-010367-0-001	TRACT	6-3	0.139900
0-069-010368-0-001	TRACT	4-15	0.182790
0-069-010592-0-001	TRACT	6-4	0.790760

0-069-010593-0-001	TRACT	6-5	0.078970
0-069-010594-0-001	TRACT	6-6	0.138200
0-069-010792-0-001	TRACT	1-7	0.039490
0-069-010925-0-001	TRACT	3-20	0.040340
0-069-011145-0-001	TRACT	4-16	0.158030
0-069-011283-0-001	TRACT	2-15	0.009220
0-069-011511-0-001	TRACT	5-5	0.552330
0-069-011644-A-001	TRACT	5-7	0.315890
0-069-011645-A-001	TRACT	5-9	0.315890
0-069-011646-A-001	TRACT	2-17	0.276400
0-069-011647-0-001	TRACT	4-50	0.648400
0-069-011647-0-002	TRACT	5-10	0.343840
0-069-011651-0-001	TRACT	6-7	0.355370
0-069-011652-0-001	TRACT	6-8	0.315890
0-069-011653-A-001	TRACT	4-18	0.157940
0-069-011653-B-001	TRACT	4-19	0.315890
0-069-011654-A-001	TRACT	4-21	0.078970
0-069-011654-B-001	TRACT	4-22	0.019740
0-069-011654-0-001	TRACT	4-20	0.368040
0-069-011655-A-001	TRACT	4-23	0.084610
0-069-011655-B-001	TRACT	3-22	0.016580
0-069-011656-0-001	TRACT	6-12	0.214680
0-069-011657-0-001	TRACT	4-24	0.118460
0-069-011658-0-001	TRACT	3-23	0.179570
0-069-011659-0-001	TRACT	1-8	0.276400
0-069-011660-0-001	TRACT	1-9	0.315890
0-069-011662-0-001	TRACT	3-25	0.304010
0-069-012034-0-001	TRACT	6-14	0.828670
0-069-012035-0-001	TRACT	6-15	0.316520
0-069-012037-A-001	TRACT	5-12	0.157940
0-069-012039-A-001	TRACT	1-10	0.213370
0-069-012045-0-001	TRACT	6-16	1.073540
0-069-012047-0-001	TRACT	6-17	0.569720
0-069-012049-0-001	TRACT	4-27	0.121640
0-069-012050-0-001	TRACT	3-27	0.167900
0-069-012052-0-001	TRACT	6-55	0.930910
0-069-012062-A-001	TRACT	5-15	0.039490
0-069-012177-0-001	TRACT	5-16	0.522350
0-069-012463-0-001	TRACT	1-11A	0.540380
0-069-012463-0-002	TRACT	1-11B	0.078970
0-069-012463-0-003	TRACT	1-11C	0.086920
0-069-012465-0-001	TRACT	4-28	0.315890
0-069-012605-0-001	TRACT	6-18	0.197430
0-069-012606-0-001	TRACT	6-19	0.296140
0-069-012607-0-001	TRACT	6-20	0.953690
0-069-013895-0-001	TRACT	3-28	0.039490
0-069-014234-0-001	TRACT	4-30	0.177420
0-069-014235-0-001	TRACT	4-31	0.324170
0-069-014236-0-001	TRACT	3-29	0.081510
0-069-014884-0-001	TRACT	4-32	0.078970
0-069-014885-0-001	TRACT	1-12	0.059230
0-069-015809-0-001	TRACT	6-56	0.205760
0-069-017117-0-001	TRACT	4-33	0.001790
0-069-017617-0-003	TRACT	3-96A	0.078970
0-069-017617-0-004	TRACT	3-96B	0.083680
0-069-017620-A-001	TRACT	3-32	0.157940

0-069-017620-0-001	TRACT	4-34	0.157940
0-069-019348-0-001	TRACT	1-13	0.039490
0-069-019354-0-001	TRACT	4-36	0.315890
0-069-019356-0-001	TRACT	4-38	0.079180
0-069-019664-0-001	TRACT	3-34	0.042030
0-069-019665-0-001	TRACT	3-35	0.078970
0-069-019666-0-001	TRACT	3-36	0.118460
0-069-019738-0-001	TRACT	6-24	0.239820
0-069-020432-A-001	TRACT	2-21	0.009430
0-069-020432-0-001	TRACT	3-37	0.039490
0-069-021139-0-001	TRACT	1-15	0.157940
0-069-021443-0-001	TRACT	3-39	0.081580
0-069-022369-0-001	TRACT	4-40	0.085310
0-069-022370-0-001	TRACT	3-40	0.157940
0-069-022371-0-001	TRACT	4-41	0.008130
0-069-022490-0-001	TRACT	6-26	0.750870
0-069-022712-0-001	TRACT	3-42	0.400580
0-069-022756-0-001	TRACT	1-19	0.137670
0-069-023822-0-001	TRACT	4-43	0.335630
0-069-024213-0-001	TRACT	3-45	0.868680
0-069-024217-0-001	TRACT	4-45	0.473950
0-069-024971-0-001	TRACT	4-46	0.215710
0-069-024972-0-001	TRACT	3-46	0.126310
0-069-024973-0-001	TRACT	3-47	0.078970
0-069-025336-0-001	TRACT	4-47	0.157940
0-069-025338-A-001	TRACT	3-48A	0.019740
0-069-025553-0-001	TRACT	1-16	0.207250
0-069-025554-0-001	TRACT	3-49	0.157940
0-069-026072-0-001	TRACT	2-1	0.217170
0-069-026073-0-001	TRACT	3-53	0.083050
0-069-026074-0-001	TRACT	2-7	0.552800
0-069-026075-0-001	TRACT	3-54	0.047650
0-069-026075-0-002	TRACT	3-55	0.019740
0-069-026076-0-001	TRACT	3-56	0.165070
0-069-026076-0-002	TRACT	3-57	0.189990
0-069-026077-0-001	TRACT	3-58	0.115800
0-069-026078-0-001	TRACT	2-18	0.449860
0-069-026079-0-001	TRACT	3-59	0.312750
0-069-026080-0-001	TRACT	2-20	0.177690
0-069-026082-0-001	TRACT	3-61	0.396140
0-069-026083-0-001	TRACT	4-48	0.001200
0-069-026084-0-001	TRACT	1-3	0.078970
0-069-026372-0-001	TRACT	5-31	0.019740
0-069-026375-0-001	TRACT	3-18	0.059600
0-069-026376-0-001	TRACT	5-25	0.236910
0-069-026377-0-001	TRACT	3-38	0.343260
0-069-026482-0-001	TRACT	3-62	0.275100
0-069-026490-0-001	TRACT	6-29	0.552800
0-069-026504-0-001	TRACT	3-67	0.281200
0-069-026514-0-001	TRACT	4-49	0.184850
0-069-026967-0-002	TRACT	3-100A	0.081030
0-069-026967-0-003	TRACT	3-100B	0.039490
0-069-026972-0-001	TRACT	4-51	0.299300
0-069-026973-0-001	TRACT	4-52	0.238460
0-069-026974-0-001	TRACT	3-101	0.039490
0-069-026975-0-001	TRACT	4-53	0.404950

0-069-026976-0-001	TRACT	4-54	0.078970
0-069-026977-0-001	TRACT	4-55	0.283310
0-069-027175-0-001	TRACT	4-56	0.006270
0-069-027188-0-001	TRACT	6-10	0.155130
0-069-027189-0-001	TRACT	6-13	0.731220
0-069-027293-A-001	TRACT	4-67	0.019740
0-069-027343-0-001	TRACT	5-32	0.019740
0-069-027343-0-002	TRACT	5-33	0.059230
0-069-027344-0-001	TRACT	5-34	0.118280
0-069-027345-0-001	TRACT	5-35	0.019740
0-069-027358-0-001	TRACT	6-46	0.039490
0-069-027359-0-001	TRACT	6-47	0.394860
0-069-027360-0-001	TRACT	6-48	0.555140
0-069-027361-0-001	TRACT	6-49	0.789710
0-069-027362-0-001	TRACT	6-50	0.552800
0-069-027364-0-001	TRACT	6-51	0.078970
0-069-027365-0-001	TRACT	6-52	0.078970
0-069-027369-0-001	TRACT	6-53	0.158450
0-069-030166-0-001	TRACT	2-84	0.059230
0-069-030167-0-001	TRACT	2-77	0.019740
0-069-033296-0-001	TRACT	2-79	0.018830
0-069-033296-0-002	TRACT	2-83	0.226690
0-069-033297-0-001	TRACT	2-80	0.039490
0-069-033297-0-002	TRACT	2-81	0.039490
0-069-033298-0-001	TRACT	2-78B	0.315890
0-069-033299-0-001	TRACT	2-78A	0.295810
0-069-033300-0-001	TRACT	4-61A	0.135390
0-069-033301-0-001	TRACT	4-60	0.157940
0-069-033301-0-002	TRACT	4-61B	0.157940
0-069-033302-0-001	TRACT	4-59B	0.131030
0-069-033303-0-001	TRACT	4-59A	0.184570
0-069-033304-0-001	TRACT	3-64	0.078970
0-069-033304-0-002	TRACT	3-65	0.054420
0-069-033304-0-003	TRACT	3-66	0.090600
0-069-033306-0-001	TRACT	3-108B	0.039490
0-069-033306-0-002	TRACT	3-109B	0.112830
0-069-033307-0-001	TRACT	3-108A	0.059230
0-069-033307-0-002	TRACT	3-109A	0.078970
0-069-033307-0-003	TRACT	3-110C	0.138290
0-069-033308-0-001	TRACT	3-107	0.078970
0-069-033308-0-002	TRACT	3-110B	0.177690
0-069-033309-0-001	TRACT	3-110A	0.098710
0-069-033310-0-001	TRACT	3-63	0.039490
0-069-035914-0-001	TRACT	2-85	0.019740
0-069-035915-0-001	TRACT	2-82	0.098710
0-069-035915-0-002	TRACT	2-86	0.177690
0-069-035916-0-001	TRACT	3-111	0.078970
0-069-035916-0-002	TRACT	3-112	0.039490
0-069-037436-0-001	TRACT	4-61C	0.019740
0-069-037437-0-001	TRACT	4-62	0.039490
0-069-037438-0-001	TRACT	4-63	0.078970
0-069-037439-0-001	TRACT	6-31	0.015790
0-069-037440-0-001	TRACT	6-59	0.133960
0-077-058420-0-001	TRACT	3-1	0.126860
0-077-060887-0-002	TRACT	3-2	0.084040

attach 28

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-OG:88-0277

JUN 26 1989

ENCLOSURE CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

Mr. L. R. Amsberry
Accounting Specialist
Mobil Exploration & Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Dear Mr. Amsberry:

By letter dated March 25, 1988, Mobil Exploration & Producing U.S. Inc. (Mobil), agent for Mobil Producing Texas and New Mexico Inc. (MPTM), requested approval of transportation allowances pertaining to carbon dioxide (CO_2) production transported from the McElmo Dome Unit in southwestern Colorado through the Cortez Pipeline, MPTM's pipeline, West Texas Pipeline, and Sheep Mountain Pipeline. Mobil also requested approval of allowances for gathering and measuring CO_2 from the McElmo Dome Unit.

The Minerals Management Service (MMS) reviewed the information you submitted, and we have approved, subject to future audit, 1987 transportation allowances as outlined in the enclosed Findings and Conclusions. By letter dated May 13, 1988, MPTM requested approval of transportation allowances for the period January 1, 1988, through February 29, 1988. You will be provided a separate response addressing the allowances for this later timeframe.

New transportation allowance regulations became effective on March 1, 1988. Since you elected to come under the new regulations as of the effective date, a Form MMS-4295 was submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

You have the right to appeal this decision in accordance with 30 CFR 290 (1988). Please refer to the appeals procedure enclosure.

If there are any questions, please call Ms. Theresa Walsh Bayani at (303) 231-3395.

Sincerely,

for Milton K. Dial
Chief, Royalty Valuation and
Standards Division

2 Enclosures

Enclosure 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION
Findings and Conclusions
on
McElmo Dome Transportation Allowances.

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado. Shell Western E&P Inc. (SWEPI) is the operator of the unit. Mobil Producing Texas & New Mexico Inc. (MPTM) is a working interest owner in the McElmo Dome Unit. The CO_2 is transported through the Cortez Pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects. The Cortez Pipeline is owned by the Cortez Pipeline Company, of which MPTM, SWEPI, and Conoco Inc. are parent owners.

By letter dated March 25, 1988, MPTM requested approval of transportation allowances pertaining to CO_2 production transported from the McElmo Dome Unit to the following delivery points: McElmo Creek Unit; East Vacuum Unit; Central Basin Pipeline; Seminole-San Andres Unit; Willard Unit; Denver Unit; South Wasson Clearfork Unit; Mahoney Unit; Wellman Unit; and Dollarhide Unit. The transportation allowances are discussed by pipeline segments which include the following: The Cortez Pipeline; MPTM's pipeline; West Texas Pipeline; and Sheep Mountain Pipeline. The MPTM also requested approval of allowances for gathering and measuring CO_2 from the McElmo Dome Unit.

FINDINGS

Cortez Pipeline

° The MPTM requested a 1987 transportation allowance for CO_2 transported through the Cortez Pipeline from the McElmo Dome Unit to various units in west Texas. The Cortez Pipeline is owned by the Cortez Pipeline Company, of which MPTM, SWEPI, and Conoco Inc. are parent owners. The "Cortez Pipeline Company Letter Tariff" charges MPTM $0.39/Mcf for CO_2 transported through the Cortez Pipeline.

° The Minerals Management Service's (MMS) decisions dated March 29, 1984, December 31, 1986, and July 1, 1987, approved the costs incurred in the Cortez Pipeline Tariff, with the exception of income tax, as a transportation allowance for the shipment of CO_2. The approved "tariff calculation" procedure allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 pipeline consent decree. All components of the tariff were allowed to be deducted from the value of

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CO_2 with the exception of State and Federal income taxes. The SWEPI and MPTM are appealing the issue regarding the income taxes.

The MPTM's Pipeline

° Deliveries to the Seminole-San Andres, Willard, Wellman, and Mahoney Units are via the Cortez Pipeline and MPTM's pipeline segment. A pipeline segment and pump connecting the Cortez Pipeline and Sheep Mountain Pipeline are operated by MPTM. The MPTM's pipeline segment extends from the Allred Station, located near the Cortez Pipeline, to the Denver City Delivery Station, located on the Sheep Mountain Pipeline. The MPTM provided actual cost data for their 1987 transportation allowance for CO_2 transported to the Seminole-San Andres, Wellman, Mahoney, and Willard Units. Therefore, a 1987 allowance will be approved.

° The transportation information submitted by MPTM for its pipeline segment is broken into four major components: depreciation, expenses, interest, and throughput. By letter dated July 1, 1987, MMS approved a 1986 allowance for MPTM's pipeline. The "Pipeline Capital Investment Depreciation Schedule" contained in the December 31, 1986, approval was utilized in the 1987 allowance calculation. (See attachment 1.)

° The MPTM used a 10 percent salvage value in calculating depreciation. The Conservation Division Manual (CDM) states ". . . unless otherwise justified by the lessee, a salvage value of 10 percent should be applied to tangible items when determining the depreciable investment cost to be used in allowance calculation. . . ." The MMS bases all allowable depreciation on the actual, out-of-pocket costs incurred for real property and equipment integral to the pipeline. The undepreciated investment for the beginning of 1987 is X-4

° Compression performed after initial delivery in the field that is critical to transporting CO_2 along MPTM's pipeline is allowable in the computation of the transportation allowance for MPTM's pipeline. The cost of compressors located along the transportation route on MPTM's pipeline where the primary function is to keep production moving through the pipeline could clearly be construed as allowable transportation costs since the compression is performed to maintain the pressure at all points along the pipeline. Compression performed where the primary function is to get production from one pipeline into another pipeline (after initial delivery from the field) is also allowable in the computation of the transportation allowance since the compression is necessary to move the production into another pipeline leading to the sales point. All the cost categories represent MMS-acceptable pipeline capital expenditures.

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° The MPTM's submittal details the costs MPTM considers to be pertinent to the expense item of the transportation allowance calculation.

° The transportation allowance costs submitted by MPTM are broken into eight major groups: operating labor; maintenance labor; operating supplies, utilities, and fuel; services purchased; maintenance supplies; other direct expenses; overhead; and indirect expenses.

° The MMS's policy is to allow actual overhead costs limited to 10 percent of operating costs. The MPTM's overhead costs exceeded 10 percent of the allowable operating costs. Therefore, MPTM's overhead costs are limited to $9,993.97. (See attachment 2.)

° The MPTM's category descriptions for operating and maintenance costs and indirect expense items represent MMS-acceptable pipeline expenses. The services purchased are within MMS-acceptable operation costs.

° The COM allows certain operating expenses in the calculation of a transportation allowance. Section 647.5A.3B states in part:

> Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which the operating costs are being computed.

° The total MMS-allowable operating costs for MPTM's pipeline do not exceed 10 percent of the undepreciated investment at the beginning of 1987.

° Taxes (except income taxes) are allowed by MMS as an expense item. Only those taxes attributive to the pipeline will be allowed.

° The MPTM submittal provided actual throughput for 1987. These figures represent CO_2 transported in MPTM's pipeline segment to the Seminole-San Andres, Willard, Wellman, and Mahoney Units.

Sheep Mountain Pipeline

° A portion of MPTM's McElmo Dome CO_2 production is transported to the Seminole-San Andres Unit via the Cortez Pipeline, MPTM's pipeline segment, and Sheep Mountain Pipeline. The MPTM requested a transportation allowance for CO_2 production transported through the Sheep Mountain Pipeline.

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- Amerada Hess Corporation X-4 is an undivided interest owner of 30 percent of the southern segment of the Sheep Mountain Pipeline system which begins in New Mexico and extends to the Seminole-San Andres Unit, Gaines County, Texas. The arm's-length "Carbon Dioxide Transportation Agreement" was negotiated between MPTM and AHC on February 13, 1984, to transport MPTM's portion of CO_2 production from the Denver City Delivery Station, located on the Sheep Mountain Pipeline, to the Seminole-San Andres Unit. The MPTM is charged a transportation fee of $0.035/Mcf of CO_2 measured at the delivery station on the Sheep Mountain Pipeline.

West Texas Pipeline

- The MPTM requested a 1987 transportation allowance for CO_2 transported through the West Texas Pipeline. The arm's-length "Carbon Dioxide Transportation Contract" was negotiated between MPTM and Big Three Industries, Inc., on April 18, 1986, to transport MPTM's portion of CO_2 production from the Denver City CO_2 Delivery Station, located on the Cortez Pipeline, to the South Wasson Clearfork Unit. The MPTM is charged a transportation fee of $4,300 per month. The monthly charge is adjusted by an adjustment multiplier as detailed in section 6.2 of the transportation agreement.

- The MPTM requested a transportation allowance of $0.11/Mcf for CO_2 transported to the Dollarhide Unit through the West Texas Pipeline. The arm's-length transportation agreement was negotiated on September 9, 1985, between MPTM and Big Three Industries, Inc.

- The CDM section 647.5C.3 states in part:

  > Allowances will be granted to cover transportation costs incurred in moving production through pipelines owned by parties other than the lessee. The allowance will be limited to . . . actual charges to the lessee for transporting production, pursuant to an arm's-length contract.

- The CDM section 647.5.3C states in part:

  > Generally, if the lessee/operator is transporting production under an arm's-length agreement by the only mode available to him, then these costs may be allowed even though they may be higher than other modes of transportation.

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Cortez Tariff No. 2

° The MPTM requested a 1987 allowance for a transfer charge for the movement of CO_2 through a gathering system from the Yellow Jacket Junction to the junction of Cortez Gathering System and the Hovenweep Central Facility Pipeline. The "Cortez Pipeline Company Letter Tariff No. 2" charges MPTM $0.05/Mcf for the movement of CO_2 from non-Hovenweep Facility sources through the gathering system located within the McElmo Dome Unit boundary.

Metering Facility Agreements

° The MPTM requested a 1987 allowance for a metering charge to measure CO_2 from the McElmo Dome Unit to the McElmo Creek Unit Pipeline. The MPTM submitted a copy of the "McElmo Creek Facility Lease Agreement" between Shell Western Pipelines Inc. (SWPI) and MPTM that charges MPTM $5,000 per month to measure CO_2 at the metering facility that is located within the McElmo Dome Unit. The SWPI is the owner of the metering facility.

° The MPTM also requested a 1987 allowance for a metering charge to measure CO_2 at the Tatum Metering Facility. The MPTM submitted a copy of the "Tatum Facility Lease Agreement" between SWPI and MPTM that charges MPTM $3,000 per month to measure CO_2 at the metering facility that is located in Lea County, New Mexico.

° At 43 CFR § 3162.7-1 (1987), "Measurement, disposition and protection of production," section (a) reads as follows:

> The lessee shall put into marketable condition, if economically feasible, all oil, other hydrocarbons, gas and sulphur produced from the leased land.

° Section 647.3A of CDM states in part:

> The lessee is obligated to place lease production in marketable condition without deduction of costs for measuring, compressing or otherwise conditioning the gas for market. Under no circumstances will royalty be computed on less than the gross proceeds accruing to the lessee from the sale of leasehold production.

° Notice to Lessees and Operators No. 1 (NTL-1), "Procedures for Reporting and Accounting for Royalties," under section III, "Gas and Associated Liquids Production, Sales, and Royalty Requirements," states:

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> Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursements and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. Likewise, no deduction will be allowed for the cost which an operator incurs by reason of placing the gas in a marketable condition as an operator is obligated to do so at no cost to the lessor.

° The preceding statement is primarily concerned with gross proceeds. However, in defining the term, gathering gas is considered part of the activities for which the operator is responsible, at no cost to the lessor.

° The new oil and gas valuation regulations provide that transportation allowances approved in writing by MMS before March 1, 1988, will be allowed to continue until such allowances terminate. Since MPTM elected to come under the new regulations effective March 1, 1988, a Form MMS-4295 was submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

CONCLUSIONS

Cortez Pipeline

° The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable with the exception that for royalty purposes State and Federal income taxes are not to be considered in computing transportation costs. Accordingly, State and Federal income taxes should be eliminated before transportation costs are computed.

The MPTM's Pipeline

° The MPTM's pipeline transportation allowance is computed annually based on actual allowable costs, consistent with MMS's established policy.

° The pipeline operating and maintenance costs represent MMS-acceptable operating costs. All compression critical to transporting CO_2 along MPTM's pipeline will be allowed.

° The MMS's policy is to allow actual overhead costs (not to exceed 10 percent of the allowable costs) in computing a transportation allowance. The MPTM's

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overhead costs exceeded 10 percent of the allowable operating costs. Therefore, MPTM's overhead costs are limited to $9,993.97.

° Attachments 1 and 2 detail all costs allowed by MMS for MPTM's pipeline. Attachment 1 is a copy of the depreciation schedule for MPTM's pipeline approved by letter dated December 31, 1986. Attachment 3 details the 1987 allowable costs for MPTM's pipeline.

Sheep Mountain Pipeline

° The MMS's policy is to grant transportation allowances to cover transportation costs incurred in moving production through pipelines not owned by the lessee. Therefore, the transportation fee of $0.035/Mcf charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the Sheep Mountain Pipeline is an acceptable cost in the computation of the transportation allowance.

West Texas Pipeline

° The transportation fee of $4,300 per month adjusted by an adjustment multiplier charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the West Texas Pipeline to the South Wasson Clearfork Unit is an acceptable cost in the computation of the transportation allowance. The approved allowances are for January 1987 through December 1987 and are the actual monthly charges.

° The transportation fee of $0.11/Mcf charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the West Texas Pipeline to the Dollarhide Unit is an acceptable cost in the computation of the transportation allowance. For this pipeline segment, the approved cost will be used during 1987.

Cortez Tariff No. 2, McElmo Creek Facility Lease Agreement, and Tatum Metering Facility

° Pertinent regulations and NTL-1 state that the lease operator has the responsibility and obligation to place the gas in marketable condition. At least one court decision has upheld the principle that the lease operator is obligated to perform necessary field measuring and gathering operations and that the gas conditioning processes are not deductible in computing Federal royalty.

° The MPTM's request for approval of measuring and gathering charges as a transportation allowance should be denied. Gathering and measuring costs are not an allowable deduction from Federal royalty.

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Limitation of Transportation Allowances

- To determine the transportation allowance for each delivery point, MPTM should calculate the sum of the approved transportation costs for the pipeline segments to each delivery point.

- The 1987 allowance which MPTM may deduct will be the lesser of the approved allowance (the sum of the approved 1987 transportation costs for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point.

- The new oil and gas valuation regulations became effective March 1, 1988. Since MPTM elected to come under the new regulations effective March 1, 1988, Forms MMS-4295 were submitted to report the estimated allowances for the period March 1, 1988, through December 31, 1988.

Attachment 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

Mobil CO_2 Transportation Allowance
Pipeline Capital Investment Depreciation Schedule

(1) Allowance Year	(2) Capital Invest.	(3) Undep. Invst. Beg. of Year	(4) Depreciation	(5) Undep. Invst. End of Year	(6) Return on Invest.
1985					
1986					
1987					
1988					
1989					
1990					
1991					
1992					
1993					
1994		X-4			
1995					
1996					
1997					
1998					
1999					
2000					
2001					
2002					
2003					
2004					
2005					

---

(1) 20-year, straight-line depreciation, 10 percent salvage value.

(2) Allowable pipeline capital investment.

(3) Remaining undepreciated investment at beginning of year.

(4) Annual depreciation (X-4 ÷ 20).

(5) Undepreciated investment, beginning of year minus annual depreciation.

(6) Undepreciated investment, beginning of year times prime interest rate of 10.75 percent.

Attachment 2

THIS DOCUMENT CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION & PRODUCING U.S. INC.

1987 Operating Expenses, MPTM CO_2 Pipeline

Actual Operating Costs[1]	$99,939.72
Overhead[2] (limited to 10% allowable operating costs)	$9,993.97
Total Operating Expenses[3]	$109,933.69
Undepreciated Investment Beginning of Year	X-4
Total MMS-Allowable Operating Expenses (limited to lesser of actual operating expenses or 10% of undepreciated investment)	

[1]Operating figures from MPTM's submittal dated March 25, 1988.

[2]The MPTM's overhead expenses exceeded 10 percent of allowable operating costs.

[3]The MPTM's actual operating expenses did not exceed 10 percent of undepreciated investment.

Attachment 3

CONTAINS COMPANY PROPRIETARY
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Transportation Allowance Calculation, MPTM CO_2 (Pipeline) - 1987

$$\text{Transportation Allowance} = \frac{\text{Depreciation}(D)^1 + \text{Operating Expenses}(E)^2 + \text{Return on Investment}(I)}{\text{Throughput}}$$

1
X 4
1

Seminole-San Andres Unit

X 1/4

Willard, Wellman, and Mahoney Units

---

[1]Depreciation and return on investment figures from attachment 1.

[2]Operating expenses from attachment 2.

[3]The MPTM submitted a breakdown of costs which includes 80 percent applied to the Seminole-San Andres Unit and 20 percent to the Willard, Wellman, and Mahoney Units.

Enclosure 2

Appeals Procedure

You have the right to appeal in accordance with 30 CFR 290 (1988). Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed within 30 days from the date of receipt of this letter with:

Minerals Management Service
Attn: Mr. Milton K. Dial
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS 653
Denver, Colorado 80225
Telephone: (303) 231-3184

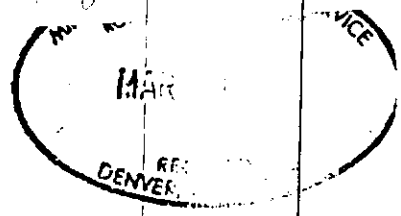
You should be aware that compliance with the orders and directives contained in this letter shall not be suspended by reason of an appeal unless authorized in writing pursuant to 30 CFR § 243.2 (1988).

United States Department of the Int

Attach 23

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

FEB 25 1989



Memorandum

To: Chief, Royalty Valuation and Standards Division

Through: Assistant Director for Program Review

From: Chief, Division of Appeals

Subject: Appeal by Mobil Producing Texas and New Mexico Inc., Concerning McElmo Dome CO_2 Transportation Allowance (MMS-87-0194-O&G)

I have reviewed your memorandum of January 26, 1988, concerning the above-captioned Director's decision. Based on that review, I have the following observations:

1. With regard to the rate of return to be used in calculating a transportation allowance, section 647.5A.1 of the Conservation Division Manual (CDM) clearly states that unless otherwise justified, the prime rate in effect at the time of initial allowance approval shall be used.

2. Although the CDM guidelines are not absolutely binding on the Minerals Management Service, they are entitled to considerable deference, particularly where (as here) their guidance is specific and explicit.

3. While there may be reasonable grounds to depart from the CDM under certain limited circumstances, the need for consistency in the administration of the agency's programs (and the need to avoid the appearance of arbitrary and capricious actions), necessitates fairly close adherence to the manual guidelines.

4. If particular CDM provisions are deemed to be inappropriate, action should be taken to amend or update those provisions and/or the relevant regulations. To simply disregard CDM provisions on a continuing basis is not an acceptable alternative.

5. Although the new royalty regulations (30 CFR 206.157(b)(2)(v), March 1, 1988), now provide that the rate of return shall be the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the reporting period for which the allowance is applicable, that provision may only be applied prospectively.

In view of the foregoing, I can find no basis for reconsideration of the subject Director's decision.

attach 27

Mobil Exploration & Producing U.S. Inc.

As Agent for Mobil Producing TX & NM Inc.

P.O. BOX 650232
DALLAS, TEXAS 75265-0232

May 13, 1988

Minerals Management Service
Attn: Mr. William H. Feldmiller
Royalty Valuation & Standards Div.
P O Box 25165 MS 653
Denver CO 80225

1.96 CO_2 TRANSPORTATION
ALLOWANCE REQUEST FOR
MCELMO DOME (LEADVILLE)
UNIT MMS-RVS-OG:85-0889

Mobil Producing Texas and New Mexico Inc. (MPTM) requests approval of January and February, 1988 transportation allowances for CO_2 produced and transported from the McElmo Dome (Leadville) Unit, Dolores and Montezuma Counties, Colorado to various points in New Mexico and West Texas. The CO_2 volumes transported include sales, exchange and MPTM's in-kind deliveries to the points listed in Exhibit "A". The basis for pipeline tariffs and transportation charges were submitted in conjunction with the 1985 transportation allowance request. Exhibit "B" shows the January and February, 1988 cost and throughput data for the MPTM pipeline and Wasson CO_2 delivery facility.

Please contact Jill Rawhouser at (214) 951-4174 if you need additional information.

L. R. Amsberry
Accounting Specialist

JERawhouser/uya
Attachments

cc: C. B. Butler - MNGI Houston
R. D. Lee - MEPUS Dallas
B. L. Marcum - MNGI Midland
E. Martinez - DAC
G. S. Smith - Midland

EHB80360.DOC

EXHIBIT A
MOBIL PRODUCING TEXAS & NEW MEXICO INC.
TRANSPORTATION ALLOWANCE REQUEST
JANUARY AND FEBRUARY 1988

	Pipeline Delivery Point	Disposition (Operator/Unit)	Transportation Allowance Requested	Rate
1.	McElmo Creek Unit Pipeline	Mobil - McElmo Creek Unit	Cortez Tariff (Applicable only to CO2 from non-Hovenweep Facility sources)	$0.05/MCF
			Meter Usage Charge	$5,000/Month
2.	Cortez Pipeline Tatum Meter Stat.	Phillips-East Vacuum Unit	Cortez Tariff	$0.39/MCF
			Meter Usage Charge	$3,000/Month
3.	Central Basin Pipeline	Sale to Amoco	Cortez Tariff	$0.39/MCF
4.	Cortez/Sheep Mtn. Seminole San Andres Unit	Amerada Hess-Seminole San Andres Unit	Cortez Tariff (1)MPTM Pipeline costs Sheep Mtn. transportation charge	$0.39/MCF $0.13319722 $0.035/MCF
5.	MPTM-Wasson Delivery Fac.	Sale to Amoco at Willard Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0.00408361
6.	MPTM-Wellman Ut.	Union Texas Petroleum Wellman Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0.00408361
7.	MPTM-Mahoney Ut.	MPTM-Mahoney Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0.00408361
8.	Cortez-Denver, Ut.	Shell-Denver Unit	Cortez Tariff	$0.39/MCF
9.	West Texas Pipeline	Shell-South Wasson Clearfork Unit	Cortez Tariff West Texas Pipeline transportation charges	$0.39/MCF See Contract CT-4346
10.	West Texas Pipeline	Union of California Dollarhide Unit	Cortez Tariff West Texas Transportation charge	$0.39/MCF $0.11/MCF

(1) See Exhibit B

EXHIBIT

MOBIL EXPL & PROD US INC
AS AGENT FOR MOBIL PRODUCING TX & NM INC
TRANSPORTATION ALLOWANCE REQUEST
JANUARY AND FEBRUARY 1988

Wasson CO2 Delivery Station

1988 Operating Costs		
Operating Labor	$	1,145.97
Maintenance Labor		1,763.54
Operating Supplies, Utilities & Fuel		7,419.32
Services Purchased		6,041.27
Maintenance Supplies		378.49
Sales and Use Taxes		0.00
Other Direct Expense		0.00
Indirect Expense		19.80
	$	16,768.39
Overhead at 26.15%		4,384.93
Ad valorem tax		0.00
Total Operating Expens	$	21,153.32
Depreciation		
Return on Investment at 11.25 percent		
Total Expenses	$	

X-4

MOBIL EXPL & PROD US INC
AS AGENT FOR MOBIL PRODUCING TX & NM INC
TRANSPORTATION ALLOWANCE REQUEST
JANUARY AND FEBRUARY 1988

Wasson CO2 Delivery Station

Allowance Request
Pumped Volumes

Total Expenses	$	66,138.93	
Appl to Pumped Vol		80%	
		52,911.15	
Pumped Volumes (mcf)		409,803	
	$	0.12911361	0.12911361
Total Expenses	$	66,138.93	
Appl to Free Flow Vol		20%	
		13,227.79	
Free Flow Volumes (MCF)		3,239,237	
	$	0.00408361	0.00408361
Total Pumped Vol Rate	$		0.13319722

APPLICABLE TO SEMINOLE SAN ANDRES VOLUME

Allowance Request
Free Flow Volumes

Total Expenses	$	66,138.93	
Appl to Free Flow Vol		20%	
		13,227.79	
Free Flow Volumes(MCF)		3,239,237	
	$	0.00408361	0.00408361

APPLICABLE TO WELLMAN AND MAHONEY VOLUMES

McELMO CREEK FACILITY LEASE AGREEMENT

This lease, effective as of the 1st day of January, 1987, is entered into by and between Shell Western Pipelines Inc., a Delaware corporation (hereinafter referred to as "SWPI" or "LESSOR"), and Mobil Producing Texas & New Mexico Inc., a Delaware corporation (hereinafter referred to as "MPTM" or "LESSEE"). This agreement shall supplant in its entirety the letter agreement between SWPI and MPTM dated November 21, 1985, notwithstanding anything herein which may be contrary to the provisions of such letter agreement.

LESSOR hereby leases unto LESSEE a throughput entitlement of X-4 X-4 standard cubic feet per day of the following described facility situated in Montezuma County, Colorado:

McElmo Creek 6" CO_2 Metering Facility
Section 6, Township 37 North, Range 18W

(hereinafter referred to as the "Facility") for the purpose of permitting LESSEE to use the Facility in carbon dioxide transportation for a term of one year from the date hereof and thereafter until terminated by either party in accordance with the notice provisions hereof. To terminate this lease, unless otherwise expressly provided, LESSOR shall provide at least nine (9) months' advance written notice to LESSEE and LESSEE shall provide at least one (1) month's advance written notice to LESSOR. Title to the Facility shall remain with LESSOR at all times and LESSEE shall have no right, title or interest in the Facility except as expressly set forth in this agreement. LESSEE agrees that

nothing herein shall be construed as a lease or transfer, in whole or in part, of any rights-of-way or other rights or privileges which LESSOR may have to maintain to operate the Facility except as otherwise necessary to give effect to the terms of this lease. LESSEE shall, at its expense, keep the Facility free and clear of any liens, claims and encumbrances of LESSEE's creditors.

LESSEE shall pay LESSOR a base rental of ——— X-4 ——— per month. Such rental shall be adjusted once each year, on January 1, by the most current Implicit Price Deflator for Gross National Product as published by the United States Government Printing Office which is available to the parties at the time of the base rental adjustment. [See Exhibit 1, attached hereto for purposes of example only, which details a sample calculation of such rental adjustment.] The adjusted base rental shall remain in effect until the next January 1 adjustment. In addition to the base rental, LESSEE shall pay LESSOR a charge equal to the product of SWPI's weighted average annual posted tariff for the Facility, a copy of the applicable documents to date being attached hereto as Exhibit 2 the terms of which are incorporated herein by reference, for the relevant annual period, and the volume of carbon dioxide which LESSEE transported through the Facility which exceeded LESSEE's annual throughput entitlement, such charge to be referred to as the "annual throughput exceedance charge". [See Exhibit 3, attached hereto for purposes of example only, which details a sample calculation of the annual throughput exceedance charge.] Future updates of the Tariff Rate Schedule will be made available upon request of LESSEE. The base rental shall be paid monthly by LESSEE in advance of the first day of each month. The annual throughput exceedance charge, if any, shall be paid by LESSEE within thirty (30) days after receipt of a statement of

PNRUR715002/062487

charges. All payments hereunder shall be made to LESSOR at its offices in Houston, Texas.

If LESSEE fails to pay LESSOR any amount due hereunder within the time specified hereinbefore, such amount shall bear interest at the rate, compounded monthly, of one percent (1%) above prime interest rate as established by the Chase Manhattan Bank, N.A., New York, or the maximum contract rate permitted by the applicable usury law of Colorado, whichever is the lesser, from the end of the period when due until paid. Such interest shall not be applied in the event failure to pay is attributable to a bona fide dispute. Notwithstanding the foregoing, if LESSEE fails to pay a monthly rental or an annual throughput exceedance charge within thirty (30) days after receipt by LESSEE of written notice of LESSEE's failure of performance, unless there is a bona fide dispute, then LESSOR may terminate this agreement without complying with the notice provisions set forth hereinbefore.

LESSOR shall operate or cause to be operated the Facility in a manner that will provide the leased throughput entitlement to LESSEE according to this agreement. LESSOR shall, at its expense, maintain or cause to be maintained the Facility in good mechanical condition and working order. LESSOR agrees that in the operation and maintenance of the Facility, LESSOR shall comply with all applicable Federal, State and local laws, ordinances, rules and regulations. LESSEE, or its duly authorized representatives upon three (3) days' prior notice to LESSOR, shall have the right of access to and to inspect the lease Facility at all reasonable times.

LESSOR shall undertake any alteration, expansion or repair of or maintenance work on said Facility which it deems necessary or appropriate in its

sole discretion. LESSOR shall have the right to select the components of the Facility and, at any time during the term of this agreement, to alter, replace, upsize, downsize, and/or change in any other manner the Facility, so long as any such change does not substantially impair the ability of the Facility to be used for its intended purpose. It is agreed that any such work undertaken by LESSOR shall be for LESSOR's account.

LESSEE shall make no repair, alteration or attachment with respect to the Facility. LESSOR may in its sole discretion agree to perform work on the Facility at the request of LESSEE, which work shall be for LESSEE's account. LESSEE agrees that it shall pay for all such work performed at its request in an amount equal to all of the reasonable costs of such work plus fifteen percent (15%) of all such costs to cover administration thereof, and that such work shall be the property of LESSOR and shall remain so upon termination of this lease without the requirement of any payment by LESSOR to LESSEE.

LESSEE understands and agrees that the Facility is leased to LESSEE without any warranty or representation, express or implied, of merchantability or fitness thereof for any particular purpose. LESSOR shall not be liable for any incidental or consequential damages or losses to LESSEE resulting from the installation, operation, alteration or use of the Facility.

LESSEE shall be responsible for the carbon dioxide which it transports through the Facility further to this agreement. LESSOR shall not be liable for any loss thereof, damage thereto or delay except to the extent such loss was occasioned by LESSOR's gross negligence or willful misconduct. In case of loss of LESSEE's carbon dioxide for which LESSOR is not liable, LESSEE shall bear the loss. Any overages and shortages not due to the negligence of LESSOR shall be

allocated on a monthly accrual basis in the proportion that LESSEE'S carbon dioxide throughput for the Facility bears to the total quantity of carbon dioxide throughput for the Facility.

No carbon dioxide will be accepted for throughput unless its quality is the same as that being otherwise transported through the Facility and the transportation of such carbon dioxide will not result in any damages to the quality or characteristics of other volumes. All carbon dioxide transported shall meet all specifications required by LESSOR.

Measurement of carbon dioxide shall be determined on the basis of pound-mass quantities, which will be converted to cubic feet quantities. The molecular weight of the metered stream of carbon dioxide, calculated from the compositional analyses, shall be the basis for conversion of pound-mass measurement units to cubic feet measurement units. The calculations for the conversion of pound-mass units to cubic feet units will be made on the basis of a mutually acceptable method correcting for the non-ideal behavior of high content carbon dioxide mixtures. The atmospheric pressure at the Facility shall be based upon 14.73 psia at sea level corrected to actual elevation, and may be assumed to be constant for calculation purposes. The pressure base shall be 14.65 psia. The carbon dioxide delivered hereunder shall be measured with orifice meters constructed and installed, and whose computations of pound-mass are made, in accordance with the October, 1981, compilation of standards in the American Petroleum Institute, Manual of Petroleum Measurement Standards, Chapter 14, with any subsequent amendments, revisions and additions which may be mutually acceptable to the parties. The temperature of the carbon dioxide shall be determined by an on-line thermometer so installed that it will sense the

temperature of the carbon dioxide flowing through the meters. The density of the carbon dioxide shall be determined by an on-line densimeter referenced to weight in a vacuum.

LESSOR shall ensure that the measurement equipment is accurate and in repair, and that such periodic tests as LESSOR may deem necessary are made but no less frequently than once each month. LESSOR agrees to ensure that LESSEE is notified in writing of such scheduled tests one (1) week in advance and LESSEE may witness such tests. If, upon any test, any measuring equipment is found to be inaccurate to the extent that it affects the measurement accuracy by an amount exceeding one percent (1%), registrations thereof shall be corrected for a period extending back to the time such inaccuracy occurred, if such time is ascertainable, and, if not ascertainable, then back one-half of the time elapsed since the last date of calibration; provided, no correction shall be made for recorded inaccuracies of less than one percent (1%) in the aggregate. LESSEE may request a calibration test at any time on a meter and LESSOR shall schedule a test within five (5) working days of such request. If any such meter when tested proves to be within the range of acceptable accuracy [that is, one percent (1%)], LESSEE shall reimburse LESSOR for testing expenses. If, for any reason, any meter is out of service or out of repair so that the amount of carbon dioxide transported cannot be ascertained or computed from the readings thereof or corrected as provided hereinbefore, the carbon dioxide metered during the period such meter is out of service or out of repair shall be estimated and agreed upon by the parties upon the basis of the best data available, using the first of the following methods which is feasible:

(a) By using the registration of any check meter, if installed and accurately registering;

(b) By correcting the error if the percentage of error is ascertainable by calibration, test, or mathmetical calculation;

(c) By using other meters in the pipeline system to calculate such an estimate by use of material balance; or

(d) By estimating the quantity transported based on transported volumes during preceding periods under similar conditions when the meter was registering accurately.

The records from such measuring equipment shall remain the property of the LESSOR, but upon requst, LESSOR will make available to LESSEE for inspection and verification its records and charges, together with calculations therefrom, which LESSOR has retained, subject to return within thirty (30) days after receipt thereof. LESSOR shall retain such records for a minimum of two (2) years.

LESSEE agrees to indemnify and hold harmless LESSOR against any loss, cost, damages, liability, claims or expense including attorneys' fees and other costs of litigation imposed by law, arising from any acts or ommissions of LESSEE in connection with the use of the Facility. LESSEE and LESSOR agree that any loss, cost, damages, liabilities, claims, expenses including attorneys' fees and other costs of litigation, or judgments that may be rendered and adjudged against LESSOR and/or LESSEE either jointly or severally in favor of other persons, arising out of or in connection with LESSOR's operation or possession of the Facility during the term of the lease shall be shared on the basis of cumulative throughput of LESSOR and LESSEE from the initial date of the lease.

Delays or failure of the parties in the performance of obligations (except financial obligations) under this agreement shall be excused until the cause of the delay or failure is removed if caused by circumstances beyond the reasonable control of such party, including, but not limited to, acts of God, strikes, fire, flood, windstorms, explosion, riot, war, sabotage, action or request of governmental authority, and accident, provided that a prompt notice of the existence of force majeure is given and such party shall be reasonably diligent in attempting to remove the cause of any delay or failure. Notwithstanding the foregoing, it is the intention of each party to relieve the other of the obligation to supply or to receive and pay for throughput capacity when, as a result of any of the above mentioned causes, either party may be unable to supply or use, in whole or in part, the throughput capacity herein contracted to be supplied or used.

No right or remedy conferred on or reserved to LESSOR or LESSEE by this agreement shall be exclusive of any other right or remedy. All rights and remedies conferred on LESSOR or LESSEE by this agreement or by law shall be cumulative and in addition to every other right and remedy available to LESSOR or LESSEE. No failure on the part of LESSOR or LESSEE to exercise and no delay in exercising any right or remedy under this agreement shall operate as a waiver unless specifically waived by LESSOR or LESSEE in writing; nor shall any single or partial exercise by LESSOR or LESSEE of any right or remedy under this agreement preclude any other or further exercise or the exercise of any other right or remedy.

All notices under the terms hereof shall be in writing and addressed as follows:

LESSOR: Shell Western Pipelines Inc.
P. O. Box 1913
Houston, TX 77251
Attn: Vice President

LESSEE: Mobil Producing Texas & New Mexico Inc.
P. O. Box 633
Midland, TX 79702
Attn: Joint Interest Manager

or to such other address as either party may designate in writing to the other party. The deposit in the United States mail of any letter so addressed and registered or the filing with the telegraph company of any telegram so addressed and prepaid shall be considered as notice to the addressee of the contents thereof.

LESSEE shall not assign this lease without the prior written consent of LESSOR. Such consent is not to be unreasonably withheld; provided, however, no consent shall be required if such assignment is to a subsidiary or affiliate of LESSEE. Notwithstanding the foregoing, LESSEE may use its throughput entitlement to transport carbon dioxide on behalf of third parties without seeking LESSOR'S consent.

SHELL WESTERN PIPELINES INC.

By: M. L. Blanton LESSOR Date 7-1-87

APPROVED
JT. INT.
CONTR.
R/W'S
ENGR.
LEGAL
LAND
TITLE R

MOBIL PRODUCING TEXAS & NEW MEXICO INC., Acting by and through its Agent Mobil Exploration & Producing U.S. Inc.

By: A. C. Spence LESSEE Date 7/29/87

EXHIBIT 1

SAMPLE CALCULATION FOR RENTAL ADJUSTMENT

FOR FACILITY LEASE AGREEMENT

==========

This exhibit details a sample calculation for the annual adjustment of the rental for the Facility. Paragraph 3 of the Lease Agreement specifies that an annual adjustment shall be made to the rental based on the Implicit Price Deflator [IPD] for the Gross National Product. The IPD is published by The United States Government Printing Office on a quarterly basis and is currently published for the Joint Economic Committee by the Council of Economic Advisors.

The base IPD to be used is 115.0, the value for the third quarter 1986. The annual adjustment shall be based on the third quarter IPD value of the calendar year immediately preceding the year in which the adjustment is being made, as published in the above referenced publication, and the calculation will be made as set forth in the following example.

IF:

Contract Year	Monthly Rental	IPD
1	$1000.00	115.0
2	1019.13	117.2
3	?	119.1

THEN:

The calculation for the monthly rental for the third contract year shall be further to the following formula:

$$\text{Current Monthly Rental} \times \frac{\text{IPD for Contract Year Being Calculated}}{\text{IPD for Current Monthly Rental}}$$

That is,

$$\$1019.13 \times \frac{119.1}{117.2} = \$1035.65$$

EXHIBIT 2

SHELL WESTERN PIPELINES INC.
P. O. Box 1913
Houston, Texas 77251

Carbon Dioxide Tariff Rate Schedule No. 2-C
(Cancels Rate Schedule No. 2-B)

TO ALL CONCERNED:

Effective February 1, 1987, the tariff rate on movement of Carbon Dioxide through a meter facility(s) and/or lateral(s) of 1000 feet or less in length and not requiring attendant compression facilities is as follows:

From	Facility To	Tariff Rate Cents per Mcf
	Big Three 10" Custody Transfer Meter, Denver City, Yoakum County, Texas	1.8
Bravo Pipeline, Yoakum County, Texas	Interconnect Sheep Mountain Pipeline, Yoakum County, Texas	6.5 w/Compression
	CO_2 Inc. 4" Custody Transfer Meter, Allred, Yoakum County, Texas	4.0
	Cornell 6" Custody Transfer Meter, Denver City, Yoakum County, Texas	2.8
	McElmo Creek 6" Custody Transfer Meter, McElmo Dome Field, Montezuma County, Colorado	2.0
	ODC 6" Custody Transfer Meter (Bravo Pipeline), Yoakum County, Texas	2.1
	Tatum 8" Custody Transfer Meter, Tatum, Lea County, New Mexico	1.6
	Wellman 4" Custody Transfer Meters (Bravo Pipeline), Yoakum County, Texas	2.6

BNBU8705102/022087

EXHIBIT 3

ANNUAL THROUGHPUT EXCEEDANCE CHARGE CALCULATION

IF:

MONTH/YEAR	CONTRACTUAL THROUGHPUT (MCF)	ACTUAL DELIVERY (MCF)
1/87	620,000	618,000
2/87	560,000	550,000
3/87	620,000	621,000
4/87	600,000	622,000
5/87	620,000	623,000
6/87	600,000	619,000
7/87	620,000	619,000
8/87	620,000	619,000
9/87	600,000	618,000
10/87	620,000	621,000
11/87	600,000	605,000
12/87	620,000	622,000
TOTAL	7,300,000	7,357,000

THEN:

(Total Actual Delivery - Total Contractual Throughput) X Tariff = Annual Throughput Exceedance Charge

That is,

(7,357,000 Mcf - 7,300,000 Mcf) X $0.02/Mcf = $1140.00

TATUM FACILITY LEASE AGREEMENT

This lease, effective as of the 1st day of January 1, 1987, is entered into by and between Shell Western Pipelines Inc., a Delaware corporation (hereinafter referred to as "SWPI" or "LESSOR"), and Mobil Producing Texas & New Mexico Inc., a Delaware corporation (hereinafter referred to as "MPTM" or "LESSEE"). This agreement shall supplant in its entirety the letter agreement between SWPI and MPTM dated November 21, 1985, notwithstanding anything herein which may be contrary to the provisions of such letter agreement. X-4

LESSOR hereby leases unto LESSEE a throughput entitlement of

standard cubic feet per day of the following described facility situated in Lea County, New Mexico:

Tatum 8" CO_2 Metering Facility

Section 31, Township 12 South, Range 36 East

(hereinafter referred to as the "Facility") for the purpose of permitting LESSEE to use the Facility in carbon dioxide transportation for a term of one year from the date hereof and thereafter until terminated by either party in accordance with the notice provisions hereof. To terminate this lease, unless otherwise expressly provided, LESSOR shall provide at least nine (9) months' advance written notice to LESSEE and LESSEE shall provide at least one (1) month's advance written notice to LESSOR. Title to the Facility shall remain with LESSOR at all times and LESSEE shall have no right, title or interest in the Facility except as expressly set forth in this agreement. LESSEE agrees that

nothing herein shall be construed as a lease or transfer, in whole or in part, of any rights-of-way or other rights or privileges which LESSOR may have to maintain to operate the Facility except as otherwise necessary to give effect to the terms of this lease. LESSEE shall, at its expense, keep the Facility free and clear of any liens, claims and encumbrances of LESSEE's creditors. X-4

LESSEE shall pay LESSOR a base rental of X-4 per month. Such rental shall be adjusted once each year, on January 1, by the most current Implicit Price Deflator for Gross National Product as published by the United States Government Printing Office which is available to the parties at the time of the base rental adjustment. [See Exhibit 1, attached hereto for purposes of example only, which details a sample calculation of such rental adjustment.] The adjusted base rental shall remain in effect until the next January 1 adjustment. In addition to the base rental, LESSEE shall pay LESSOR a charge equal to the product of SWPI's average annual posted tariff for the Facility, a copy of the applicable documents to date being attached hereto as Exhibit 2 the terms of which are incorporated herein by reference, for the relevant annual period, and the volume of carbon dioxide which LESSEE transported through the Facility which exceeded LESSEE's annual throughput entitlement, such charge to be referred to as the "annual throughput exceedance charge". [See Exhibit 3, attached hereto for purposes of example only, which details a sample calculation of the annual throughput exceedance charge.] Future updates of the Tariff Rate Schedule will be made available upon request of LESSEE. The base rental shall be paid monthly by LESSEE in advance of the first day of each month. The annual throughput exceedance charge, if any, shall be paid by LESSEE within thirty (30) days after receipt of a statement of

charges. All payments hereunder shall be made to LESSOR at its offices in Houston, Texas.

If LESSEE fails to pay LESSOR any amount due hereunder within the time specified hereinbefore, such amount shall bear interest at the rate, compounded monthly, of one percent (1%) above prime interest rate as established by the Chase Manhattan Bank, N.A., New York, or the maximum contract rate permitted by the applicable usury law of New Mexico, whichever is the lesser, from the end of the period when due until paid. Such interest shall not be applied in the event failure to pay is attributable to a bona fide dispute. Notwithstanding the foregoing, if LESSEE fails to pay a monthly rental or an annual throughput exceedance charge within thirty (30) days after receipt by LESSEE of written notice of LESSEE's failure of performance, unless there is a bona fide dispute, then LESSOR may terminate this agreement without complying with the notice provisions set forth hereinbefore.

LESSOR shall operate or cause to be operated the Facility in a manner that will provide the leased throughput entitlement to LESSEE according to this agreement. LESSOR shall, at its expense, maintain or cause to be maintained the Facility in good mechanical condition and working order. LESSOR agrees that in the operation and maintenance of the Facility, LESSOR shall comply with all applicable Federal, State and local laws, ordinances, rules and regulations. LESSEE, or its duly authorized representatives upon three (3) days' prior notice to LESSOR, shall have the right of access to and to inspect the lease Facility at all reasonable times.

LESSOR shall undertake any alteration, expansion or repair of or maintenance work on said Facility which it deems necessary or appropriate in its

sole discretion. LESSOR shall have the right to select the components of the Facility and, at any time during the term of this agreement, to alter, replace, upsize, downsize, and/or change in any other manner the Facility, so long as any such change does not substantially impair the ability of the Facility to be used for its intended purpose. It is agreed that any such work undertaken by LESSOR shall be for LESSOR's account.

LESSEE shall make no repair, alteration or attachment with respect to the Facility. LESSOR may in its sole discretion agree to perform work on the Facility at the request of LESSEE, which work shall be for LESSEE's account. LESSEE agrees that it shall pay for all such work performed at its request in an amount equal to all of the reasonable costs of such work plus fifteen percent (15%) of all such costs to cover administration thereof, and that such work shall be the property of LESSOR and shall remain so upon termination of this lease without the requirement of any payment by LESSOR to LESSEE.

LESSEE understands and agrees that the Facility is leased to LESSEE without any warranty or representation, express or implied, of merchantability or fitness thereof for any particular purpose. LESSOR shall not be liable for any incidental or consequential damages or losses to LESSEE resulting from the installation, operation, alteration or use of the Facility.

LESSEE shall be responsible for the carbon dioxide which it transports through the Facility further to this agreement. LESSOR shall not be liable for any loss thereof, damage thereto or delay except to the extent such loss was occasioned by LESSOR's gross negligence or willful misconduct. In case of loss of LESSEE's carbon dioxide for which LESSOR is not liable, LESSEE shall bear the loss. Any overages and shortages not due to the negligence of LESSOR shall be

allocated on a monthly accrual basis in the proportion that LESSEE'S carbon dioxide throughput for the Facility bears to the total quantity of carbon dioxide throughput for the Facility.

No carbon dioxide will be accepted for throughput unless its quality is the same as that being otherwise transported through the Facility and the transportation of such carbon dioxide will not result in any damages to the quality or characteristics of other volumes. All carbon dioxide transported shall meet all specifications required by LESSOR.

Measurement of carbon dioxide shall be determined on the basis of pound-mass quantities, which will be converted to cubic feet quantities. The molecular weight of the metered stream of carbon dioxide, calculated from the compositional analyses, shall be the basis for conversion of pound-mass measurement units to cubic feet measurement units. The calculations for the conversion of pound-mass units to cubic feet units will be made on the basis of a mutually acceptable method correcting for the non-ideal behavior of high content carbon dioxide mixtures. The atmospheric pressure at the Facility shall be based upon 14.73 psia at sea level corrected to actual elevation, and may be assumed to be constant for calculation purposes. The pressure base shall be 14.65 psia. The carbon dioxide delivered hereunder shall be measured with orifice meters constructed and installed, and whose computations of pound-mass are made, in accordance with the October, 1981, compilation of standards in the American Petroleum Institute, Manual of Petroleum Measurement Standards, Chapter 14, with any subsequent amendments, revisions and additions which may be mutually acceptable to the parties. The temperature of the carbon dioxide shall be determined by an on-line thermometer so installed that it will sense the

temperature of the carbon dioxide flowing through the meters. The density of the carbon dioxide shall be determined by an on-line densimeter referenced to weight in a vacuum.

LESSOR shall ensure that the measurement *equipment* is accurate and in repair, and that such periodic tests as LESSOR may deem necessary are made but no less frequently than once each month. LESSOR agrees to ensure that LESSEE is notified in writing of such scheduled tests one (1) week in advance and LESSEE may witness such tests. If, upon any test, any measuring equipment is found to be inaccurate to the extent that it affects the measurement accuracy by an amount exceeding one percent (1%), registrations thereof shall be corrected for a period extending back to the time such inaccuracy occurred, if such time is ascertainable, and, if not ascertainable, then back one-half of the time elapsed since the last date of calibration; provided, no correction shall be made for recorded inaccuracies of less than one percent (1%) in the aggregate. LESSEE may request a calibration test at any time on a meter and LESSOR shall schedule a test within five (5) working days of such request. If any such meter when tested proves to be within the range of acceptable accuracy [that is, one percent (1%)], LESSEE shall reimburse LESSOR for testing expenses. If, for any reason, any meter is out of service or out of repair so that the amount of carbon dioxide transported cannot be ascertained or computed from the readings thereof or corrected as provided hereinbefore, the carbon dioxide metered during the period such meter is out of service or out of repair shall be estimated and agreed upon by the parties upon the basis of the best data available, using the first of the following methods which is feasible:

(a) By using the registration of any check meter, if installed and accurately registering;

(b) By correcting the error if the percentage of error is ascertainable by calibration, test, or mathmetical calculation;

(c) By using other meters in the pipeline system to calculate such an estimate by use of material balance; or

(d) By estimating the quantity transported based on transported volumes during preceding periods under similar conditions when the meter was registering accurately.

The records from such measuring equipment shall remain the property of the LESSOR, but upon requst, LESSOR will make available to LESSEE for inspection and verification its records and charges, together with calculations therefrom, which LESSOR has retained, subject to return within thirty (30) days after receipt thereof. LESSOR shell retain such records for a minimum of two (2) years.

LESSEE agrees to indemnify and hold harmless LESSOR against any loss, cost, damages, liability, claims or expense including attorneys' fees and other costs of litigation imposed by law, arising from any acts or ommissions of LESSEE in connection with the use of the Facility. LESSEE and LESSOR agree that any loss, cost, damages, liabilities, claims, expenses including attorneys' fees and other costs of litigation, or judgments that may be rendered and adjudged against LESSOR and/or LESSEE either jointly or severally in favor of other persons, arising out of or in connection with LESSOR's operation or possession of the Facility during the term of the lease shall be shared on the basis of cumulative throughput of LESSOR and LESSEE from the initial date of the lease.

Delays or failure of the parties in the performance of obligations (except financial obligations) under this agreement shall be excused until the cause of the delay or failure is removed if caused by circumstances beyond the reasonable control of such party, including, but not limited to, acts of God, strikes, fire, flood, windstorms, explosion, riot, war, sabotage, action or request of governmental authority, and accident, provided that a prompt notice of the existence of force majeure is given and such party shall be reasonably diligent in attempting to remove the cause of any delay or failure. Notwithstanding the foregoing, it is the intention of each party to relieve the other of the obligation to supply or to receive and pay for throughput capacity when, as a result of any of the above mentioned causes, either party may be unable to supply or use, in whole or in part, the throughput capacity herein contracted to be supplied or used.

No right or remedy conferred on or reserved to LESSOR or LESSEE by this agreement shall be exclusive of any other right or remedy. All rights and remedies conferred on LESSOR or LESSEE by this agreement or by law shall be cumulative and in addition to every other right and remedy available to LESSOR or LESSEE. No failure on the part of LESSOR or LESSEE to exercise and no delay in exercising any right or remedy under this agreement shall operate as a waiver unless specifically waived by LESSOR or LESSEE in writing; nor shall any single or partial exercise by LESSOR or LESSEE of any right or remedy under this agreement preclude any other or further exercise or the exercise of any other right or remedy.

All notices under the terms hereof shall be in writing and addressed as follows:

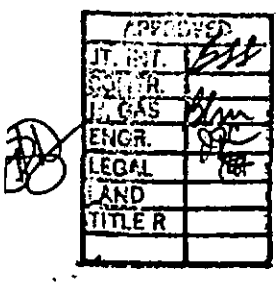
LESSOR: Shell Western Pipelines Inc.
P. O. Box 1913
Houston, TX 77251
Attn: Vice President

LESSEE: Mobil Producing Texas & New Mexico Inc.
P. O. Box 633
Midland, TX 79702
Attn: Joint Interest Manager

or to such other address as either party may designate in writing to the other party. The deposit in the United States mail of any letter so addressed and registered or the filing with the telegraph company of any telegram so addressed and prepaid shall be considered as notice to the addressee of the contents thereof.

LESSEE shall not assign this lease hereunder without the prior written consent of LESSOR. Such consent is not to be unreasonably withheld; provided, however, no consent shall be required if such assignment is to a subsidiary or affiliate of LESSEE. Notwithstanding the foregoing, LESSEE may use its throughput entitlement to transport carbon dioxide on behalf of third parties without seeking LESSOR'S consent.

SHELL WESTERN PIPELINES INC.



By: M. L. Blanton
LESSOR

Date 7-1-87

MOBIL PRODUCING TEXAS & NEW MEXICO INC., Acting by and through its Agent Mobil Exploration & Producing U.S. Inc.

By: A. C. Spence
LESSEE

Date 7/29/87

EXHIBIT 3

ANNUAL THROUGHPUT EXCEEDANCE CHARGE CALCULATION

IF:

MONTH/YEAR	CONTRACTUAL THROUGHPUT (MCF)	ACTUAL DELIVERY (MCF)
1/87	465,000	454,000
2/87	420,000	425,000
3/87	465,000	470,000
4/87	450,000	449,000
5/87	465,000	464,000
6/87	450,000	451,000
7/87	465,000	463,000
8/87	465,000	467,000
9/87	450,000	475,000
10/87	465,000	466,000
11/87	450,000	451,000
12/87	465,000	464,000
TOTAL	5,475,000	5,499,000

THEN:

(Total Actual Delivery - Total Contractual Throughput) X Tariff = Annual Throughput Exceedance Charge

That is,

(5,499,000 Mcf - 5,475,000 Mcf) X $0.016/Mcf = $384.00

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

RMP-DAD/VA
Mail Stop 662

Memorandum

To: Director

Through: Assistant Director for Program Review MAY 05 1988

From: Associate Director for Royalty Management

Subject: Appeal by Mobil Producing Texas and New Mexico Inc., Concerning McElmo Dome CO_2 Transportation Allowance (MMS-87-0194-O&G)

On October 30, 1987, you signed an appeals decision on the subject appeal, which determined that the Royalty Valuation and Standards Division (RVSD) had used an incorrect rate of return in determining a transportation allowance. The appeals decision reads as follows:

> The record shows that RVSD based Mobil's rate of return on the prime rate in effect on or about January 1, 1985 (the date Mobil's transportation allowance became effective). However, as indicated previously, the CDM [Conservation Division Manual] guidelines state that the rate of return shall be based on the prime interest in effect at the time of the initial allowance approval. Since Mobil's transportation allowance was approved on December 31, 1986, it appears that RVSD erred in using the prime rate in effect on January 1, 1985.

It has always been our policy to use the prime interest rate in effect at the beginning of the period for which the allowance will apply to calculate the allowance rate. The date of actual approval, which may occur after the period for which the allowance will apply, should not be a consideration in determining an appropriate rate of return to use in calculating an allowance.

The RVSD requested that the Division of Appeals reconsider this decision, but the Division of Appeals responded that it could find no basis for reconsideration of the Director's decision.

With this memorandum I am requesting that you approve our historic practice of using the prime interest rate in effect on the first day of the first deduction period, which is defined as any 12-month period for which the allowance will be effective. The CDM may be somewhat ambiguous, but this has

been our consistent policy in determining transportation and processing allowances for the period prior to March 1, 1988, the effective date of the new product valuation regulations for oil and gas.

Mobil has further appealed your decision to the IBLA. It has appealed this issue along with other issues. If you approve our policy, we can correct the MMS decision on this issue in briefings before the IBLA. We would also issue an addendum to the decision to correct the record for the published decisions. For your information, the rate of return at the beginning of the allowance period was 10.75 percent. The prime interest rate on the date the allowance was approved was 7.5 percent. Mobil, in its briefings to the IBLA, has stated it prefers the decision made by RVSD on this issue but would still propose a higher rate of return.

Jerry D. Hill

Approve:

Acting Director, Minerals Management Service

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

RMP-DAD/VA
Mail Stop 662

APR 29 1988

Memorandum

To: Director

Through: Assistant Director for Program Review

From: Associate Director for Royalty Management

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Jerry D. Hill

Approve:

_____

Director, Minerals Management Service

DEPRECIATION SCHEDULE

CORTEZ PIPELINE

YEAR	INVESTMENT	DEPRECIATION	UNDEPRECIATED INVESTMENT*	DEPRECIATION TO DATE	RETURN ON INVESTMENT
1985					
1986					
1987					
1988					
1989					
1990					
1991					
1992					
1993					
1994					
1995					
1996					
1997					
1998					
1999					
2000					
2001					
2002					
2003					
2004					

X-4

JAN & Feb. 1986 ROI - X-4

CORTEZ PIPELINE
ACTUAL EXPENSES

SCHEDULE C

(COSTS EXPRESSED IN 1000'S) EXPENSE ITEM	1985	1986	1987	JAN. & FEB. 1988	JAN 87 - FEB 88	MAR 88 - DEC 88
OPERATING COSTS						
POWER COST	199	166	172	28	200	140
SUPPLIES, EXPENSE AND MAINT. MATER	594	311	345	71	416	354
OUTSIDE SERVICES						
SALARIES, WAGES AND BENEFITS	1329	1220	1062	199	1261	995
OTHER	910	604	298	102	400	509
RENTALS	473	478	436	74	510	370
OTHER	42	140	108	19	127	93
TOTAL OPERATING COSTS	3547	2919	2421	493	2914	2461
OTHER COSTS						
RETURN ON INVESTMENT						
DEPRECIATION						
AD VALOREM TAX						
OTHER						
TOTAL OTHER COSTS						
TOTAL COSTS						
THRUPUT (MMCF)	131970	184955	170821	28889	199710	144445
COST PER MCF						

X - 4

United States Department of the Interior

Attach 2.6

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY
REFER TO:

MMS-RVSD-OG

APR 20 1988

Memorandum

To: Deputy Associate Director for Valuation and Audit

Through: Chief, Royalty Valuation and Standards Division

From: Chief, Oil and Gas Valuation Branch
Royalty Valuation and Standards Division

Subject: Appeal by Mobil Producing Texas and New Mexico, Inc. Concerning McElmo Dome CO_2 Transportation Allowance (MMS-87-0194-0&G)

The Director's decision dated October 30, 1987 (copy attached), was issued in response to Mobil Producing Texas and New Mexico, Inc.'s (Mobil) appeal of a Royalty Valuation and Standards Division (RVSD) order dated December 31, 1986 (MMS-RVS-OG:85-0889). The October 30 decision remanded the issue concerning the rate of return applicable to the transportation allowance to RVSD for recalculation. In the October 30 decision, the Director determined that RVSD should have calculated the rate of return based on the prime interest rate in effect at the time of the initial allowance approval as stated in section 647.5A.3A. of the Conservation Division Manual (CDM).

Since Mobil's transporation allowance was approved on December 31, 1986, the Director concluded that RVSD erred in using the prime rate in effect on January 1, 1985. The RVSD believes that the Director should have upheld RVSD's original decision regarding the rate of return. By memorandum dated January 26, 1988 (copy attached), RVSD recommended to the Director that this issue regarding the recalculation of the rate of return for Mobil's transporation allowance be reconsidered. By memorandum dated February 25, 1988, the Director determined that ". . .if particular CDM provisions are deemed inappropriate, action should be taken to amend or update those provisions and/or the relevant regulations . . . ." The Director found no basis for reconsideration of the decision regarding the issue of the rate of return.

The CDM section 647.5.3E states, "If the application is timely received (normally within 30 days from the date of first sales, unless a later date is justified), then the allowance when approved should be retroactive to the date of first sales." The CDM further states that if the application is not timely received, then any allowance should be denied for the period prior to the receipt of the allowance request. A literal interpretation of this section is

that Mobil's transportation allowance would not have been approved for any period prior to October 1985 because the application was not received within "30 days from the date of first sales." However, MMS's policy is to approve transportation allowances retroactively to the first production month for which royalty is due.

The October 30 and February 25 decisions that determined that RVSD should have calculated the rate of return ". . . based on the prime interest rate in effect at the time of the initial allowance approval . . ." was also a literal interpretation of the CDM. The RVSD believes that to use the prime interest rate in effect on the date the RVSD order was approved (signed) is inappropriate. The MMS's policy is to use the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS, even if approved retroactively. This policy has been consistently applied by RVSD. Therefore, RVSD requests that this issue regarding the recalculation of the rate of return for Mobil's transportation be readdressed.

If you have any questions, please contact Theresa Walsh at extension 3395.

John L. Price

John L. Price

2 Attachments

attach. 25

Mobil Exploration & Producing U.S. Inc.

As Agent for Mobil Producing Texas and New Mexico Inc.

P.O. BOX 650232
DALLAS, TEXAS 75265-0232

April 20, 1988

Minerals Management Service
Royalty Management Program/Allowances
P O Box 5200
Denver CO 80127

0.21 GAS TRANSPORTATION
ALLOWANCE REPORT
MCELMO DOME CO2
(LEADVILLE) UNIT
DOLORES AND MONTEZUMA
COUNTIES, COLORADO

Attached is a Gas Transportation Allowance Report for the McElmo Dome CO2 (Leadville) Unit for the reporting period January, 1987 to February, 1988 and the requested flow diagram. Also attached is a listing of 212 A.I.D. numbers for the Unit under which Mobil pays royalties. We were given verbal approval during a telephone call between the MMS and R. D. Lee of Mobil to attach a list rather than filling out individual Transportation Allowance forms for each A.I.D. number. Please let us know if this is not acceptable.

In addition, we used a tariff of $0.39/MCF for the Cortez Pipeline segment of the transportation and showed the total value of the tariff on Schedule 1A in "Other". We request approval of this method of reporting the transportation allowance.

The current period estimate was derived using 10/14's of the prior period actual.

If you have any questions, please call Jill Rawhouser at (214) 951-4174.

R. N. Williams
Gas Accounting Supervisor

JERawhouser/aj
Attachments

cc: Chief, Trans. & Proc. Val. Br.
Royalty Valuation and
Standards Division
Minerals Management Service
P. O. Box 25165, Mail Stop 653
Denver, CO 80225

C. B. Butler - MNGI/Houston
R. D. Lee - MEPUS/Dallas
B. L. Marcum - MNGI/Midland
E. Martinez - DAC
G. S. Smith - Midland

EFA80344.DOC

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

GAS TRANSPORTATION ALLOWANCE REPORT

OMB NO. 1010-0075
Expires March 31, 1990

FOR MMS USE ONLY:

[1] PAYOR NAME Mobil Oil Corp and/or Affiliates

ADDRESS P O Box 900

CITY Dallas STATE Texas ZIP 75221

[2] PAYOR CODE 38554

[4] FEDERAL [X]
or
INDIAN [ ]

[5] REPORT TYPE 2

[6] REPORTING PERIOD Jan 1987 to Feb. 1988

[3] FOR PAYOR USE ONLY: McElmo Dome CO_2

The Paperwork Reduction Act of 1980 (44 U.S.C. 3501 et seq.) requires MMS to inform you that this information is being collected for the purpose of managing its gas transportation allowance program.

[7]	[8] ACCOUNTING IDENTIFICATION (AID) NUMBER	[9] PRODUCT CODE	[10] SELLING ARRANGEMENT CODE	[11] ARM'S-LENGTH/ PAYOR-OWNED INDICATOR	[12] PRIOR PERIOD ACTUAL DATA a ROYALTY QUANTITY	b ALLOWANCE RATE PER UNIT	c ROYALTY ALLOWANCE AMOUNT	[13] CURRENT PERIOD ESTIMATED DATA a ROYALTY QUANTITY	b ALLOWANCE RATE PER UNIT	c ROYALTY ALLOWANCE AMOUNT
1	See attached	17	01	5	11,262,556	.387756	4,367,123.66	8,044,683	.387756	3,119,374.10
2										
3										
4										
5										
6										
7										
8										
9										
10										
11										
12	PAGE TOTAL				11,262,556	XXXXXXXXXXX	4,367,123.66	8,044,683	XXXXXXXXXXX	3,119,374.10
13	REPORT TOTAL (LAST PAGE ONLY)				11,262,556	XXXXXXXXXXX	4,367,123.66	8,044,683	XXXXXXXXXXX	3,119,374.1

IF MORE LINES ARE NEEDED, ATTACH ADDITIONAL PAGES OF FORM MMS-4295

I have read and examined the statements in this report and, to the best of my knowledge, they are accurate and complete.

NAME (FIRST, MIDDLE INITIAL, LAST) (typed or printed): Larry R. Amsberry
DATE: 4/20/88

AUTHORIZED SIGNATURE: L R Amsberry
DATE: 4/20/88

NAME OF PREPARER: J. E. Rawhouser
TELEPHONE NUMBER: 214-951-4174

WARNING: PUBLIC LAW 97-451 PROVIDES CIVIL AND CRIMINAL PENALTIES FOR FALSE OR INACCURATE REPORTING.

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) [X] PROPRIETARY [ ] NONPROPRIETARY

FORM MMS-4295 (REV. 1/88)

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- GAS TRANSPORTATION FACILITY SUMMARY SHEET

[1] PAYOR NAME AND CODE Mobil Oil Corp and/or Affiliate / 38554

ADDRESS P O Box 900

CITY Dallas STATE Tx ZIP 75221

[2] ACCOUNTING ID NUMBER: See attached

SELLING ARRANGEMENT CODE: 01

FACILITY NAME/ID NUMBER: McElmo Dome CO2

PRODUCT CODE: 17

PERIOD: JAN 19 87 to Feb 19 88

(a) Segment Name or Number From	To	(b) Mode of Transportation	(c) Arm's-Length/ Payor-Owned Indicator	(d) Arm's-Length Contract/ Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Undepreciated Capital Investment at Beginning of Year	(h) Return on Investment (f) x (g)	
A. TRANSPORTING GAS TO A REMOTE GAS PROCESSING FACILITY.									
				$	$		$	$	3
									4
									5
									6
									7
			Totals	$	$			$	8

Allowance rate = (lines 8d + 8e + 8h)/Quantity of production transported from the lease to the gas processing facility. ____ ÷ ____ = $ ____ [9]
Part A Total Cost ÷ Part A Total Quantity = Gas Rate/Mcf

Allowance rate for transporting NGL's or Sulfur from the lease to plant. ____ ____ [10]
Sulfur Rate/LT NGL Rate/Gal

B. TRANSPORTING GAS OR GAS PRODUCTS FROM LEASE OR PLANT TO A REMOTE SALES POINT.

McElmo Dome	Del. Pt. via Cortez pipeline	4	$26,922,357.38	$		$	$	11
McElmo Dome	Del. Pt. via MPTM p/l pipeline	4	134,149.31	X-4	X-4	X-4	X-4	12
McElmo Dome	Del. Pt. via Sheep Mtn Pipeline	6	74,521.71					13
		Totals	$ continued	$			$	14

Allowance rate = (lines 14d + 14e + 14h)/Quantity of products. ____ ÷ ____ = $ ____ [15]
Part B Total Cost ÷ Part B Total Quantity = Product Rate

Total Unit Allowance Rate = the sum of line 9h and 15h if the allowance is for gas; line 10g and 15h if the allowance is for sulfur; or 10h and 15h if the allowance is for NGL's. The allowance rate cannot exceed 50 percent of the value of the product without prior MMS approval. ____ [16]
Allowance Rate

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) [X] PROPRIETARY [ ] NONPROPRIETARY

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

SCHEDULE 1 -- GAS TRANSPORTATION FACILITY SUMMARY SHEET

[2] ACCOUNTING ID NUMBER: see attached

SELLING ARRANGEMENT CODE: 01

[1] PAYOR NAME AND CODE: Mobil Oil Corp. and/or affiliates' / 38554

FACILITY NAME/ID NUMBER: McElmo Dome CO2

ADDRESS: P O Box 900

PRODUCT CODE: 17

CITY: Dallas STATE: Texas ZIP: 75221

PERIOD: JAN 19 87 to Feb 19 88

(a) Segment Name or Number From	(a) To	(b) Mode of Transportation	(c) Arm's-Length/ Payor-Owned Indicator	(d) Arm's-Length Contract/ Payor-Owned Operating Costs	(e) Depreciation	(f) Rate of Return	(g) Undepreciated Capital Investment at Beginning of Year	(h) Return on Investment (f) x (g)	
A. TRANSPORTING GAS TO A REMOTE GAS PROCESSING FACILITY.									
				$	$		$	$	3
									4
									5
									6
									7
			Totals	$	$			$	8

Allowance rate = (lines 8d + 8e + 8h)/Quantity of production transported from the lease to the gas processing facility. ____ (Part A Total Cost) ÷ ____ (Part A Total Quantity) = $ ____ (Gas Rate/Mcf) — 9

Allowance rate for transporting NGL's or Sulfur from the lease to plant. Sulfur Rate/LT ____ NGL Rate/Gal ____ — 10

B. TRANSPORTING GAS OR GAS PRODUCTS FROM LEASE OR PLANT TO A REMOTE SALES POINT.

McElmo Dome	Del. Pt	pipeline	6	$ 48,000.00	$		$	$	11
McElmo Dome	Del. Pt. via Bigthree	pipeline	6	60,902.19					12
									13
			Totals	$27,239,930.59	$ X-4			$ X-4	14

Allowance rate = (lines 14d + 14e + 14h)/Quantity of products. X-4 (Part B Total Cost) ÷ 70,946,329 (Part B Total Quantity) = $ X-4 (Product Rate) — 15

Total Unit Allowance Rate = the sum of line 9h and 15h if the allowance is for gas; line 10g and 15h if the allowance is for sulfur; or 10h and 15h if the allowance is for NGL's. The allowance rate cannot exceed 50 percent of the value of the product without prior MMS approval.

X-4 (Allowance Rate) — 16

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) [X] PROPRIETARY [ ] NONPROPRIETARY

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

PAYOR IDEN. FICATION BLOCK	
Payor Name and Code:	Mobil / 38554
Accounting ID No:	See attached
Selling Arrangement Code:	01
Facility ID No:	McElmo Dome CO2
Segment ID No:	Del. Pt. via Cortez Pipeline
Period:	JAN 1987 to Feb 1988

SCHEDULE 1A -- NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/ SEGMENT OPERATIONS, MAINTENANCE AND OVERHEAD EXPENDITURES

☐ Estimated Costs - Check when estimating costs for system/segment start-up.

A	**Lessee's Operating Costs for System/Segment**		
	Operations Supervision and Engineering	$	1
	Operations Labor		2
	Utilities		3
	Materials		4
	Ad Valorem Property Taxes		5
	Rent		6
	Supplies		7
	Other (specify). Attach Supplemental Schedule 1A as necessary Tariff		8
		26,922,357.38	9
	Total Operating Costs -- Subtotal	$ 26,922,357.38	10
B.	**Lessee's Maintenance Costs**		
	Maintenance Supervision	$	11
	Maintenance Labor		12
	Materials		13
	Other (specify). Attach Supplemental Schedule 1A as necessary		14
			15
	Total Maintenance Costs -- Subtotal	$	16
C.	**Lessee's Overhead Allocation (specify)**		
	_____	$	17
	_____		18
	Other (specify) use Supplemental Schedule 1A		19
	Total Overhead Allocation	$	20
D.	Total Operating and Maintenance Costs (Line 10 + line 16 + line 20)	$ 26,922,357.38	21
E.	Allocated to Segment Lease Volume 68,916,541 ÷ Total throughput 68,916,541	$ 1.000000	22
F.	Segment Allocated Operating, Maintenance, and Overhead Costs (Line 21 x line 22) Enter in column d, Schedule 1	$ 26,922,357.38	23

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) ☒ PROPRIETARY ☐ NONPROPRIETARY

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

PAYOR IDEI ICATION BLOCK	
Payor Name and Code:	Mobil 138554
Accounting ID No:	see attached
Selling Arrangement Code:	01
Facility ID No:	McElmo Dome CO2
Segment ID No:	Del. Pt. via MPTM pipeline
Period:	Jan 1987 to Feb 1988

SCHEDULE 1A -- NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/ SEGMENT OPERATIONS, MAINTENANCE AND OVERHEAD EXPENDITURES

☐ Estimated Costs - Check when estimating costs for system/segment start-up.

A. Lessee's Operating Costs for System/Segment

Operations Supervision and Engineering	$	1
Operations Labor	7,924.97	2
Utilities		3
Materials		4
Ad Valorem Property Taxes		5
Rent		6
Supplies	42,503.73	7
Other (specify). Attach Supplemental Schedule 1A as necessary — Services Purchased	32,442.52	8
Other Ind. Exp.	184.45	9
Total Operating Costs -- Subtotal	$ 83,055.67	10

B. Lessee's Maintenance Costs

Maintenance Supervision	$	11
Maintenance Labor	14,602.84	12
Materials	8,682.60	13
Other (specify). Attach Supplemental Schedule 1A		14
as necessary		15
Total Maintenance Costs -- Subtotal	$ 23,285.44	16

C. Lessee's Overhead Allocation (specify)

Exploration & Producing Overhead	$ 27,808.20	17
		18
Other (specify) use Supplemental Schedule 1A		19
Total Overhead Allocation	$ 27,808.20	20

D. Total Operating and Maintenance Costs (Line 10 + line 16 + line 20) — $ 134,149.31 — 21

E. Allocated to Segment
Lease Volume 9,878,326 ÷ Total throughput 9878,326 — $ 1.00000 — 22

F. Segment Allocated Operating, Maintenance, and Overhead Costs (Line 21 x line 22) Enter in column d, Schedule 1 — $ 134,149.31 — 23

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) ☒ PROPRIETARY ☐ NONPROPRIETARY

U.S. DEPARTMENT OF THE INTERIOR
Minerals Management Service
Royalty Management Program

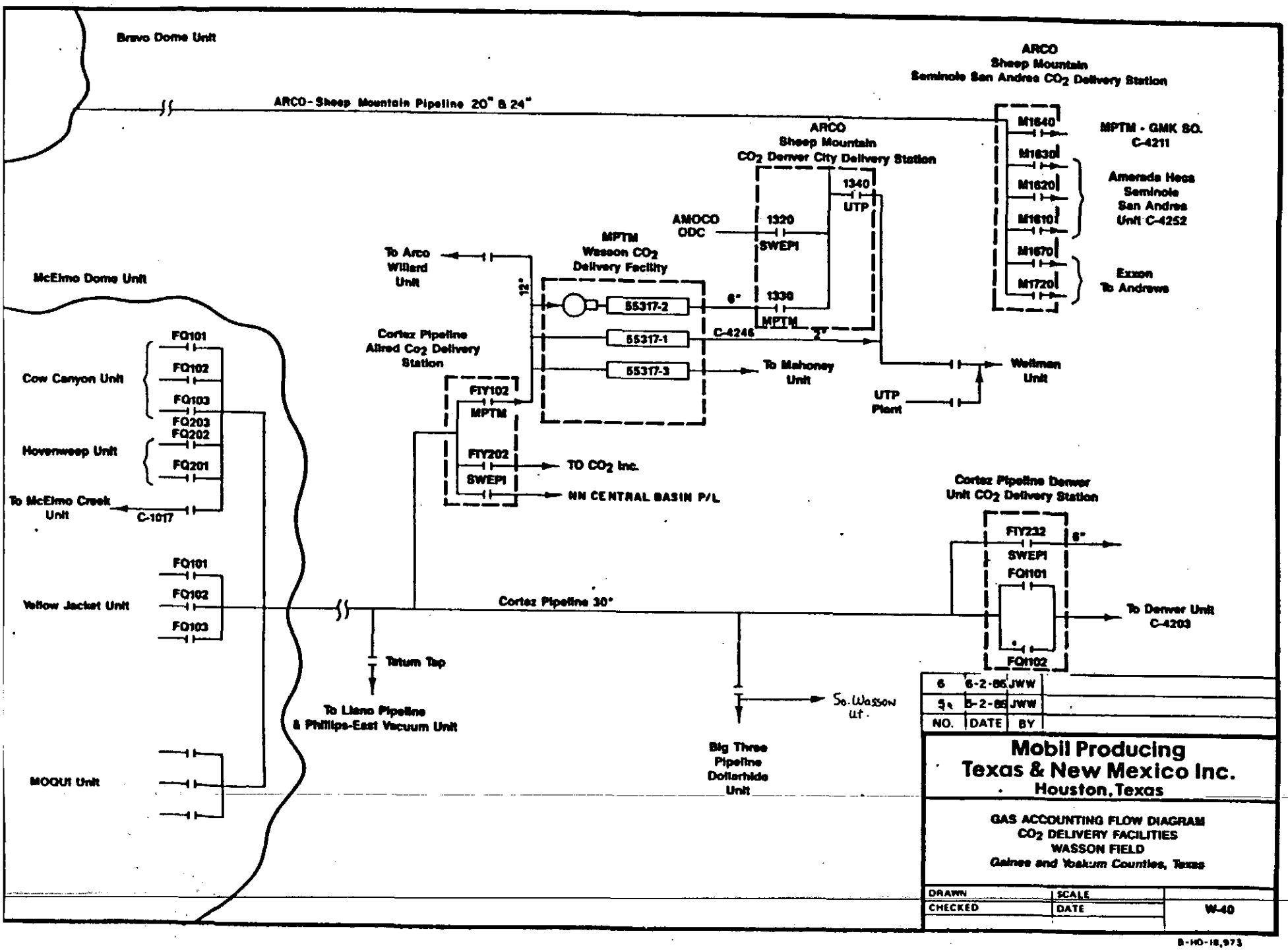
PAYOR IDENTIFICATION BLOCK	
Payor Name and Code:	Mobil / 38554
Accounting ID No:	see attached
Selling Arrangement Code:	01
Facility ID No:	McElmo Dome CO2
Segment ID No:	Del. Pt. via MPTM pipeline
Period:	JAN 1987 to Feb 1988

SCHEDULE 1B -- NON-ARM'S-LENGTH TRANSPORTATION SYSTEM/SEGMENT DEPRECIATION AND CAPITAL EXPENDITURE SUMMARY

1	2		3	4		5	6	7
Expenditure Item	Initial Capital Investment and Date Placed in Service		Salvage Value	Depreciable Life/Years of Depreciation Taken to Date		Undepreciated Capital Investment at Beginning of Year	Depreciation	Undepreciated Capital Investment at End-of-Year
Wasson CO2 facility	$ 1	1985	$ 1	20	2	$ 1	$ 1	$ 1
"	X-4	1986	X-4	19	1	X-4	X-4	X-4
"	1	1987	1	18	0	1	1	1

Totals		$ 1	$ 1
Allocated to Segment (from line 22, Schedule 1A)		$ X-4	$ X-4
Segment Depreciation and Capital Expenditure (Line 8 x line 9) Enter in column g and e, Schedule 1		$ 1	$ 1
		8	9
			10

THIS INFORMATION SHOULD BE CONSIDERED (Please check one) ☒ PROPRIETARY ☐ NONPROPRIETARY


Bravo Dome Unit
ARCO - Sheep Mountain Pipeline 20" & 24"
ARCO
Sheep Mountain
Seminole San Andres CO_2 Delivery Station
M1640
M1630
M1620
M1610
M1670
M1720
MPTM - GMK SO.
C-4211
Amerada Hess
Seminole
San Andres
Unit C-4252
Exxon
To Andrews
ARCO
Sheep Mountain
CO_2 Denver City Delivery Station
1340
UTP
AMOCO
ODC
1320
SWEPI
MPTM
Wasson CO_2
Delivery Facility
To Arco
Willard
Unit
12"
55317-2
6"
1330
MPTM
McElmo Dome Unit
Cortez Pipeline
Allred Co_2 Delivery
Station
55317-1
C-4246
2"
55317-3
To Mahoney
Unit
Wellman
Unit
UTP
Plant
FQ101
FQ102
FQ103
Cow Canyon Unit
FQ203
FQ202
Hovenweep Unit
FQ201
To McElmo Creek
Unit
C-1017
FIY102
MPTM
FIY202
TO CO_2 Inc.
SWEPI
NN CENTRAL BASIN P/L
Cortez Pipeline Denver
Unit CO_2 Delivery Station
FIY232
6"
SWEPI
FQ1101
FQ1102
To Denver Unit
C-4203
FQ101
FQ102
FQ103
Yellow Jacket Unit
Cortez Pipeline 30"
Tatum Tap
To Llano Pipeline
& Phillips-East Vacuum Unit
So. Wasson
ut.
Big Three
Pipeline
Dollarhide
Unit
MOQUI Unit
6 6-2-86 JWW
5 5-2-86 JWW
NO. DATE BY
Mobil Producing
Texas & New Mexico Inc.
Houston, Texas
GAS ACCOUNTING FLOW DIAGRAM
CO_2 DELIVERY FACILITIES
WASSON FIELD
Gaines and Yoakum Counties, Texas
DRAWN
SCALE
CHECKED
DATE
W-40
B-HO-18,973

Mobil Exploration & Producing U.S. Inc.
As Agent for Mobil Producing Texas & New Mexico Inc.

attach. 24

March 25, 1988

Minerals Management Service
Royalty Valuation & Standards Div.
Attn: Mr. Stan Brown
P O Box 25165 MS 653
Denver CO 80225

1.96 CO2 TRANSPORTATION
ALLOWANCE REQUEST FOR
MCELMO DOME (LEADVILLE)
UNIT MMS-RVS-OG:85-0889

Dear Mr. Brown:

Mobil Producing Texas and New Mexico Inc. (MPTM) requests approval of 1987 transportation allowances for CO2 produced and transported from the McElmo Dome (Leadville) Unit, Dolores and Montezuma Counties, Colorado to various points in New Mexico and West Texas. The CO2 volumes transported include sales, exchange and MPTM's in-kind deliveries to the points listed in Exhibit "A". The basis for pipeline tariffs and transportation charges were submitted in conjunction with the 1985 transportation allowance request. Exhibit "B" shows the 1987 cost and throughput data for the MPTM pipeline and Wasson CO2 delivery facility.

Please contact Jill Rawhouser at (214) 951-4174 if you need additional information.

Very truly yours,

L. R. Amsberry
Accounting Specialist

JERawhouser/aj
Attachments

CC: C. B. Butler - MNGI/Houston
R. D. Lee - MEPUS/Dallas
B. L. Marcum - MNGI/Midland
G. S. Smith - Midland

EFA80284

EXHIBIT A
MOBIL PRODUCING TEXAS & NEW MEXICO INC.
TRANSPORTATION ALLOWANCE REQUEST
1987

	Pipeline Delivery Point	Disposition (Operator/Unit)	Transportation Allowance Requested	Rate
1.	McElmo Creek Unit Pipeline	Mobil - McElmo Creek Unit	Cortez Tariff (Applicable only to CO2 from non-Hovenweep Facility sources)	$0.05/MCF
			Meter Usage Charge	$5,000/Month
2.	Cortez Pipeline Tatum Meter Stat.	Phillips-East Vacuum Unit	Cortez Tariff	$0.39/MCF
			Meter Usage Charge	$3,000/Month
3.	Central Basin Pipeline	Sale to Amoco	Cortez Tariff	$0.39/MCF
4.	Cortez/Sheep Mtn. Seminole San Andres Unit	Amerada Hess-Seminole San Andres Unit	Cortez Tariff (1)MPTM Pipeline costs Sheep Mtn. transportation charge	$0.39/MCF $0.19783451 $0.035/MCF
5.	MPTM-Wasson Delivery Fac.	Sale to Amoco at Willard Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0.00455397
6.	MPTM-Wellman Ut.	Union Texas Petroleum Wellman Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0.00455397
7.	MPTM-Mahoney Ut.	MPTM-Mahoney Unit	Cortez Tariff (1) MPTM Pipeline costs	$0.39/MCF $0..00455397
8.	Cortez-Denver Ut.	Shell-Denver Unit	Cortez Tariff	$0.39/MCF
9.	West Texas Pipeline	Shell-South Wasson Clearfork Unit	Cortez Tariff West Texas Pipeline transportation charges	$0.39/MCF See Contract CT-4346
10.	West Texas Pipeline	Union of California Dollarhide Unit	Cortez Tariff West Texas Transportation charge	$0.39/MCF $0.11/MCF

(1) See Exhibit B

Exhibit B

MOBIL EXPL & PROD US INC
AS AGENT FOR MOBIL PRODUCING TX & NM INC
TRANSPORTATION ALLOWANCE REQUEST
1987

Wasson CO2 Delivery Station

1987 Operating Costs		
Operating Labor	$	6,779.00
Maintenance Labor		12,839.30
Operating Supplies, Utilities & Fuel		35,084.41
Services Purchased		26,401.25
Maintenance Supplies		8,304.11
Sales and Use Taxes		0.00
Other Direct Expense		0.00
Indirect Expense		164.65
Fixed Asset Addition		10,367.00
	$	99,939.72
Overhead at 26.15%		26,134.24
Ad valorem tax		0.00
Total Operating Expens	$	126,073.96
Depreciation		
Return on Investment at 11.25 percent		X-4
Total Expenses	$	

MOBIL EXPL & PROD US INC
AS AGENT FOR MOBIL PRODUCING TX & NM INC
TRANSPORTATION ALLOWANCE REQUEST
1987

Wasson CO2 Delivery Station

Allowance Request
Pumped Volumes

Total Expenses	$	406,346.97	
Appl to Pumped Vol		80%	
		325,077.57	
Pumped Volumes (mcf)		1,681,895	
	$	0.19328054	0.19328054
Total Expenses	$	406,346.97	
Appl to Free Flow Vol		20%	
		81,269.39	
Free Flow Volumes (MCF)		17,845,822	
	$	0.00455397	0.00455397
Total Pumped Vol Rate	$		0.19783451

APPLICABLE TO SEMINOLE SAN ANDRES VOLUME

Allowance Request
Free Flow Volumes

Total Expenses	$	406,346.97	
Appl to Free Flow Vol		20%	
		81,269.39	
Free Flow Volumes(MCF)		17,845,822	
	$	0.00455397	0.00455397

APPLICABLE TO WELLMAN AND MAHONEY VOLUMES

attach 22

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-OG:87-1325

JAN 26 1988

Memorandum

To: Chief, Division of Appeals

Through: Assistant Director for Program Review
Deputy Associate Director for Valuation and Audit

From: Acting Chief, Royalty Valuation and Standards Division

Subject: Appeal by Mobil Producing Texas and New Mexico Inc. Concerning McElmo Dome CO_2 Transportation Allowance (MMS-87-0194-O&G)

The Director's decision dated October 30, 1987, (copy attached) was issued in response to Mobil Producing Texas and New Mexico Inc.'s (Mobil) appeal of a Royalty Valuation and Standards Division (RVSD) order dated December 31, 1986 (MMS-RVS-OG:85-0889). The October 30 decision remanded the issue concerning the rate of return applicable to the transportation allowance to RVSD for recalculation.

In the October 30 decision, the Director determined that RVSD should have calculated the rate of return based on the prime interest rate in effect at the time of the initial allowance approval. Since Mobil's transportation allowance was approved on December 31, 1986, the Director concluded that RVSD erred in using the prime rate in effect on January 1, 1985. The RVSD believes that the Director in the October 30 decision should have upheld RVSD's original decision regarding the rate of return.

The Conservation Division Manual (CDM) provides the guidelines for determining the reasonable costs incurred by the lessee in transporting onshore production to the nearest sales outlet. The CDM section 647.5A.3A, provides that ". . . the prime interest rate in effect at the time of initial allowance approval should be used."

The Minerals Management Service's (MMS) policy is to use the prime interest rate, as published in the Wall Street Journal, in effect on the first day of the first deduction period, which is defined as any 12-month period for which the allowance will be effective, as approved by MMS. The first deduction period begins on the first day that production is actually transported during the first production month for which royalty is due. This policy is fully supported by MMS practice. Mobil's transportation allowance was approved on December 31, 1986, but the first deduction period for which a transportation allowance was approved was the Calendar Year 1985. Therefore, RVSD based

Mobil's rate of return on the prime interest rate in effect on January 2, 1985 (the date Mobil's transportation allowance became effective).

The CDM section 647.5.3E states, "If the application is timely received (normally within 30 days from the date of first sales, unless a later date is justified), then the allowance when approved should be retroactive to the date of first sales." The CDM further states that if the application is not timely received, then any allowance should be denied for the period prior to the receipt of the allowance request. A literal interpretation of this section is that Mobil's transportation allowance would not have been approved for any period prior to October 1985 because the application was not received within "30 days from the date of first sales." However, MMS's policy is to approve transportation allowances retroactively to the first production month for which royalty is due.

The October 30 decision that determined that RVSD should have calculated the rate of return ". . . based on the prime interest rate in effect at the time of the initial allowance approval . . ." was also a literal interpretation of the CDM. However, MMS's policy is to use the prime interest rate in effect on the first day of the deduction period for which the allowance has been approved by MMS, even if approved retroactively. This policy has been consistently applied by RVSD. Therefore, RVSD recommends that this issue regarding the recalculation of the rate of return for Mobil's transportation allowance be reconsidered.

If you have any questions, please contact Ms. Theresa Walsh at FTS 326-3395.

Attachment

STUTZMAN & BROMBERG
ATTORNEYS AND COUNSELORS
2323 BRYAN STREET
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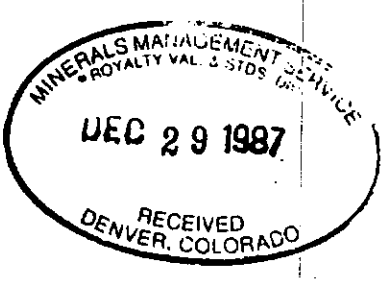
KENNETH F. PLIFKA

attach 21

December 21, 1987



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Board of Land Appeals
Office of Hearings and Appeals
4015 Wilson Blvd.
Arlington, Virginia 22203

Re: Docket No.: MMS-87-0194-O&G
Notice of Appeal to Partial Denial of Transportation Allowance with respect to Carbon Dioxide Production, McElmo Dome Unit, Colorado.

Gentlemen:

In accordance with the provisions of 43 C.F.R. § 4.412, enclosed for filing please find Statement of Reasons filed on behalf of Mobil Producing Texas & New Mexico Inc. ("Mobil") in support of Mobil's Notice of Appeal dated November 23, 1987 with respect to the above-captioned matter.

Cordially,

Kenneth F. Plifka

KFP:cjs

Enclosure

cc: Mr. Robert T. Brousseau
Mr. William R. Buck
Mr. David A. Schuenke - Reston, Virginia
Certified Mail RRR #P657075156
Associate Solicitor - Washington, D. C.
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Certified Mail RRR #P657075158
Regional Solicitor - Denver, Colorado
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MO006-004

UNITED STATES DEPARTMENT OF THE INTERIOR
BOARD OF LAND APPEALS

IN THE MATTER OF	§	APPEAL OF DECISION RE:
MOBIL PRODUCING TEXAS	§	TRANSPORTATION ALLOWANCES
& NEW MEXICO INC.	§	McELMO DOME UNIT CO_2 PRODUCTION
	§	DOCKET NO: MMS-87-0194-0&6

STATEMENT OF REASONS

TO THE BOARD OF LAND APPEALS:

Mobil Producing Texas & New Mexico Inc. ("Mobil") hereby files this its Statement of Reasons in support of Mobil's appeal of the Decision of the Director of the Minerals Management Service ("MMS"), dated October 30, 1987 (the "MMS Decision"), with respect to transportation allowances for CO_2 production transported from the McElmo Dome Unit, Dolores and Montezuma Counties, Colorado, to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit, all of which are located in West Texas. By Notice of Appeal dated November 23, 1987, Mobil appealed the MMS Decision in accordance with 43 C.F.R. § 4.411 et seq.

Under the MMS Decision, MMS affirmed the Decision of the Chief, Royalty Valuation and Standards Division ("RVSD") of the MMS dated December 31, 1986 (the "RSVD Decision"). RSVD calculated the transportation allowances for CO_2 production transported from the McElmo Dome Unit in accordance with

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certain unpublished guidelines known as Department of the Interior's Conservation Division Manual, Part 647 (the "CDM"). Unless the context otherwise requires, section numbers set forth herein refer to sections of the CDM and page references are to portions of the MMS Decision.

I. General Argument.

Mobil challenges the MMS Decision, in so far as the MMS Decision is based on policies and guidelines set forth in the CDM. The CDM, which takes the form of a legislative rule having the force of law, is not lawfully in effect since the CDM was not promulgated and published in compliance with Section 552 of the Administrative Procedure Act (the "APA"). The MMS has given no notice nor justification for procedures which, if applied, could substantially affect Mobil's liability to the United States for royalties accruing with respect to the McElmo Dome Unit.

MMS argues that the CDM contains interpretative rather than legislative rules and is therefore exempt from the notice and comment provisions of the APA. See Page 4 and Section 553 (b)(a) of the APA. Courts, attempting to define the term "interpretative rule," have uniformly held that the label a particular agency puts upon an exercise of administrative power is not conclusive, and that a rule will not be deemed interpretative merely because the agency classifies it as such. See, e.g., Columbia Broadcasting System, Inc. v. United

States, 316 U.S. 407, 416 (1942); Chamber of Commerce of the United States v. O.S.H.A., 636 F.2d 464, 468 (D.C. Cir. 1980) ["we do not classify a rule as interpretive (sic) just because the agency says it is"]; Brown Exp., Inc. v. United States, 607 F.2d 695, 700 (5th Cir. 1979) ("the court...must determine the category in which a rule falls"); Lewis-Mota v. Secretary of Labor, 469 F.2d 478, 481 (2d Cir. 1972) ("the label is not... conclusive; rather it is what the agency does in fact"). As a result, "it is the substance of what the [agency] has purported to do and has done which is decisive." Columbia Broadcasting, supra at 416.

Generally speaking, legislative rules are those which create law, are issued pursuant to a legislatively-delegated power to make rules having the force of law and/or are more than merely an agency's expression of its construction of a statute or rule. See, e.g., Chamber of Commerce, supra at 468; Brown Exp., Inc., supra at 700; Gibson Wine Co. v. Snyder, 194 F.2d 329, 331 (D.C. Cir. 1952) ("legislative rules are those which create law, usually implementary to an existing law"); 2 K. Davis, ADMINISTRATIVE LAW TREATISE §§ 7:9 - 7:16 (2d ed. 1979). Interpretative rules, on the other hand, are rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers. See, e.g., Brown Exp., Inc., supra at 700; Continental Oil Company v. Burns, 317 F.Supp. 194, 197 (D. Del.

1970); U.S. Department of Justice, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 30 n.3 (1947).

Courts stress that any decision on whether the APA's notice and comment provisions should apply must be based upon the APA's basic purpose, rather than upon facile semantic distinctions. Continental Oil, supra at 197. Therefore, as a general rule, courts have held that when a proposed regulation of general applicability has a substantial impact upon a regulated industry, notice and opportunity for comment must first be provided. See, e.g., Brown Exp., Inc., supra at 702; Continental Oil, supra at 197; Pharmaceutical Manufacturers Association v. Finch, 307 F.Supp. 858, 863 (D. Del. 1970).

Despite MMS's unsupported conclusion to the contrary, the CDM does more than merely clarify an existing regulation. The CDM is an exercise of a legislatively-delegated power to make rules of general applicability having the force of law which, upon implementation, have a substantial impact upon all oil and gas producers - including Mobil. MMS does not dispute Mobil's assertion that the CDM was not promulgated in accordance with the APA, or that the CDM has a substantial impact upon the CO_2 operations of Mobil and other producers. On the contrary, MMS acknowledges that the CDM was promulgated pursuant to MMS's legislatively- delegated power to determine the value of production from a Federal lease for royalty computation purposes. See pages 2 and 4. As a result of the

CDM's substantial impact and promulgation pursuant to a legislatively-delegated power, the notice and comment provisions of the APA apply. Since the CDM was not promulgated and published in a manner consistent with Section 552 of the APA, the policy guidelines therein, to the extent adverse to Mobil, should be vacated and deemed void. See; e.g., Chamber of Commerce, supra at 469.

MMS should not be allowed to treat the procedural obligations imposed by Congress upon administrative agencies under the APA as a meaningless ritual. The Supreme Court has held that the notice and comment provisions "were designed to assure fairness and mature consideration of rules of general application." NLRB v. Wyman-Gordon Co., 394 U.S. 759, 764 (1969). Courts have further held that given the lack of supervision over agency decision-making as a result of judicial deference, the APA's notice and comment provisions, as a practical matter, constitute an affected party's only defense mechanism. See, Chamber of Commerce, supra at 470. Mobil and other oil and gas producers were never afforded an opportunity to comment upon the substantive legislative rules set forth in the CDM. As a result, MMS's reliance upon unpublished and improperly promulgated rules set forth in the CDM is arbitrary and capricious.

II. Operating Costs.

For purposes of calculating the transportation allowance, the MMS Decision affirmed RVSD's limitation on operating costs to ten percent (10%) of Mobil's undepreciated initial investment cost, rather than reverse the RVSD Decision and allow Mobil a deduction for operating costs actually incurred. The RSVD Decision supported this limitation by reference to CDM Section 647.5A.3B, which states in relevant part:

> Operating costs are those non-depreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which operating costs are calculated.

Mobil challenges RSVD's limitation of operating costs to the lesser of actual costs or 10% of the initial investment cost. No such limitation is placed by RSVD on operating costs incurred in arms-length transactions by producers who are not owners of CO_2 pipelines. Mobil believes that the application of such limitation results in discrimination between CO_2 producers who are owners of CO_2 pipelines and those CO_2 producers who are not owners. As a result of such discrimination, MMS's failure to allow Mobil to deduct operating costs to the extent actually incurred for purposes of calculating the transportation allowance is unreasonable, arbitrary and capricious.

In addition, the MMS Decision affirms RVSD's inclusion of ad valorem taxes in calculating the ten percent (10%) cap on operating costs, despite the fact that the CDM states that operating costs are those "required to operate and maintain the pipeline system." Mobil reaffirms its argument that ad valorem taxes should not be considered in calculating the ten percent (10%) cap, since such taxes are not a cost of transporting CO_2. Ad valorem taxes should be deductible as an expense free of the ten percent (10%) limitation, since such taxes are not operating costs. Ad valorem taxes are neither established nor controlled by Mobil, therefore their inclusion as an operating cost for purposes of the ten percent (10%) cap is unreasonable, arbitrary and capricious.

III. Rate of Return on Investment.

In determining the rate of return on investment, the MMS Decision states that RVSD should have used the prime interest rate in effect on December 31, 1986 - the date of the RVSD Decision, rather than January 1, 1985 - the beginning of the year for which Mobil's initial allowance was granted. MMS reaches this conclusion despite the fact that the RVSD Decision clearly states that it is "MMS's policy to use the prime interest rate...in effect at the beginning of the year for which initial allowance is granted." See the RVSD Decision at page 4. Under the MMS Decision, MMS could wait until the prime interest rate drops to a low level before making its initial

allowance decision, thereby causing material harm to Mobil and others similarly situated. In order to avoid this patently arbitrary result, the MMS Decision, at a minimum, should be reversed to the extent it purports to set Mobil's rate of return at the prime interest rate in effect on December 31, 1986.

Notwithstanding the above arguments, Mobil asserts that MMS's use of the prime interest rate is unreasonable, arbitrary and capricious since such rate reflects the short-term cost of money to the bank's most favored customers and can fluctuate greatly within a year. MMS's use of the prime interest rate does not take into account the substantial financial and other risks taken by Mobil and others in developing, owning, operating and managing CO_2 transportation facilities. Reserves must be estimated prior to construction of any CO_2 transportation facility. As a result, Mobil and others face a significant risk that, if actual reserves are less than original estimates, their costs will not be recovered. Use of the prime interest rate offers Mobil and others little or no incentive to conduct exploration, development, operation, and transporation activities. MMS, as the operating arm for the Secretary of Interior, has an affirmative duty to provide producers like Mobil with an incentive for development. See, e.g. California Company v. Udall, 296, F.2d 384, 388 (D.C. Cir. 1961). MMS shirks this duty by limiting Mobil's rate of return

to the prime interest rate - a rate charged by lending institutions on only the most risk-free loans.

Mobil believes that the rate of return should be established by MMS and published in the first Federal Register issued in February of each calendar year, to be effective for that calendar year. Mobil requests that MMS calculate such rate by multiplying (i) the average of the twelve (12) rates for twenty-year Treasury Bills published in the Wall Street Journal on the first publication date of each month of the preceding calendar year, by (ii) one hundred fifty percent (150%). As computed above, such rate will reasonably approximate a return on investment consistent with industry practice and will provide Mobil and other producers with an incentive to incur the substantial financial and other risks involved in CO_2 transportation operations. MMS's failure to provide Mobil and other producers with reasonable incentives to conduct exploration, operation and transportation activities violates MMS's statutory duties and is therefore arbitrary and capricious.

IV. Compression Expenses.

Under the MMS Decision, all compression related operating and maintenance expenses for Mobil's pipeline segment were disallowed by MMS. The MMS Decision agrees with RVSD's conclusion that only operating and maintenance expenses (including power necessary to operate the pipeline) will be

accepted. MMS's disallowance of compression related expenses is unreasonable, arbitrary and capricious, since MMS fails to recognize that such expenses are transportation costs, and not lease production, operating or maintenance costs. No market exists for CO_2 at the McElmo Dome Unit field, and as a result all CO_2 must be transported or delivered to remote locations outside of the perimeter of such field. All costs associated with this transportation or delivery must be allowed, as there is no method other than compression to transport the CO_2 from the Cortez Pipeline to the Sheep Mountain line. MMS, in affirming the RVSD Decision, acted unreasonably in disallowing compression related expenses, since such expenses currently comprise eighty percent (80%) of actual operating expenses for Mobil's pipeline segment. In addition, the MMS Decision, by failing to allow Mobil's deduction for compression related expenses, discriminates between CO_2 producers who are owners of the CO_2 pipelines and those CO_2 producers who are not owners. Industry practice dictates that compression costs be factored into CO_2 prices set under any arms-length contract. MMS offers no rational reason why non-arms length contracts should be treated differently. Simply stating that "[t]his interpretation is one of long standing" evidences MMS's arbitrary position on this issue. See page 5.

In affirming the RVSD Decision, MMS states that the Department of Interior (the "Department") has consistently held

that compression costs are not deductible for royalty purposes. MMS cites three Department decisions which arguably offer more support for Mobil's position than MMS's position. See, The Texas Company, 64 I.D. 76 (1957); The California Company, 66 I.D. 54 (1954), aff'd., 296 F.2d 384 (D.C. Cir. 1961); Placid Oil Company, 70 I.D. 438 (1963). In The Texas Company, supra, a lessee under a Federal lease sought to deduct certain gathering and compression costs for royalty computation purposes. Such costs were incurred in order to transport, condition and market lessee's gas from the wellhead to a delivery point within the perimeter of lessee's oil and gas field. Lessee admitted that the compression charges were incurred to "boost" the gas and that a market for lessee's gas existed in lessee's field. The Acting Solicitor, Edmund T. Fritz, held that since (a) a market existed in lessee's field, and (b) the compression costs were incurred to condition and transport the gas between the two points in lessee's field, such compression costs were deemed an ordinary incident of lessee's lease operations and non-deductible. In reaching such holding, the Acting Solicitor expressly distinguished the situation where a lessee has to transport the gas outside of its field because no market exists in such field. The Texas Company, supra at 79-80. In this case, Mobil and MMS agree that no market exists for Mobil's CO_2 in the McElmo Dome Unit field and that Mobil must transport the CO_2 out of such field

to the first available market. Under The Texas Company decision, Mobil's compression costs are not marketing or "boosting" charges, but represent bona fide transportation costs.

The California Company and Placid Oil Company decisions, supra, each involved facts similar to those found in The Texas Company case. A lessee sought to deduct compression costs incurred to condition gas for sale in a nearby market. The Court of Appeals for the District of Columbia in The California Company decision emphasized that no transportation costs were involved and that the Secretary of the Interior (the "Secretary") was not arguing "that costs incurred in moving gas from the field in the neighborhood of the wells to a distant selling point are includable in the royalty base." California Company v. Udall, 296 F.2d 384, 387 (D.C. Cir. 1961). The compression costs were incurred by The California Company to condition the gas and to deliver same to a field a short distance from the wells. Since the compression costs were not incurred to transport the gas to a distant selling point, the D.C. Circuit affirmed the Secretary's disallowance of lessee's compression costs. In so holding, the D.C. Circuit imposed a statutory duty upon the Secretary to provide a lessee with an incentive for development, and stated that the public does not benefit from resources that remain undeveloped. Id. at 388. Mobil is attempting to market the CO_2 from the McElmo Dome

Unit field, despite declining prices and scarcity of CO_2 markets. By disallowing Mobil's compression costs, MMS has ignored its duty to provide Mobil with an incentive for development so as to maximize the public's benefit. Mobil's compression costs were incurred to transport the CO_2 to a distant market and, therefore, under The California Company decision, such costs are fully deductible for royalty computation purposes.

It has long been the Secretary's policy "to allow for the deduction of transportation costs in the computation of market value and royalty interests." Shell Oil Company, 70 I.D. 393, 395 n.6 (1963), citing United States v. General Petroleum Corp. of California, 73 F.Supp. 225 (S.D. Calif. 1946), aff'd., 184 F.2d 802 (9th Cir. 1950). In Kerr-McGee Corporation, 22 I.B.L.A. 124 (1975), this Board allowed a royalty deduction for costs incurred by a lessee in transporting oil by truck from the well-head to the first available market outside of the lessee's field. This Board concluded that logic compels the conclusion that such costs are properly considered for a transportation allowance. Id. at 128. As the lessee in Kerr-McGee, Mobil has incurred transportation costs in order to deliver the CO_2 from the McElmo Dome Unit field to the first available market outside of such field. That such costs were compression-related rather than the result of trucking charges is of no moment. Since Mobil's compression costs were for

transportation rather than conditioning or marketing, such costs should have been fully deducted by MMS for royalty computation purposes.

V. Allowance Limitation.

The MMS Decision, citing Section 647.5.3E of the CDM, further affirms RVSD's limitation on the transportation allowance to the lesser of the approved rate or fifty percent (50%) of the CO_2's value at the sales point. The CDM was promulgated by MMS's predecessor, without public notice or comment, in early 1974 during times of record product prices and numerous CO_2 markets. The past thirteen years have shown a steady decline in CO_2 prices and CO_2 markets have become scarce. While product prices have decreased considerably during the past thirteen years, Mobil's operating costs during the same period have increased. CO_2 commodity prices are subject to competitive market forces and transportation costs tend to be higher as sales point distances increase from the McElmo Dome field. The increased distance to sales points are likely to render transportation costs in excess of fifty percent (50%) of the aggregate CO_2 sales price. Mobil, therefore, asserts that MMS's failure to recognize current market conditions so as to allow deductions for actual costs incurred is unreasonable, and MMS's fifty percent (50%) cap on operating costs is arbitrary and capricious.

VI. Federal Income Taxes.

The MMS Decision further affirmed RVSD's disallowance of Federal income taxes from the Cortez CO_2 Pipeline "tariff calculation" of transportation costs. The Cortez Pipeline Tariff was calculated in accordance with the 1941 Pipeline Consent Decree, which Decree did recognize income taxes as a cost component. Nonetheless, the Cortez Pipeline Tariff, in reality, does not so recognize such taxes because it was calculated using higher throughput volumes than have been or are actually being transported in the line thereby rendering the tariff too low to even cover other cost components not disputed by MMS. In addition, Mobil believes that Federal and state income taxes should be allowed as a cost component of the Cortez CO_2 Pipeline Company tariff, since to do otherwise would unfairly discriminate between CO_2 producers who are owners of CO_2 pipelines and CO_2 producers who are not owners.

VII. Standard of Review.

Mobil acknowledges that agency decisions are generally entitled to substantial deference. See, e.g., Chevron USA, Inc. v. National Resources Defense Council, Inc., 467 U.S. 837, 843-845 (1984). Mobil believes, however, that those portions of the MMS Decision discussed herein should be reversed as arbitrary, capricious, an abuse of discretion, or contrary to law. See, 5 U.S.C. § 706(2)(A); Citizens to Preserve Overton

Park, Inc. v. Volpe, 401 U.S. 402, 413-414 (1971). In addition, Mobil believes that the MMS Decision fails to consider all relevant factors, including, without limitation, current law, industry practice, standard accounting procedures, economic realities and current market conditions, and therefore should not be afforded deference, substantial or otherwise, by the courts, this Board, or any other reviewing body.

VIII. Conclusion.

As set forth in detail above, the MMS Decision affirmed RVSD's incorrect calculation of the transportation allowances applicable to CO_2 produced from the McElmo Dome Unit. Mobil, therefore, respectfully requests that this Board, after formal hearing and consideration of these Statement of Reasons, recalculate and approve such transportation allowances in accordance with the procedures outlined herein.

Respectfully submitted,

STUTZMAN & BROMBERG
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(214) 969-4900

Robert T. Brousseau
Kenneth F. Plifka

ATTORNEYS FOR MOBIL PRODUCING TEXAS & NEW MEXICO, INC.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Statement of Reasons was sent via certified mail, return receipt requested to the parties set forth below on this 21st day of December, 1987.

Mr. David A. Schuenke
Chief, Division of Appeals
Office of Program Review
Minerals Management Service
United States Department
of the Interior
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

VIA CERTIFIED MAIL
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#P657 075 156

Associate Solicitor
Division of Energy and Resources
United States Department of Interior
Washington, D.C. 20240

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
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Mr. William H. Feldmiller
Chief, Royalty Valuation
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Kenneth F. Plifka

Thank you in advance for your continued cooperation.

Sincerely yours,

STUTZMAN & BROMBERG

By: _____
Robert T. Brousseau
Kenneth F. Plifka

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ATTORNEYS FOR MOBIL PRODUCING TEXAS AND NEW MEXICO, INC.

cc: Mr. W. R. Buck
Counsel
Mobil Exploration &
Producing U.S. Inc.
3000 Diamond Park
Dallas, Texas 75247

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Notice of Appeal was sent via certified mail, return receipt requested to the parties set forth below on this 23rd day of November, 1987.

Associate Solicitor
Division of Energy and Resources
United States Department of Interior
Washington, D.C. 20240

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-432

Mr. William H. Feldmiller
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VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-433

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Denver Federal Center
Denver, Colorado 80225

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
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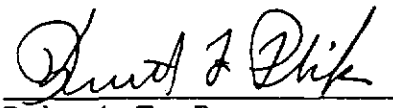
STUTZMAN & BROMBERG

By: 
Robert T. Brousseau
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Dallas, Texas 75201
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ATTORNEYS FOR MOBIL PRODUCING TEXAS AND NEW MEXICO, INC.

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3. Article Addressed to:
Mr. William R. Feldmiller
Chief, Royalty Valuation
and Standards Division
Minerals Management Service
United States Department of Interior
P.O. Box 25165, Mail Stop 653
Denver, Colorado 80225
11/23/87
M0006-004

4. Article Number
P718-249-433

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5. Signature — Addressee
X

6. Signature — Agent
X R. J. Johnson

7. Date of Delivery
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8. Addressee's Address *(ONLY if requested and fee paid)*
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1. ☒ Show to whom delivered, date, and addressee's address. 2. ☐ Restricted Delivery
†(Extra charge)† †(Extra charge)†

3. Article Addressed to:
Mr. David A. Schuenke 11/23/87
Chief, Division of Appeals
Office of Program Review
Minerals Management Service
United States Department of the Interior
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091 M06-004

4. Article Number
P718-249-431

Type of Service:
☐ Registered ☐ Insured
☒ Certified ☐ COD
☐ Express Mail

Always obtain signature of addressee or agent and DATE DELIVERED.

5. Signature — Addressee
X

6. Signature — Agent
X Dora T. Mote

7. Date of Delivery
11/27/87

8. Addressee's Address *(ONLY if requested and fee paid)*

PS Form 3811, Mar. 1987 ★ U.S.G.P.O. 1987-178-268 DOMESTIC RETURN RECE

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Put your address in the "RETURN TO" Space on the reverse side. Failure to do this will prevent this card from being returned to you. The return receipt fee will provide you the name of the person delivered to and the date of delivery. For additional fees the following services are available. Consult postmaster for fees and check box(es) for additional service(s) requested.
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†(Extra charge)† †(Extra charge)†

3. Article Addressed to:
Regional Solicitor
Rocky Mountain Region
United States Department of Interior
P.O. Box 25007
Denver, Colorado 80225
11/23/87
M0006-004

4. Article Number
P718-249-434

Type of Service:
☐ Registered ☐ Insured
☒ Certified ☐ COD
☐ Express Mail

Always obtain signature of addressee or agent and DATE DELIVERED.

5. Signature — Addressee
X

6. Signature — Agent
X Mark E. Padilla

7. Date of Delivery
NOV 25 1987

8. Addressee's Address *(ONLY if requested and fee paid)*
DENVER FEDERAL CENTER
80225

PS Form 3811, Mar. 1987 ★ U.S.G.P.O. 1987-178-268 DOMESTIC RETURN RECEIPT

SENDER: Complete items 1 and 2 when additional services are desired, and complete items 3 and 4.
Put your address in the "RETURN TO" Space on the reverse side. Failure to do this will prevent this card from being returned to you. The return receipt fee will provide you the name of the person delivered to and the date of delivery. For additional fees the following services are available. Consult postmaster for fees and check box(es) for additional service(s) requested.
1. ☒ Show to whom delivered, date, and addressee's address. 2. ☐ Restricted Delivery
†(Extra charge)† †(Extra charge)†

3. Article Addressed to:
Associate Solicitor
Division of Energy and
Resources
United States Department of Interior
Washington, D.C. 20240

4. Article Number
P718-249-432

Type of Service:
☐ Registered ☐ Insured
☒ Certified ☐ COD
☐ Express Mail

Always obtain signature of addressee or agent and DATE DELIVERED.

5. Signature — Addressee
X Martha B. Robert

6. Signature — Agent
X

7. Date of Delivery
11/27/87

8. Addressee's Address *(ONLY if requested and fee paid)*

PS Form 3811, Mar. 1987 ★ U.S.G.P.O. 1987-178-268 DOMESTIC RETURN RECE

STUTZMAN & BROMBERG
ATTORNEYS AND COUNSELORS
2323 BRYAN STREET
SUITE 2200
DALLAS, TEXAS 75201

TELEPHONE: (214) 969-4900
TELECOPIER: (214) 969-4999

KENNETH F. PLIFKA

NOV 25 1987

November 23, 1987

Mr. David A. Schuenke
Chief, Division of Appeals
Office of Program Review
Minerals Management Service
United States Department of
the Interior
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

DELIVERED VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-431

Re: Docket No.: MMS-87-0194-O&G
Notice of Appeal to Partial Denial of Transportation Allowance with respect to Carbon Dioxide Production, McElmo Dome Unit, Colorado

Dear Mr. Schuenke:

The undersigned, on behalf of Mobil Producing Texas and New Mexico Inc. ("Mobil"), hereby files Mobil's Notice of Appeal to the Interior Board of Land Appeals (the "IBLA") of the Decision of the Director, Minerals Management Service dated October 30, 1987 (the "Decision"), a copy of which was served upon Mobil on November 9, 1987. Mobil will file its Statement of Reasons in support of Mobil's appeal to the IBLA within the time period prescribed by 43 C.F.R. § 4.412(a)(1986).

As a result of the importance of the issues involved and in accordance with 43 C.F.R. §4.25 (1986), Mobil respectfully requests that the IBLA exercise its discretion and grant Mobil the opportunity for oral argument in this appeal.

As expressly provided for under the Decision, please be advised that, in addition to this appeal, Mobil presently intends to seek relief from the fifty percent (50%) transportation allowance ceiling before the Royalty Valuation and Standards Division of the Minerals Management Service. All correspondence regarding matters relative to Mobil's appeal should be directed to Mr. Kenneth F. Plifka, c/o Stutzman & Bromberg at the above address.

Thank you in advance for your continued cooperation.

Sincerely yours,

STUTZMAN & BROMBERG

By: _____
Robert T. Brousseau
Kenneth F. Plifka

2200 Allianz Financial Centre
2323 Bryan Street
Dallas, Texas 75201
(214) 969-4900

ATTORNEYS FOR MOBIL PRODUCING TEXAS AND NEW MEXICO, INC.

cc: Mr. W. R. Buck
Counsel
Mobil Exploration &
Producing U.S. Inc.
3000 Diamond Park
Dallas, Texas 75247

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Notice of Appeal was sent via certified mail, return receipt requested to the parties set forth below on this 23rd day of November, 1987.

Associate Solicitor
Division of Energy and Resources
United States Department of Interior
Washington, D.C. 20240

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-432

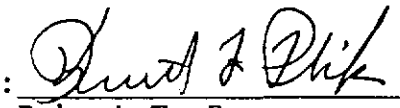
Mr. William H. Feldmiller
Chief, Royalty Valuation
and Standards Division
Minerals Management Service
United States Department of Interior
P.O. Box 25165, Mail Stop 653
Denver, Colorado 80225

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-433

Regional Solicitor
Rocky Mountain Region
United States Department of Interior
P.O. Box 25007
Denver Federal Center
Denver, Colorado 80225

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED
#P718-249-434

STUTZMAN & BROMBERG

By: 
Robert T. Brousseau
Kenneth F. Plifka

2200 Allianz Financial Centre
2323 Bryan Street
Dallas, Texas 75201
(214) 969-4900

ATTORNEYS FOR MOBIL PRODUCING TEXAS AND NEW MEXICO, INC.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
WASHINGTON, D.C. 20240

NOV 4 1987

NOV 1 0 1987

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. W. R. Buck
Mobil Exploration and
Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75265-0232

Re: MMS-87-0194-O&G
Mobil Producing Texas and
New Mexico Inc.

Dear Mr. Buck:

Enclosed are two copies of a decision issued in response to the appeal.

This decision will be available to the public and will be published by the Rocky Mountain Mineral Law Foundation. If you believe that information contained in the decision is protected from release to the public because it is privileged or proprietary, please file with this office your claim identifying the specific items you consider proprietary, together with the statutory basis for the claim, within 30 days of your receipt of this letter. Such claims will be evaluated in accordance with applicable legal principles.

Sincerely,

David A. Schuenke
Chief, Division of Appeals
Office of Program Review

2 Enclosures

bcc: Solicitor's Docket
AD/PR Appeals (MMS-87-0194-O&G)
R/M, Houston Area Compliance Office, E. Gonzales
R/M, Dallas Area Compliance Office, N. Kelly
R/M, Lakewood Area Compliance Office, Denver
R/M, Royalty Compliance Division, Denver
R/M, Fiscal Accounting Division, Denver, J. Detlefs
R/M, Royalty Valuation and Standards Division, Denver
R/M, Technical Information Management, Denver, R. Hicks
Associate Director--Royalty Management
AD/PR Chron
Desk Files (MA)(EM)

LMS:MAnderson:pr:11/03/87:648-7729: :Disk #1(new)

Sandras 10/30/87

Valuation Attachment 53

Mail Stop 653

MMS-RVS-OG:87-0093

ENCLOSURE CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

Mr. R. M. Williams
Mobil Exploration and
Producing Services Inc.
P.O. Box 900
Dallas, Texas 75221-0900

Dear Mr. Williams:

By letter dated January 28, 1987, Mobil Exploration and Producing Services Inc. requested Minerals Management Service's (MMS) approval of a royalty valuation procedure for carbon dioxide (CO_2) production from the McElmo Dome Unit. The CO_2 is transported by pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects.

Enclosed is a copy of our Findings and Conclusions detailing the approved valuation procedure.

You have the right to appeal MMS's valuation in accordance with 30 CFR 290. The appeals procedure is outlined on the enclosed Appeals Procedure page.

If you have any questions, please contact us at (303) 231-3395.

Sincerely,

ORIG. SGD. T. J. BLAIR

for William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

2 Enclosures

bcc: F:87-0093
RM Chron/DC
RM Chron/Lakewood
RVS Chron

LMS:RMP:RVSD:MS-653:WALSH:ebw:10/16/87:231-3529:OGV:87-0093

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION

Findings and Conclusions on McElmo Dome CO_2 Production

Mobil Exploration and Producing Services Inc.

BACKGROUND

By letter dated January 28, 1987, Mobil Exploration and Producing Services, Inc. (Mobil) requested Minerals Management Service's (MMS) approval of a royalty valuation procedure for carbon dioxide (CO_2) production from the McElmo Dome Unit in Montezuma and Dolores Counties, Colorado. Shell Western E&P Inc. (SWEPI) is the operator of the unit. Mobil has a working interest in the McElmo Dome Unit. The CO_2 is transported through the Cortez Pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects. The Cortez Pipeline is owned by Cortez Pipeline Company of which Mobil, SWEPI, and Conoco, Inc. are parent owners. The CO_2 is also transported through other pipeline segments to various delivery points in west Texas.

By letters dated January 30, 1987, and March 16, 1987, Mobil requested approval of transportation allowances pertaining to CO_2 production transported from the McElmo Dome Unit to various units in west Texas. Transportation allowances will be addressed separately from the valuation procedure.

By letter dated July 1, 1987, Royalty Valuation and Standards Division (RVSD) issued a draft decision to Mobil regarding the McElmo Dome valuation procedure. On August 15, 1987, Mobil and RVSD representatives met to discuss the valuation procedure.

FINDINGS

- The points of sale for McElmo Dome CO_2 are at various units in the west Texas Permian Basin Area. The CO_2 is transported by pipeline to west Texas and is used at various tertiary recovery projects to enhance oil recovery. The contract delivery points for CO_2 from the McElmo Dome Unit are at or near these tertiary recovery projects.

- Mobil disposes of McElmo Dome CO_2 under 12 contracts. Three of these contracts are exchange agreements, six are in-kind supply agreements, and three are arm's-length sales agreements.

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

- By letter dated January 28, 1987, Mobil requested a valuation determination for McElmo Dome CO_2. Mobil proposed the following method to calculate the value of McElmo Dome CO_2 on which royalties will be paid:

  a) for arm's-length sales contracts, using the delivered prices established by the contracts between Mobil and its buyers less actual costs of transporting to the contract delivery points;

  b) for in-kind supply agreements, using the prices contained in the contracts executed by the operators of the applicable units for the purchase of CO_2 on behalf of the unit working interest owners (principal contracts) less actual costs of transporting to the contract delivery points;

  c) for exchange agreements, using the price contained in the principal contract at the unit where Mobil receives CO_2 from its exchange partners less actual costs of transporting to the contract delivery points.

- After the deliveries are valued, Mobil proposes to calculate a weighted-average price using the total volumes and values applicable to Mobil's CO_2 deliveries from the McElmo Dome Unit. The weighted-average price is then applied to the volume available for sale/delivery from the McElmo Dome Unit into the Cortez Pipeline.

- McElmo Dome CO_2 is sold under three arm's-length contracts to the Denver Unit (SWEPI/Mobil), to the South Wasson Clearfork Unit (SWEPI/Mobil), and to the Seminole-San Andres Unit, Mobil Wasson Delivery Station, and Denver San Andres Unit (Amoco Oil Company/Mobil). The MMS reviewed the three arm's-length contracts and found them acceptable as the basis for establishing the value for that portion of McElmo Dome CO_2 sold under those contracts to the various units.

- In-kind supply agreements allow a working interest owner in a tertiary recovery project to supply its share of required CO_2 "in-kind" in lieu of sharing in the cost of purchasing CO_2 for the project. Mobil supplies CO_2 in-kind at the Wellman, East Vacuum, Denver, Dollarhide, McElmo Creek, and Seminole-San Andres units. In each of these units, additional CO_2 is purchased outright by the unit operator acting on behalf of the working interest owners. The in-kind supply agreements equate the value of the CO_2 delivered to those units to the volume-weighted-average price paid under non-in-kind arm's-length purchase contracts at each unit. For in-kind deliveries, Mobil has proposed to value McElmo Dome CO_2 by using the value established under the terms of the principal arm's-length contracts in effect at the unit where the McElmo Dome CO_2 is delivered.

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

- The principal CO_2 sales purchase contracts for the Wellman, East Vacuum, Denver, Dollarhide, McElmo Creek, and Seminole-San Andres units are arm's-length contracts. For in-kind deliveries, MMS agrees that using the principal arm's-length contract in effect for the unit where McElmo Dome CO_2 is delivered is the best method to determine royalty value. The CO_2 is not sold at the lease or unit; therefore, MMS must go to the first sales point remote from the lease or unit to establish value. The first sales point is at the various units where McElmo Dome CO_2 is actually being delivered.

- Mobil disposes of McElmo Dome CO_2 under three exchange agreements with ARCO Oil and Gas Company (ARCO), X-4, and Exxon Company, U.S.A. (Exxon). Mobil delivers McElmo Dome CO_2 to tertiary recovery units in west Texas for ARCO's, X-4 and Exxon's accounts in exchange for ARCO's, X-4, and Exxon's deliveries of CO_2 to various units for Mobil's account. The majority of the CO_2 that is delivered for Mobil's account under the exchange agreement with ARCO, X-4 and Exxon is delivered to the Seminole-San Andres Unit. Mobil delivers McElmo Dome CO_2 under the exchange agreements to the following units: East Vacuum, McElmo Creek, Denver, and South Wasson Clearfork units. Mobil proposed to value the McElmo Dome CO_2 delivered under exchange agreements to the various units by using the value established under the terms of the principal arm's-length contract in use at the Seminole-San Andres Unit.

- The CO_2 is not sold at the lease or unit; therefore, MMS must go to the first sales point remote from the lease or unit to establish value. The first sales point is actually at each of the units where McElmo Dome CO_2 is being delivered by Mobil. Since none of the McElmo Dome CO_2 is being delivered under the exchange agreements to the Seminole-San Andres Unit, the principal CO_2 sales and purchase agreement in effect at the Seminole-San Andres Unit is not the best measure of the market value of McElmo Dome CO_2 exchanged under the exchange agreements with ARCO, X-4 and Exxon.

- The exchange agreements are not sales agreements but, rather, are for the benefit of ARCO's, X-4 Exxon's and Mobil's operational needs. Mobil delivers a monthly volume of McElmo Dome CO_2 to the various delivery points for ARCO's, X-4 and Exxon's accounts in exchange for an equal volume of CO_2 delivered by ARCO, X-4 and Exxon for Mobil's account. Any differences in monthly total volumes are settled by increasing the volumes of CO_2 to the party which has received the lesser amount of CO_2 ("under-receiving party") in the following months to eliminate the monthly deficiency. Such balancing will continue during successive months, if necessary. If for any reason monthly deficiencies continue for a period of three consecutive months without being settled as stated above, the under-receiving party may have the total volume of CO_2 equal to the accrued monthly deficiencies

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

delivered at a mutually agreed upon rate and during a certain period. However, if at the end of the contract term, there are any accrued monthly deficiencies, such deficiencies may be settled by cash payment by the party which has a greater amount of CO_2 delivered ("over-receiving party") in an amount equal to the product of the total volume of all monthly deficiencies and the settlement value at the unit where the CO_2 was delivered.

- Under the terms of the exchange agreements, Mobil exchanges an equal volume of CO_2 at the various units. The comparison of the sales prices contained in the principal CO_2 contracts at the various units where Mobil delivers CO_2 and the units where ARCO, X-4 and Exxon deliver CO_2 is not feasible since the settlement value is on total volumes exchanged. The sales prices contained in the principal CO_2 sales contracts at the various units are a function of the price of oil and the execution dates of the contracts. Therefore, the CO_2 sales prices and the monthly total volumes fluctuate, making the comparison of the sales prices at the individual units where Mobil exchanges CO_2 and where ARCO, X-4 and Exxon exchange CO_2 impracticable.

- Since other McElmo Dome CO_2 is sold at the East Vacuum, McElmo Creek, Denver, and the South Wasson Clearfork units (where McElmo Dome CO_2 is exchanged), the principal arm's-length contracts at those units should establish value for that portion of McElmo Dome CO_2 exchanged by Mobil in west Texas.

- Mobil also delivers McElmo Dome CO_2 to the Mahoney Unit. Mobil is the unit operator and owns 100 percent working interest in the Mahoney Unit. Currently, no principal CO_2 sales and purchase agreement exists for the Mahoney Unit. Therefore, Mobil has proposed to value McElmo Dome CO_2 delivered to the Mahoney Unit based on the value stated in the principal CO_2 sales and purchase agreement in use at the Willard Unit. The Willard Unit is the closest tertiary recovery unit located in the same field as the Mahoney Unit. The arm's-length contract for the Willard Unit was negotiated at approximately the same time as the McElmo Dome CO_2 was initially delivered to the Mahoney Unit. The MMS has reviewed the arm's-length contract in use at the Willard Unit and has determined that the price cited in the arm's-length contract is acceptable as value.

- Applicable laws, regulations, and lease terms specifically require that royalty is due on "production removed or sold from the leased lands." For each of the valuation scenarios discussed above, MMS will require royalties on the volume of CO_2 leaving the McElmo Dome Unit regardless of when Mobil receives final settlement.

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

CONCLUSIONS

- The arm's-length sales contracts negotiated by the unit operators and Mobil for the delivery of McElmo Dome CO_2 to the Denver, South Wasson Clearfork, and the Seminole-San Andres units will separately establish the value for that portion of CO_2 produced from the McElmo Dome Unit which is attributable to these units.

- The value of CO_2 supplied in-kind to the Wellman, East Vacuum, Denver, Dollarhide, McElmo Creek and the Seminole-San Andres units shall be the prices contained in the principal CO_2 sales and purchase contracts in existence at these units. The MMS determined that the values stated in the principal CO_2 contracts with the unit operators acting on behalf of the working-interest owners are acceptable as value.

- For McElmo Dome CO_2 delivered to the East Vacuum, McElmo Creek, Denver, and South Wasson Clearfork units, but subject to exchange agreements between Mobil and ARCO, X-4 and Exxon, the value shall be the price contained in the principal CO_2 sales and purchase contract in use at the East Vacuum, McElmo Creek, Denver, and South Wasson Clearfork units.

- A principal CO_2 arm's-length contract does not exist at the Mahoney Unit. Therefore, MMS has determined that value for the CO_2 delivered to the Mahoney Unit shall be the price contained in the principal CO_2 sales and purchase contract in use at the Willard Unit.

- For each contract under which Mobil delivers McElmo Dome CO_2 to a west Texas tertiary recovery unit, the value for royalty purposes at the point of settlement shall be the value stated in the contract in effect for the unit, less the MMS-approved transportation allowance. Each value for royalty purposes determined by this method shall be applied to that portion of the CO_2 attributable to the west Texas tertiary recovery unit at the McElmo Dome Unit boundary measurement point. Attributable portions will be determined by dividing each individual west Texas monthly delivery by the total monthly west Texas deliveries to arrive at a percentage allocation. A hypothetical example for the Month A is provided below for illustrative purposes:

Example of McElmo Dome CO_2 Valuation for Month A

Deliveries of CO_2 to west Texas delivery points; Month A	2,000 Mcf
CO_2 production measured at McElmo Dome Unit; Month A	10,000 Mcf

CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL EXPLORATION AND PRODUCING SERVICES INC.

Mobil's West Texas Deliveries for Month A

	Volume	Percent
Deliveries to Unit A	1,000 Mcf	50%
Deliveries to Unit B	600 Mcf	30%
Deliveries to Unit C	400 Mcf	20%
Total West Texas Deliveries	2,000 Mcf	100%

	Arm's-Length Sales Price	MMS-Approved Transportation Allowance
Unit A	$1.00/Mcf	$0.10/Mcf
Unit B	$1.50/Mcf	$0.20/Mcf
Unit C	$2.00/Mcf	$0.25/Mcf

Calculation of the Royalty Value

Unit		Percent of the Volume Leaving McElmo Dome	Value for Royalty Purposes
A	$0.90 ($1.00-$0.10)	x 50% of 10,000	$4,500
B	$1.30 ($1.50-$0.20)	x 30% of 10,000	$3,900
C	$1.75 ($2.00-$0.25)	x 20% of 10,000	$3,500

The above amounts represent the value for royalty purposes of McElmo Dome CO_2 produced during Month A. These values, times the royalty rate, determine the royalty due for McElmo Dome CO_2 and would be reported as separate line items on Form MMS-2014. To deduct a transportation allowance, Mobil should follow the standard two-line entry format required by MMS's Auditing and Financial System as outlined in the revised Payor Handbook released September 1986, Section 3.9, "Reporting Allowances." If further clarification is needed regarding the Form MMS-2014 reporting requirements, Mobil may contact personnel in MMS's Lessee Contact Branch.

- By regulation, royalty shall never be less than the gross proceeds accruing, or which could accrue, to the lessee for the sale or disposition of McElmo Dome CO_2.

RECEIVED
1994 NOV 21 AM 8:12
VAL. SVCS. DIV

MMS

U.S. Department of the Interior
Minerals Management Service
Appeals Division

NOTE

To: Shirley I. Keller, VSD

From: Frederick C. Gray, Appeals Div Fred Gray

Subject: Appeals Docket Number MMS-93-0997-O&G
McElmo Dome CO_2 Transportation Allowances
Mobil/Cortez Pipeline

I spoke with Geoff Heath (Ofc of the Solicitor) today (November 15, 1994) in reference to the subject Appeal and he relayed the following information:

1. On February 28, 1994, Mobil filed suit in U.S. District Court for the District of Columbia (Mobil Exploration & Producing U.S. Inc. v. Babbitt, Civ. No. 94-0387-SSH) to challenge several MMS decisions and orders with respect to the subject Appeal.

2. DOJ filed a Motion to Dismiss with the D.C. District Court on the basis of the lack of final agency action, i.e. our pending administrative appeal.

3. The Court has not as yet ruled on government's Motion -- Geoff asked me to check back with him in one month.

4. Geoff informs that if the Court approves the Motion to Dismiss, then the matter remains under our Appeals process. If, however, the Court denys the Motion, then MMS should "stay" the Appeal process while awaiting the Court's disposition.

5. In the meantime, a Supplemental Statement of Reasons has been filed by the Mobil counsel in response to your field report. Noteworthy are two new issues: transactions between Mobil & Cortez Pipeline are at arm's-length versus non-arm's-length; and Mobil has been denied Due Process in that MMS has not allowed for a "hearing" before termination of previously approved transportation allowances.

I have attached a copy of the Supplemental SOR for your file and consideration.

attach. 20

United States Department of the Interi

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

OCT 30 1987

MMS-87-0194-O&G	:	Carbon Dioxide Production, McElmo Dome Unit, Colorado
Mobil Producing Texas and New Mexico Inc.	:	Appeal of Partial Denial of Transportation Allowance
Appellant	:	Appeal Remanded

Statement of Facts

This is an appeal filed by Mobil Producing Texas and New Mexico Inc. (Mobil) pursuant to the regulations in 30 CFR Part 290 (1986). Mobil's appeal concerns an order issued by the Chief, Royalty Valuation and Standards Division (RVSD), Royalty Management Program (RMP), Minerals Management Service (MMS), disallowing a portion of the transportation costs claimed by Mobil.

Background

Carbon dioxide (CO_2) is produced from Federal leases in the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado, and transported via pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects. Mobil is a working interest owner in the McElmo Dome Unit.

On December 31, 1986, MMS approved transportation allowances for Mobil's pipeline and the Cortez pipeline (in which Mobil has an ownership interest). Mobil contends that MMS erred in its computation of the allowances for those pipelines.

Analysis

Under section 17 of the Mineral Lands Leasing Act, 30 U.S.C. 226 (1982), the Secretary of the Interior (Secretary) has the authority to determine

the value of production from a Federal lease for the purpose of computing the royalty under that lease. Amoco Production Co., 78 IBLA 93, 96 (1983). Section 3103.30-1(d) of 43 CFR (1983)[1] states:

> The Secretary may establish reasonable values for purposes of computing royalty rates on any or all oil, gas, natural gasoline, and other liquid products obtained from gas, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. In appropriate cases, this will be done after notice to the parties and opportunity to be heard. [Emphasis added.]

One such relevant matter is the cost of transportation of lease production to market where there is no market at the point of production. It has long been considered reasonable with respect to Federal oil and gas leases to deduct a transportation allowance from the market value of the product at the nearest open market. This determines value at the wellhead where no market exists at the wellhead (the point at which a product would ordinarily be sold and valued). United States v. General Petroleum Corp., 73 F. Supp. 25, 262-63 (S.D. Cal. 1947), aff'd, Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950); C & K Petroleum, Inc., 27 IBLA 15 (1976); Kerr-McGee Corp., 22 IBLA 124 (1975); Shell Oil Co., 70 I.D. 393 (1963). The Secretary has discretionary authority to determine the factors to be used in computing such a transportation allowance for royalty purposes. Shell Oil Co., 52 IBLA 15 (1981).

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[1] Although the product involved in this appeal is CO_2 rather than oil or gas, the oil and gas regulations are deemed to be applicable because the CO_2 is produced under the aegis of a Federal oil and gas lease and because CO_2 is a gas.

The U.S. Supreme Court has held that the Secretary's interpretation must be respected by the courts if that interpretation is reasonable in spite of the fact that other interpretations may also be reasonable. Udall v. Tallman, 380 U.S. 1, 16 (1965); McLaren v. Fleisher, 256 U.S. 477, 481 (1921); and Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 413-414 (1945).

Thus, it is the party challenging the Secretary's determination that must establish that the methodology used in the Government's computations is, in fact, erroneous. Amoco Production Co., 78 IBLA 93 (1983).

There is no dispute in this case as to whether a transportation allowance will be permitted; rather, the dispute concerns the amount of the allowance approved by MMS.

In support of its contention that RMP erred in calculating the subject transportation allowances, Mobil submits the following arguments:

1. That RMP should not have relied on the guidelines set forth in the manual issued by the Conservation Division of the U.S. Geological Survey.[2]

2. That RMP should have included the expenses incurred by Mobil for compression of the CO_2.

3. That RMP should have included Federal income taxes paid by Mobil as a cost factor.

4. That RMP should not have included ad valorem taxes in Mobil's operating costs.

---

[2]By Secretarial Order No. 3071, dated January 19, 1982, as amended May 10, 1982, all minerals management functions previously exercised by the Conservation Division, U.S. Geological Survey, were transferred to the Department's Minerals Management Service. By Secretarial Order No. 3087, dated December 3, 1982, as amended February 7, 1983, the onshore, nonroyalty management functions of the Minerals Management Service were transferred to the Department's Bureau of Land Management.

5. That RMP should not have limited the allowances to 50 percent of the value of the CO_2 at the point of sale.

6. That RMP should have used a rate of return of 11.25 percent rather than 10.75 percent or, alternatively, should have used a different formula for computing the rate of return.

In the interest of clarity, I will deal with each of these arguments separately.

The Applicability of Guidelines

With regard to the computation of the transportation allowances, the Appellant claims that RMP's use of the Conservation Division Manual (CDM) guidelines has no force and effect because those guidelines were not published in accordance with the notice and comment requirements of the Administrative Procedure Act (APA), 5 U.S.C. 552(a) (1982).

It is clear, however, that the requirements of the APA pertain only to legislative rules and are inapplicable to interpretative rules. An interpretative rule clarifies or construes an existing law or regulation, while a legislative rule is substantive modification or adoption of a new regulation. 2 K. Davis, Administrative Law Treatise, 48-49 (2d ed. 1979). The CDM guidelines referred to herein are interpretative rules. They are premised upon and provide guidance as to how RMP will implement its authority to determine transportation allowances. Thus, the advance notice and comment provisions of the APA (5 U.S.C. 553, 1982) are inapplicable.

Compression Costs

The Appellant contends that MMS erred in not including in Mobil's transportation allowance the cost of compressing the CO_2.

As noted previously, the Secretary possesses considerable discretion for determining the "value" of production. In the exercise of his statutory discretion, the Secretary has decided that royalties must be based on the value of the production after it has been placed in a marketable state.

The regulations at 43 CFR 3162.7-1 (1986) state that:

> The lessee shall put into marketable condition, if economically feasible, all oil, other hydrocarbons, gas, and sulphur produced from the leased land.

Consistent with the foregoing, Notice to Lessees and Operators (NTL) No. 1, Procedures for Reporting and Accounting for Royalties, provides in relevant part:

> [N]o deduction will be allowed for the cost which an operator incurs by reason of placing the gas in a marketable condition as an operator is obligated to do so at no cost to the lessor. [Emphasis added.]

The cost of compression of natural gas produced from Federal leases is considered as part of the cost of marketing the production. Kuntz, The Law of Oil and Gas, 40.5, p. 324. This interpretation is one of long standing. Even before the creation of MMS, the CDM provided at section 647.2.3A:

> The lessee is obligated to place lease production in marketable condition without deduction of costs for measuring, compressing, or otherwise conditioning the gas for market.

This issue has been appealed numerous times, and the Department of the Interior (Department) has consistently held that the costs of gathering, dehydrating, and compression of gas produced on a Federal lease may not be deducted when computing the royalty value against which the royalty rate is applied. The Texas Company, 64 I.D. 76 (1957); The California Company, 66 I.D. 54 (1954), aff'd, 296 F.2d 384 (D.C. Cir. (1961); Placid Oil Company,

70 I.D. 438 (1963). Thus, I conclude that RMP did not err in excluding compression costs from its computation of Mobil's CO_2 transportation allowance.

Federal Taxes as a Cost Factor

The Appellant disagrees with MMS's refusal to recognize as a valid deduction the Federal income tax that it (Mobil) claims is attributable to the pipeline owned by the Appellant. The Appellant argues that the other producers that are not related to the pipeline owner will be able to deduct the whole pipeline tariff, whereas the Appellant will be able to deduct less than that amount since the portion of the tariff attributable to income taxes of the Appellant will not be recognized as a cost. The Appellant asserts that this disparity in computing the royalty is unfair because it results in a different royalty value assigned to different lessees producing from the same source.

Income tax is not recognized by MMS as an expense for purposes of determining a transportation allowance involving a pipeline which is not wholly independent of the lessee/producer. This has been the policy of MMS and its predecessor agencies for 10 years. CDM, section 647.5.

This policy is premised on the impossibility of accurately allocating the correct tax burden to the pipeline, as well as the other activities of the pipeline/producer. An inflated pipeline tariff in those circumstances would benefit the lessee in providing for a greater reduction from royalty (and thereby depriving the lessor of its full royalty entitlement). The MMS adopted the policy of limiting the transportation allowance to actual costs exclusive of income tax. The MMS policy is a reasonable measure intended to

eliminate the potential for abuse that could result from expense manipulation between pipelines and production facilities not wholly independent of each other.

Even though the Appellant could arguably devise an alternative procedure that may be reasonable, that does not sustain the Appellant's burden. The lessor is empowered under the statute, regulations, and the lease contracts to unilaterally establish a reasonable royalty value. The policy established by the lessor has been in place and applied uniformly for 10 years. The policy is intended to preclude abuse and overcome audit burdens that would be imposed under other policies. The policy and the results derived therefrom are not erroneous.

Operating Costs

It is MMS's long-standing policy to include ad valorem taxes attributable to a pipeline as an allowable operating cost. The CDM, section 647.5A.3B, clearly allows taxes (except income taxes) as an operating cost.

The Appellant objects to the inclusion by RMP of ad valorem taxes in the calculation of operating costs, arguing that such taxes are not part of the cost of producing CO_2 from the McElmo Dome Unit and that the rule, which was intended to benefit CO_2 producers, operates to Mobil's detriment with respect to its liability for royalties.

Section 647.5A.3B of the CDM provides that operating costs, as an element of a transportation allowance, shall be the lesser of (1) actual operating costs or (2) 10 percent of the undepreciated initial or adjusted investment cost of the producer owned and operated pipeline(s). In this case, Mobil's actual operating costs were $369,161.09 (a figure which included

$211,020.62 in ad valorem taxes), while 10 percent of Mobil's undepreciated investment costs amounted to —— X-4 —— Thus, the allowance for operating costs (as an element of Mobil's transportation allowance) was —— X-4 ——.

If Mobil's ad valorem taxes had been excluded from RMP's calculations, the Appellant's actual operating costs would have been —— X-4 —— and the resulting allowance for operating costs would have been — X-4 — less. Thus, the inclusion of ad valorem taxes in Mobil's operating costs was to Mobil's benefit.

Mobil's contention that these calculations operated to its detriment is apparently based on its belief that if ad valorem taxes had not been included in actual operating costs, they might have been fully deductible under some other category. I can find no basis for such a belief, and the Appellant has offered none.

The Transportation Allowance Ceiling

I now turn to the Appellant's challenge of RMP's limitation of Mobil's allowance for transportation costs to 50 percent of the value of the CO_2 at the point of sale.

As stated previously, a lessee is entitled to an allowance based on the cost of transporting the production to the nearest market. Shell Oil Co., 52 IBLA 15, 20 (1981). However, under established guidelines (CDM, section 647.5.3E), "Under no circumstances should transportation costs exceed 50 percent of the product's fair market value at the nearest competitive sales point." The guidelines represent a lawful exercise of the Department's broad discretion to determine royalty values. Amoco Production Co., 78 IBLA 93, 96 (1983).

The United States has consistently enforced these guidelines, and lessees have, for many years, computed and paid royalties on this basis. This long-standing interpretation of the leases by the parties supports the 50 percent limitation. 38 Am. Jur. 2d. Gas and Oil, section 87, at page 564.

The Appellant contends that the 50 percent limitation is unreasonable in light of declining product prices and the scarcity of CO_2 markets. The Appellant has not, however, presented specific figures or documentary evidence in support of that contention.

It is the obligation of the Appellant to show error. When a statement of reasons does not with some particularity show adequate reasons for appeal and support the allegations with evidence showing error, the appeal cannot be afforded favorable consideration. United States v. Connor, 72 IBLA 254 (April 27, 1983), and Bob G. Howell, 75 IBLA 113 (Aug. 12, 1983). A mere assertion that an allowance is, for various reasons, inadequate is not, absent some supporting evidence, sufficient to sustain the Appellant's burden of proof.

The imposition of a limitation on transportation allowances to 50 percent of the value of the products is a proper exercise of the Secretary's discretion to establish minimum royalty values. The Secretary also has discretion to grant relief from the 50 percent limitation in those cases in which the lessee can demonstrate unusual circumstances which warrant such action. Chevron U.S.A. Inc., MMS-85-0082-O&G (1986). However, the Appellant herein has not made such a demonstration.

Rate of Return

One factor in computing a transportation allowance is the rate of return on the investment cost associated with transportation of the product. The

reason for including a rate of return in a transportation allowance is to reimburse the lessee for the cost of the capital obtained to fund the project (e.g., construction of the pipeline).

It is MMS policy to base the rate of return on the prime rate as published in the Wall Street Journal. Unless otherwise justified, the prime interest rate in effect at the time of initial allowance approval is used as the rate of allowable return on the depreciated investment (CDM, section 647.5A.1).

The Appellant contends that the prime rate is subject to excessive fluctuation and recommends a different formula (the average rate for 20-year Treasury Bills over a 12-month period multiplied by 150 percent). The Appellant has not, however, provided a convincing factual basis which would support a finding that the 10.75 percent rate utilized by RMP was or is unreasonable or that a different rate would be more reasonable. In absence of a showing that the rate selected is clearly erroneous, the methodology utilized by RMP will be upheld, particularly where it represents an established policy which has been consistently applied over a period of time.

The record shows that RVSD based Mobil's rate of return on the prime rate in effect on or about January 1, 1985 (the date Mobil's transportation allowance became effective). However, as indicated previously, the CDM guidelines state that the rate of return shall be based on the prime interest in effect at the time of the initial allowance approval. Since Mobil's transportation allowance was approved on December 31, 1986, it appears that RVSD erred in using the prime rate in effect on January 1, 1985.

Conclusions and Order

For the reasons stated herein, Mobil's appeal of the MMS order dated December 31, 1986, is hereby remanded to RVSD for recalculation of the rate

of return applicable to the subject transportation allowances. This decision is rendered without prejudice to the right of Mobil to seek relief from the 50 percent ceiling on transportation allowances by submitting a request for such relief to RVSD. Chevron U.S.A. Inc., MMS-85-0082-O&G (1986). If made, such a request should include: the leases to which the allowance(s) would apply; a proposed transportation allowance rate or rates; the economic justification for the allowance(s); and the period of time covered by the allowance(s).

This decision may be appealed to the Interior Board of Land Appeals pursuant to 30 CFR Part 290 (1986) and 43 CFR 4.411 and 4.413 (1986). A copy of 43 CFR 4.411 and 4.413 (1986) is enclosed for reference. Copies of the notice of appeal and any statement of reasons, written arguments, or briefs must be served upon the Associate Solicitor, Division of Energy and Resources, U.S. Department of the Interior, Washington, D.C. 20240, and upon the Chief, Division of Appeals (MS623), Office of Program Review, Minerals Management Service, U.S. Department of the Interior, 12203 Sunrise Valley Drive, Reston, Virginia 22091.

Director

Enclosure

CONTRACT SUMMARY

OPERATOR/BUYER SELLER/SUPPLIER EXCHANGER/TRANSPORTER	PROJECT	TYPE OF CONTRACT	MAGas CONTRACT NUMBER	CONTRACT VOLUME BCF	CONTRACT YEAR	TERM YEARS	INITIAL PRICE ¢/MCF	FLOOR PRICE ¢/MCF	CRUDE REF. $/BBL	FIRM PRICE UNTIL	AVG. POSTING $/BBL	CURRENT COMMODITY PRICE	CURRENT TRANSPORTATION TARIFF	CURRENT TRANSPORTATION OTHER$	CURRENT LAYDOWN ¢/MCF $
	SEMINOLE	IN-KIND SUPPLY	C-4252	75.7	01-Apr-83					NONE			60.00		
	SEMINOLE	TRANSPORTATION	CT-4392	75.7	01-Apr-83					N/A			3.5		
	DENVER UNIT & SUCFU	EXCHANGE	C-4339	6.4	01-Jan-87					NONE			++		
	MISC. PROJECTS	SALES	C-4312	25.0	30 DAY EVER					30 DAYS			40.000		
	GMX SOUTH	PURCHASE	C-4211	3.6	01-Dec-83					NONE			60.000		
	E.VACUUM	EXCHANGE	C-4297	14.0	01-Oct-85					NONE			39.000		
	DENVER UNIT II	EXCHANGE	C-4338	33.1	01-Jan-87					1-Jan-90			39.000		
	DOLLARHIDE♦	TRANSPORTATION	C-4294	17.2	13-Jan-86					N/A			+++		
	S. WASSON CLRFK.	TRANSPORTATION	CT-4346	40.6	01-Jul-86					N/A			+++		
	SACROC- GRAY RANCH	SALES	C-4419	8.8	30-Jun-87					NONE			0.000		
	SACROC- W.G. RANCH	SALES	C-4420	1.33	30-Jun-87					NONE			0.000		
	SACROC- DSTN. SL.81	SALES	C-4421	0.33	30-Jun-87					NONE			0.000		
	McELMO CK.& E.VAC.	EXCHANGE	C-4296	39.7	01-Sep-85					NONE			++		
	McELMO CREEK	IN-KIND SUPPLY	C-8905-A	18.4	01-Sep-85					NONE			0.000		
	S. WASSON CLRFK.♦	EXCHANGE	C-4367	2.9	01-Jan-87					01-Jan-89			43.300		
	TWO FREDS-MIVIDA^^	SALES	S-7245	^^	01-May-73					^^			0.000		
	McELMO CREEK	IN-KIND SUPPLY	#####	24.3	01-Sep-85					NONE			0.000		
	H O MAHONEY	IN-KIND SUPPLY	###	42.0	N/A					NONE			39.000		
	E. VACUUM GRAYBURG	IN-KIND SUPPLY	C-4295	16.7	01-Oct-85					NONE			39.000		
	DENVER UNIT	SALES####	C-4203	285.0	19-Apr-84					NONE			39.000		
	DENVER UNIT II	IN-KIND SUPPLY	C-4362	9.7	01-Jul-86					01-Jan-90			39.000		
	McELMO CREEK	PURCHASE	C-6711	21.9	01-Sep-85					NONE			0.000		
	S. WASSON CLRFK.♦	SALES	C-4341	21.1	01-Jul-86					01-Jan-89			43.300		
	DOLLARHIDE♦	IN-KIND SUPPLY	C-4321	17.2	13-Jan-86					01-Jul-88			39.000		
	WELLMAN	IN-KIND SUPPLY	C-4246	7.9	01-Aug-83					NONE			60.000		

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Attachment A

JULY - SEP 87

FILE: CO2ADM | 11-Aug-87 | CO2 CONTRACT ADMINISTRATION CONTRACT SUMMARY | LAST UPDATE:11-AUG-87 | page 1

OPERATOR/BUYER SELLER/SUPPLIER EXCHANGER/TRANSPORTER	PROJECT	TYPE OF CONTRACT	MMcf CONTRACT NUMBER	CONTRACT VOLUME BCF	CONTRACT YEAR	TERM YEARS	INITIAL PRICE ¢/MCF	FLOOR PRICE ¢/MCF	CRUDE REF. $/BBL	FIRM PRICE UNTIL	AVG. POSTING $/BBL	CURRENT COMMODITY PRICE	CURRENT TRANSPORTATION TARIFF	CURRENT TRANSPORTATION OTHER@	CURRENT LAYDOWN ¢/MCF @
	SEMINOLE	IN-KIND SUPPLY	C-4252	75.7	01-Apr-83					NONE			60.00		
	SEMINOLE	TRANSPORTATION	CT-4392	75.7	01-Apr-83					N/A			3.5		
	DENVER UNIT & SACFU	EXCHANGE	C-4339	6.4	01-Jan-87					NONE			**		
	MISC. PROJECTS	SALES	C-4312	25.0	30 DAY EX					30 DAYS			40.000		
	GMK SOUTH	PURCHASE	C-4211	3.6	01-Dec-83					NONE			60.000		
	E.VACUUM	EXCHANGE	C-4297	10.6	01-Oct-85					NONE			39.000		
	DENVER UNIT II	EXCHANGE	C-4330	33.1	01-Jan-87					01-Jan-90			39.000		
	DOLLARHIDE	TRANSPORTATION	C-4294	17.2	13-Jan-86					N/A			***		
	S. BASSON CLFK.	TRANSPORTATION	CT-4346	40.6	01-Jul-86					N/A			***		
	SACROC- GRAY RANCH	SALES		0.0	CONTRACTS					NONE			0.000		
	SACROC- U.G. RANCH	SALES		1.33	PENDING					NONE			0.000		
	SACROC- DSTR. SL.01	SALES		0.33	EXECUTION					NONE			0.000		
	McELMO CK.& E.VAC.	EXCHANGE	C-4296	39.7	01-Sep-85					NONE			**		
	McELMO CREEK	IN-KIND SUPPLY	C-0905-A	10.4	01-Sep-85					NONE			0.000		
	S. BASSON CLFK.*	EXCHANGE	C-4367	2.9	01-Jan-87					01-Jan-89			41.500		
	TWO FREDS-RIVIERA**	SALES	S-7205	**	01-May-73					**			0.000		
	McELMO CREEK	IN-KIND SUPPLY	00000	24.3	01-Sep-85					NONE			0.000		
	H O MAHONEY	IN-KIND SUPPLY	000	42.0	N/A					NONE			39.000		
	E. VACUUM GRAYBURG	IN-KIND SUPPLY	C-4295	16.7	01-Oct-85					NONE			39.000		
	DENVER UNIT	SALES0000	C-4203	285.0	19-Apr-84					NONE			39.000		
	DENVER UNIT II	IN-KIND SUPPLY	C-4342	9.7	01-Jul-86					01-Jan-90			39.000		
	McELMO CREEK	PURCHASE	C-6711	21.9	01-Sep-85					NONE			0.000		
	S. BASSON CLFK.*	SALES	C-4341	21.1	01-Jul-86					01-Jan-89			41.500		
	DOLLARHIDE	IN-KIND SUPPLY	C-4321	17.2	13-Jan-86					01-Jul-88			39.000		
	WELLMAN	IN-KIND SUPPLY	C-4246	7.9	01-Aug-83					NONE			60.000		

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CONTRACT EXECUTION PENDING 0

will need CT

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FILE: CO2ADM 09-Nov-87 CO2 CONTRACT ADMINISTRATION LAST UPDATE:09-NOV-87 page 1

CONTRACT SUMMARY

OPERATOR/BUYER SELLER/SUPPLIER EXCHANGER/TRANSPORTER	PROJECT	TYPE OF CONTRACT	MAGas CONTRACT NUMBER	CONTRACT VOLUME BCF	CONTRACT YEAR	TERM YEARS	INITIAL PRICE ¢/MCF	FLOOR PRICE ¢/MCF	CRUDE REF. $/BBL	FIRM PRICE UNTIL	AVG. POSTING $/BBL	CURRENT COMMODITY PRICE	CURRENT TRANSPORTATION TARIFF	CURRENT TRANSPORTATION OTHER#	CURRENT LAYDOWN ¢/MCF #
SEMINOLE	IN-KIND SUPPLY	C-4252	75.7	01-Apr-83						NONE		60.00			
SEMINOLE	TRANSPORTATION	CT-4392	75.7	01-Apr-83						N/A		3.5			
DENVER UNIT & SNCFU	EXCHANGE	C-4339	6.4	01-Jan-87						NONE		++			
MISC. PROJECTS	SALES	C-4312	25.0	30 DAY EVE						30 DAYS		40.000			
GMX SOUTH	PURCHASE	C-4211	3.6	01-Dec-83						NONE		60.000			
E.VACUUM	EXCHANGE	C-4297	14.0	01-Oct-85						NONE		39.000			
DENVER UNIT II	EXCHANGE	C-4338	33.1	01-Jan-87						31-Jan-90		39.000			
DOLLARHIDE+	TRANSPORTATION	C-4294	17.2	13-Jan-86						N/A		+++			
S. MASSON CLRFK.	TRANSPORTATION	CT-4346	40.6	01-Jul-86						N/A		+++			
SACROC- GRAY RANCH	SALES	C-4419	8.8	30-Jun-87						NONE		0.000			
SACROC- W.G. RANCH	SALES	C-4420	1.33	30-Jun-87						NONE		0.000			
SACROC- BSIN. SL.#1	SALES	C-4421	0.33	30-Jun-87						NONE		0.000			
McELMO CK.& E.VAC.	EXCHANGE	C-4296	39.7	01-Sep-85						NONE		++			
McELMO CREEK	IN-KIND SUPPLY	C-8905-A	18.4	01-Sep-85						NONE		0.000			
S. MASSON CLRFK.+	EXCHANGE	C-4347	2.9	01-Jan-87						01-Jan-89		41.500			
TWO FREDS-MIVIDA**	SALES	S-7245	**	01-May-73						**		0.000			
McELMO CREEK	IN-KIND SUPPLY	####	24.3	01-Sep-85						NONE		0.000			
W D MAHONEY	IN-KIND SUPPLY	###	62.8	N/A						NONE		39.000			
E. VACUUM GRAYBURG	IN-KIND SUPPLY	C-4295	16.7	01-Oct-85						NONE		39.000			
DENVER UNIT	SALES####	C-4203	285.0	19-Apr-84						NONE		39.000			
DENVER UNIT II	IN-KIND SUPPLY	C-4367	9.7	01-Jul-86						01-Jan-90		39.000			
McELMO CREEK	PURCHASE	C-4711	21.9	01-Sep-85						NONE		0.000			
S. MASSON CLRFK.+	SALES	C-4341	21.1	01-Jul-86						01-Jan-89		41.500			
DOLLARHIDE+	IN-KIND SUPPLY	C-4321	17.2	13-Jan-86						01-Jul-88		39.000			
WELLMAN	IN-KIND SUPPLY	C-4246	7.9	01-Aug-83						NONE		60.000			

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Attachment A

attach. 19

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

Mail Stop 653

MMS-RVS-OG:87-0102

JUL 1 1987

ENCLOSURE CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL PRODUCING TEXAS & NEW MEXICO INC.

Mr. Hector Casas
Gas Accounting Supervisor
Mobil Producing Texas & New Mexico Inc.
Nine Greenway Plaza
Houston, Texas 77046

Dear Mr. Casas:

By letter dated January 30, 1987, you requested Minerals Management Service's (MMS) approval of transportation allowances pertaining to CO_2 production transported from the McElmo Dome Unit in southwestern Colorado through the Cortez Pipeline, Mobil Producing Texas & New Mexico Inc.'s (MPTM) pipeline, and the West Texas Pipeline.

The MMS reviewed the information you submitted. Transportation allowances requested for the Cortez Pipeline and MPTM's pipeline segment were previously approved by MMS by letter dated December 31, 1986. Therefore, only the additional transportation allowances requested in your January 30 letter and not previously approved were considered for approval.

We have approved subject to audit 1985 transportation allowances as outlined in the Findings and Conclusions.

Enclosed is a copy of our Findings and Conclusions showing the basis for our approval of the transportation allowances.

You have the right to appeal this decision. Please refer to the enclosure on appeals procedure.

If there are any questions, please call (303) 231-3395.

Sincerely,

William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

2 Enclosures

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL PRODUCING TEXAS & NEW MEXICO INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION
Findings and Conclusions
on
McElmo Dome Unit CO_2 Transportation Allowances

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Montezuma County, Colorado. Shell Western E&P Inc. (SWEPI) is the operator of the unit. Mobil Producing Texas & New Mexico Inc. (MPTM) is a working interest owner in the McElmo Dome Unit. The CO_2 is transported through the Cortez Pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects.

By letter dated January 30, 1987, MPTM requested approval of transportation allowances for CO_2 transported from the McElmo Dome Unit to tertiary recovery units in west Texas. Transportation allowances requested for the Cortez Pipeline and MPTM's pipeline segment were previously approved by Minerals Management Services's (MMS) letter dated December 31, 1986. On May 7, 1987, Mr. Charles Shirley (MPTM) notifed MMS that the 1985 transportation allowances requested for CO_2 transported through the West Texas Pipeline do not apply in 1985; therefore, a 1985 transportation allowance was not granted for the West Texas Pipeline.

The Cortez Pipeline

- The MPTM requested a 1985 transportation allowance for CO_2 transported through the Cortez Pipeline from the McElmo Dome Unit to the Tatum Meter Station and the Allred Meter Station. The MPTM submitted a copy of the "Cortez Pipeline Company Letter Tariff" which charges MPTM $0.39 per Mcf for CO_2 transported through the Cortez Pipeline. The MMS's decision dated December 31, 1986, approved the 1985 costs incurred in the Cortez Pipeline Tariff, with the exception of income tax, as a transportation allowance for the shipment of CO_2. The approved "tariff calculation procedure" allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 pipeline consent decree. By letter dated February 3, 1987, MPTM filed an appeal to the December 31, 1986, decision regarding the issue of the State and Federal income taxes.

The Cortez Tariff No. 2

- The MPTM requested a 1985 allowance for a transfer charge for the movement of CO_2 through a gathering system which is located within the McElmo Dome Unit. The "Cortez Pipeline Company CO_2 Letter Tariff No. 2" charges MPTM

CONTAINS COMPANY PROPRIETARY
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MOBIL PRODUCING TEXAS & NEW MEXICO INC.

$0.05 per Mcf to transfer CO_2 from non-Hovenweep Facility sources to the junction of the Cortez Gathering System and the Hovenweep Central Facility Pipeline. The CO_2 is gathered and transported through the McElmo Creek Unit Pipeline from the McElmo Dome Unit to the McElmo Creek Unit in Utah.

The SWEPI Metering Facility Agreement

- The MPTM also requested a 1985 allowance for a metering charge to measure and deliver CO_2 from McElmo Dome Unit to the McElmo Creek Unit Pipeline at the Hovenweep Facility in Montezuma County, Colorado. The MPTM submitted a copy of the "Metering Facility Agreement -- Hovenweep Facility" between SWEPI and Mobil Oil Corporation (Mobil) which charges Mobil $0.015 per Mcf to measure CO_2 at the metering facility which is located within the McElmo Dome Unit. The SWEPI is the owner of the metering facility.

- Under 43 CFR 3162.7, "Measurement, disposition and protection of production," Section (a) reads as follows:

  "The lessee shall put into marketable condition, if economically feasible, all oils, other hydrocarbons, gas and sulphur produced from the leased land."

- Section 647.3A of the Conservation Division Manual (CDM), a procedural document of the U.S. Geological Survey (predecessor to the MMS), states in part:

  "The lessee is obligated to place lease production in marketable condition without deduction of costs for measuring, compressing or otherwise conditioning the gas for market. Under no circumstances will royalty be computed on less than the gross proceeds accruing to the lessee from the sale of leasehold production."

- Decisions by the Director, Geological Survey, and a supporting court decision, The California Company v. Secretary of the Interior, August 10, 1961, have upheld the principle that the lease operator is obligated to perform necessary field gathering, dehydration, and compression operations. The court made a distinction between "transportation" of gas and "conditioning" of gas and accepted the Secretary's definition of production as "gas conditioned for market."

- Notice to Lessees and Operators No. 1 (NTL-1), "Procedures for Reporting and Accounting for Royalties," states under Section III, "Gas and Associated Liquids Production, Sales, and Royalty Requirements":

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> "Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursements and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. Likewise, no deduction will be allowed for the cost which an operator incurs by reason of placing the gas in a marketable condition as an operator is obligated to do so at no cost to the lessor."

° The preceding statement is primarily concerned with gross proceeds. However, in defining the term it is clear that gathering and measuring gas are considered part of the activities for which the operator is responsible, at no cost to the lessor.

The MPTM's Pipeline

° The MPTM requested a 1985 transportation allowance for CO_2 production transported through the MPTM pipeline segment to the Mahoney and Willard units. The MPTM's pipeline extends from the Allred Station located on Cortez Pipeline, to the Denver City Delivery Station located on the Sheep Mountain Pipeline.

° By letter dated December 31, 1986, MMS approved MPTM pipeline's 1985 transportation allowance rate based on allowable actual costs. The MMS-approved 1985 allowance rate is $0.011049 per Mcf for CO_2 production transported through MPTM's pipeline. The previously MMS-approved 1985 allowance included the entire actual costs for MPTM's pipeline and the throughput figures for 1985 for CO_2 transported to the Wellman, Mahoney and Willard units. By letter dated February 3, 1987, MPTM filed an appeal regarding the MMS-approved transportation allowance.

° The CDM, Section 647.3E states:

> "Under no circumstances should transported costs exceed 50 percent of the product's fair market value at the market competitive sales point."

CONCLUSIONS

The Cortez Pipeline

° The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable, with the exception that, for royalty purposes, State and Federal income taxes

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL PRODUCING TEXAS & NEW MEXICO INC.

are not to be considered in computing transportation costs. Accordingly, State and Federal income taxes should be eliminated before transportation costs are computed. The MMS's decision dated December 31, 1986, previously approved 1985 costs incurred in the Cortez Pipeline.

The Cortez Tariff No. 2 and The SWEPI Metering Facility Agreement

° Pertinent regulations and NTL-1 state that the lease operator has the responsibility and obligation to place the gas in marketable condition. At least one court decision has upheld the principle that the lease operator is obligated to perform necessary field measuring and gathering operations and that the gas conditioning processes are not deductible in computing Federal royalty.

° The MPTM's request for approval of measuring and gathering charges as a transportation allowance should be denied. Gathering and measuring costs are not an allowable deduction from Federal royalty.

The MPTM's Pipeline

° The MMS-approved 1985 allowance rate is $0.011049 per Mcf for CO_2 transported through MPTM's pipeline segment to the Wellman, Mahoney and Willard units. This transportation allowance was previously approved by letter dated December 31, 1986, and was based on actual allowable costs submitted by MPTM. The MPTM should submit actual cost data for each year by April of the following year in order for MMS to compute and approve successive annual transportation allowance rates.

° The 1985 allowances which MPTM may deduct will be the lesser of the approved allowance (the sum of the approved transportation allowances for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point.

Enclosure

Appeals Procedure

You have the right to appeal in accordance with the provisions of Title 30, Code of Federal Regulations Part 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed within 30 days from the date of receipt of this letter with:

Minerals Management Service
Attention: Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS 653
Denver, Colorado 80225
Telephone: (303) 231-3184

A copy of your appeal should be forwarded to:

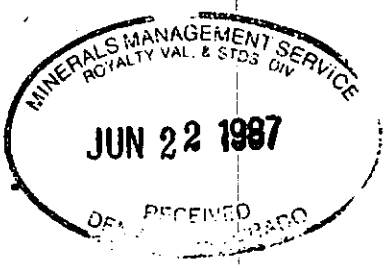
Chief, Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091
Telephone: (703) 648-7729

You should be aware that compliance with the orders and directives contained in this letter shall not be suspended by reason of an appeal unless authorized in writing pursuant to 30 CFR 243.2.

attach. 18

Mobil Exploration and Producing U.S. Inc.

PC
DALLAS, TEXAS



June 18, 1987

Mr. Andy Anderson, Esq.
Division of Appeals
Mineral Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Ruston, Virginia 22091

EXTENSION OF TIME TO RESPOND TO
REPORT AND RECOMMENDATION
DOCKET NO. MMS - 87-0194-O&G

Dear Mr. Anderson:

This is to confirm our conversation of this date wherein you agreed to extend the time period for responding to the report and recommendations prepared by your office and relating to the above referenced docket by 14 days. Mobil received the report and recommendations on June 16, 1987. Consequently, taking into consideration the extension, our new response date is July 14, 1987.

Thank you for your courtesies in this matter. If you should have any questions, please do not hesitate to call me at (214) 951-3350.

Very truly yours,

W. R. Buck

WRB:ss
WRB687.15

cc: Chief Royalty Valuation and Standards Division
Royalty Management Program
P. O. Box 25165
Mail Stop 653
Denver, Colorado 80225

UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE

IN THE MATTER OF	§	APPEAL OF DECISION RE:
	§	
MOBIL PRODUCING TEXAS	§	TRANSPORTATION ALLOWANCES
	§	
AND NEW MEXICO INC.	§	McELMO DOME UNIT CO_2 PRODUCTION
	§	
	§	DOCKET NO.: MMS-87-0194-0&6

RESPONSE TO REPORT AND RECOMMENDATION OF CHIEF, ROYALTY VALUATION AND STANDARDS DIVISION

TO THE DIRECTOR,
MINERALS MANAGEMENT SERVICE:

Mobil Producing Texas and New Mexico Inc. ("Mobil") hereby files this its Response to Report and Recommendation of the Chief, Royalty Valuation and Standards Division ("RVSD") of the Minerals Management Service ("MMS"), dated June 8, 1987 (the "RVSD Report"), with respect to transportation allowances for CO_2 production transported from the McElmo Dome Unit, Dolores and Montezuma Counties, Colorado to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit, all of which are located in West Texas.

The RVSD Report was filed in opposition to Mobil's Statement of Reasons dated March 8, 1986, with respect to Mobil's Notice of Appeal of the RVSD Decision (herein so called) dated December 31, 1987. Mobil files this Response in order to clarify and to further develop certain issues raised in the RVSD Report. This Response, however, shall not be

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deemed or construed as a limitation, restriction or waiver of any matters asserted by Mobil in its Statement of Reasons.

I. General Argument.

RVSD admits in the RVSD Report that "[o]nshore oil and gas regulations do not specifically address royalty requirements", and that RVSD calculated the transportation allowances based upon unpublished guidelines and procedures known as Department of the Interior's Conservation Division Manual, Part 647 (the "CDM"). RVSD Report at page 2. The RVSD Report fails to explain why the CDM was not published in accordance with Section 552 of the Administrative Procedures Act. In addition, RVSD does not dispute Mobil's argument that the CDM procedures substantially affect Mobil's liability to the United States for royalties. Mobil, therefore, renews its request that the unpublished procedures set forth in the CDM not be applied adversely against Mobil.

II. Operating Costs.

Mobil challenges RVSD's inclusion of ad valorem taxes for purposes of calculating the ten percent (10%) cap on operating expenses. The RVSD Report fails to reply to Mobil's argument that ad valorem taxes are not, as set forth in the CDM, operating costs "required to operate and maintain the pipeline system." (CDM Section 647.5A.3B). Instead, RVSD merely states that the CDM "allows taxes" as an operating expense item. RVSD Report at page 3. While the CDM may allow ad valorem taxes as

an operating cost, the CDM does not mandate their inclusion in the ten percent (10%) cap calculation. The CDM's allowance of ad valorem taxes as an operating cost was originally designed to benefit CO_2 producers. RVSD's allowance in the present dispute, however, detrimentally affects Mobil's liability for royalties. Ad valorem taxes comprise at least fifty-seven percent (57%) of Mobil's total operating costs at the McElmo Dome Unit, and are neither established nor controlled by Mobil. Mobil, therefore, requests that as a result of the unique circumstances surrounding the McElmo Dome Unit operations, and in order to be consistent with the original intent of the CDM, that ad valorem taxes not be included in the ten percent (10%) cap calculation.

The RVSD Report likewise fails to address Mobil's argument that the ten percent (10%) cap unreasonably discriminates against the CO_2 producers who own the Cortez CO_2 pipeline, and those CO_2 producers who are not owners. RVSD, in the RVSD Report, fails to offer any explanation, logical or otherwise, for this discrimination, and as a result, RVSD's failure to allow Mobil to deduct actual operating costs is unreasonable, arbitrary and capricious.

III. Rate of Return on Investment.

The RVSD Report additionally does not address Mobil's argument that MMS's use of the prime interest rate to determine rate of return is unreasonable, arbitrary and capricious.

Mobil recommended a rate of return calculation which would reasonably approximate a return on investment consistent with industry practice. Prime interest rates reflect the short-term cost of money to the bank's most favored customer's and, as a result, fluctuate greatly within any given year. Under Mobil's recommendation, the investment rate of return would be calculated by MMS and would be based upon a formula tied to relatively stable twenty-year Treasury Bill rates. Mobil asserts that such a calculation would provide much needed stability, and would more accurately reflect the realities in the CO_2 production industry.

IV. Compression Expenses.

The RVSD Decision disallows Mobil's deduction for compression related expenses, despite the fact that no market exists for CO_2 at the McElmo Dome Unit field. Mobil actually incurs substantial compression related expenses in transporting the CO_2 to the Sheep Mountain line, and such expenses are critical in order for Mobil to sell the CO_2 produced by the McElmo Dome Unit. RVSD ignores this operational reality, and disregards standard accounting practices by its failure to recognize that the production function terminates at the first point at which the CO_2 is delivered to a main pipeline. As a result of the unusual operational circumstances at the McElmo Dome Unit field, Mobil, under standard accounting procedures, should be allowed to fully deduct compression related expenses.

In addition, RVSD does not respond to Mobil's argument that RVSD's failure to allow Mobil's deduction for compression related expenses discriminates between CO_2 producers who are owners and those who are non-owners of the Cortez CO_2 pipeline. Mobil would incur the compression related expenses regardless of whether or not Mobil owned a portion of the Cortex CO_2 pipeline. Such expenses were not incurred to reduce Mobil's royalty liability, but were incurred to sell the CO_2 to the market. RVSD's failure to recognize this undisputed fact is unreasonable and, therefore, arbitrary and capricious.

V. Allowance Limitation.

The RVSD Decision, based upon the CDM, further limits Mobil's transportation allowance to the lesser of the approved rate or fifty percent (50%) of the CO_2's value at the sales point. RVSD acknowledges that the Secretary may grant relief from this fifty percent (50%) limitation if circumstances warrant such action. RVSD Report at page 5. Mobil assets that such circumstances do exist. The CDM was released by MMS's predecessor, the Geological Survey, in early 1974 during times of record product prices and numerous CO_2 markets. Just as the Department of Interior has changed since 1974, so has the CO_2 marketplace. As a result of the scarcity of CO_2 markets, Mobil's transportation costs are higher as sales point distances increase from the McElmo Dome Unit field. These are

necessary transportation costs, which should not be subject to the arbitrary fifty percent (50%) limitation.

The CDM was released thirteen (13) years ago and reflected the then current market conditions. Mobil requests that MMS acknowledge that CO_2 markets have drastically changed since 1974, and that MMS eliminate the fifty percent (50%) transportation allowance limitation. In the alternative, Mobil requests that the Secretary grant Mobil relief from such limitation because of circumstances beyond Mobil's control which adversely impact Mobil's CO_2 sales from the McElmo Dome Unit field.

VI. Federal Income Taxes.

RVSD fails to respond or even acknowledge Mobil's argument that Federal income taxes should be allowed as a cost component of the Cortez CO_2 Pipeline tariff, since to do otherwise would unfairly discriminate between CO_2 producers who are owners and those who are not owners of the Cortez CO_2 pipeline. RVSD should not penalize Mobil merely because Mobil owns an interest in the Cortez CO_2 pipeline. The RVSD Decision, therefore, should be found arbitrary and capricious.

VII. Conclusion.

As set forth in detail above, the RVSD Report reaffirms the RVSD Decision's incorrect calculation of the transportation allowances applicable to CO_2 produced from the McElmo Dome Unit field. Mobil, therefore, respectfully requests that this

Response be considered and that the transportation allowance be recalculated and approved in accordance with the procedures outlined herein and in Mobil's Statement of Reasons. As a result of the severe impact and scope of the RVSD Decision, Mobil also requests an oral hearing on the matters referred to herein.

Respectfully submitted,

MOBIL PRODUCING TEXAS AND NEW MEXICO INC.,
By its Agent
Mobil Exploration and Producing U.S. Inc.
P.O. Box 650232
Dallas, Texas 75255-0232

W.R. Buck,
Counsel

Mobil Exploration and Producing Services Inc

attach. 16

P.O. BOX 900
DALLAS, TEXAS 75221

JOHN B. McWILLIAMS
GENERAL COUNSEL

February 3, 1987

VIA FEDERAL EXPRESS

Minerals Management Service
Att: Mr. William H. Feldmiller
Chief, Royalty Valuation and
Standards Division
Denver Federal Center
P. O. Box 25165, Mail Stop 653
Denver, Colorado 80225

Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

NOTICE OF APPEAL
TRANSPORATION ALLOWANCES
MCELMO DOME UNIT CO_2
PRODUCTION

Dear Mr. Feldmiller:

Mobil Producing Texas and New Mexico Inc. is in receipt of your Decision of December 31, 1986 pertaining to transportation allowances relating to McElmo Dome Unit CO_2 production. The Decision was received January 9, 1987.

We are filing herewith a Notice of Appeal to The Director, Minerals Management Service. Because of the complexity of the issues, [redacted] requesting an additional [redacted] days to March 7, 1987, to file a Statement of Reasons in this matter.

A copy of the December 31, 1986 Decision is also attached for your convenience and reference.

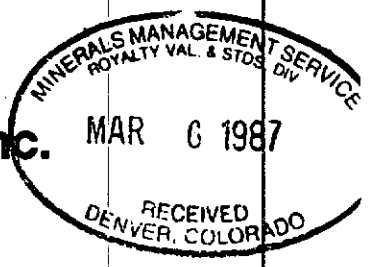
Sincerely,

John B. McWilliams

JBM/ekb

Attachments

Mobil Exploration and Producing Services Inc.



VIA FEDERAL EXPRESS

P.O. BOX 650232
DALLAS, TEXAS 75265-0232

JOHN B. McWILLIAMS
GENERAL COUNSEL

March 5, 1987

Mr. William H. Feldmiller
Chief, Royalty Valuation
and Standards Division
Minerals Management Service
P. O. Box 25165, Mail Stop 653
Denver, Colorado 80225

STATEMENT OF REASONS
TRANSPORTATION ALLOWANCES
McELMO DOME UNIT CO_2
PRODUCTION - DOLORES AND
MONTEZUMA COUNTIES, COLORADO

Dear Mr. Feldmiller:

On behalf of Mobil Producing Texas and New Mexico Inc. ("Mobil"), enclosed please find Mobil's Statement of Reasons in support of Mobil's Notice of Appeal dated February 3, 1987 with respect to the above-captioned matter.

Sincerely,

R. D. Lee

for J. B. McWilliams,
General Counsel

JBM/ekb

Enclosure

cc: Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE

IN THE MATTER OF	§	APPEAL OF DECISION RE:
MOBIL PRODUCING TEXAS	§	TRANSPORTATION ALLOWANCES
AND NEW MEXICO INC.	§	McELMO DOME UNIT CO_2 PRODUCTION

TO THE DIRECTOR,
MINERALS MANAGEMENT SERVICE:

STATEMENT OF REASONS

Mobil Producing Texas and New Mexico Inc. ("Mobil") hereby files this its Statement of Reasons in support of Mobil's appeal of the Decision of the Chief, Royalty Valuation and Standards Division ("RVSD") of the Minerals Management Service ("MMS"), dated December 31, 1986 (the "RVSD Decision"), with respect to transportation allowances for CO_2 production transported from the McElmo Dome Unit, Dolores and Montezuma Counties, Colorado to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit, all of which are located in West Texas.

By Notice of Appeal dated February 3, 1987, Mobil appealed the RSVD Decision and requested an additional thirty (30) days in which to file its Statement of Reasons in support thereof. RSVD, pursuant to a letter dated February 24, 1987, approved Mobil's request and granted Mobil until March 7, 1987 to file its Statement of Reasons, in support of such appeal.

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Under the RSVD Decision, RSVD calculated the transportation allowances for CO_2 production transported from the McElmo Dome Unit in accordance with certain unpublished guidelines known as Department of the Interior's Conservation Division Manual, Part 647 (the "CDM"). Unless the context otherwise requires, section numbers set forth herein refer to sections of the CDM and page and paragraph references are to portions of the RSVD Decision.

I. General Argument.

Mobil challenges the RSVD Decision, in so far as the RSVD Decision is based on policies and guidelines set forth in the CDM. The CDM, which takes the form of a directive and materially modifies existing regulations, is not lawfully in effect since the CDM was not promulgated and published in compliance with 5 U.S.C. §552. No notice or justification has been given for procedures which, if applied, could substantially affect Mobil's liability to the United States for royalties accruing with respect to the McElmo Dome Unit. Since the CDM was not promulgated and published in a manner consistent with Section 552 of the Administrative Procedures Act, the policy guidelines therein, to the extent adverse to Mobil, should be deemed void.

II. Operating Costs.

For purposes of calculating the transportation allowance, RSVD has limited operating costs to ten percent (10%) of Mobil's undepreciated initial investment cost, rather than

allow Mobil a deduction for operating costs actually incurred. See page 3, paragraph 2. The RSVD Decision supports this limitation by reference to CDM Section 647.5A.3B, which states in relevant part:

> Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which operating costs are calculated.

RSVD has included ad valorem taxes in calculating the ten percent (10%) cap on operating costs, despite the fact that the CDM states that operating costs are those "required to operate and maintain the pipeline system." Mobil asserts that ad valorem taxes should not be considered in calculating the ten percent (10%) cap, since such taxes are not a cost of producing CO_2 from the McElmo Dome Unit. Ad valorem taxes comprise fifty-seven percent (57%) of total operating expenses incurred by Mobil with respect to the McElmo Dome Unit and are neither established nor controlled by Mobil, therefore their inclusion as an operating cost for purposes of the ten percent (10%) cap is unreasonable, arbitrary and capricious.

In addition, Mobil challenges RSVD's limitation of operating costs to the lesser of actual costs or 10% of the initial investment cost. No such limitation is placed by RSVD

on operating costs incurred by producers who are not owners of the Cortex CO_2 pipeline. Mobil believes that the application of such limitation results in discrimination between CO_2 producers who are owners of the Cortez CO_2 pipeline and those CO_2 producers who are not owners. As a result of such discrimination, RSVD's failure to allow Mobil to deduct operating costs to the extent actually incurred for purposes of calculating the transportation allowance is unreasonable, arbitrary and capricious.

III. Rate of Return on Investment.

In determining the rate of return on investment, the RSVD Decision sets the rate at 10.75% per annum, such rate being the prime interest rate published on January 8, 1985 in the Wall Street Journal. See page 4, paragraph 2. The RSVD Decision states that it is MMS's policy to use the prime interest rate in effect at the beginning of the year for which initial allowance is granted, as published in the Wall Street Journal. Under this policy the RSVD Decision should have used the prime interest rate published on January 2, 1985, rather than that published on January 8, 1985. The prime interest rate as published in the Wall Street Journal on January 2, 1985 was 11.25% per annum. Accordingly, Mobil asserts that the appropriate rate of return was 11.25% per annum, rather than 10.75% per annum as set forth in the RSVD Decision. RSVD's failure to calculate the rate of return at 11.25% per annum is unreasonable, arbitrary and capricious.

In addition, Mobil asserts that MMS's use of the prime interest rate is unreasonable, arbitrary and capricious since such rate reflects the short-term cost of money to the bank's most favored customers and can fluctuate greatly within a year. Mobil believes that the rate of return should be established by MMS and published in the first Federal Register issued in February of each calendar year, to be effective for that calendar year. Mobil requests that MMS calculate such rate by multiplying (i) the average of the twelve (12) rates for twenty-year Treasury Bills published in the Wall Street Journal on the first publication date of each month of the preceding calendar year, by (ii) one hundred fifty percent (150%). As computed above, such rate will reasonably approximate a return on investment consistent with industry practice. MMS's failure to comply with industry practice by calculating the rate of return based upon prime interest instead of the interest rate set forth above is unreasonable and therefore arbitrary and capricious.

IV. Compression Expenses.

Under the RSVD Decision, all compression related operating and maintenance expenses were disallowed by RSVD. See page 6, paragraph 4. The RSVD Decision states that only operating and maintenance expenses (including power necessary to operate the pipeline) will be accepted. RSVD's disallowance of compression-related expenses is unreasonable, arbitrary and capricious, since RSVD fails to recognize that such expenses are

production, operating or maintenance in nature. No market exists for CO_2 at the McElmo Dome field, and as a result all CO_2 must be transported or delivered to remote locations. Costs associated with this transportation or delivery must be allowed, as there is no method other than compression to transport the CO_2 from the Cortez Pipeline to the Sheep Mountain line. Mobil believes that RSVD acted unreasonably in disallowing compression related expenses, since such expenses currently comprise eighty percent (80%) of Mobil's actual operating expenses. Mobil additionally believes that the RSVD Decision by failing to allow Mobil's deduction for compression related expenses discriminates between CO_2 producers who are owners of the Cortez CO_2 pipeline and those CO_2 producers who are not owners.

In addition, Mobil maintains that standard accounting practice would allow compression related expenses to be deducted as a production cost. Standard accounting practice provides that production costs are those costs incurred to operate and maintain an enterprise's wells and related equipment and facilities. See Statement No. 19, Financial Accounting and Reporting by Oil & Gas Producing Companies, Financial Accounting Standards Board ("Statement No. 19"). Under Statement No. 19 production involves lifting the gas to the surface and gathering, treating, field processing, and field storage of the gas. While Statement No. 19 states that the production function normally terminates at the outlet

valve, Statement No. 19 continues by stating "if unusual physical or operational circumstances exist, it may be more appropriate to regard the production function as terminating at the first point at which oil, gas or gas liquids are delivered to a main pipeline, a common carrier, a refinery, or a marine terminal." Paragraph 23 of Statement No: 19 (emphasis supplied). Mobil asserts that unusual operational circumstances at the McElmo Dome field do exist, which require Mobil to incur compression related expenses to transport the CO_2 to the Sheep Mountain line. Under standard accounting practice, as set forth in Statement No. 19, Mobil should be allowed to deduct compression related expenses for purposes of calculating the transportation allowances for the McElmo Dome field. The RSVD Decision by failing to consider standard accounting procedures is unreasonable and, therefore, arbitrary and capricious.

V. Allowance Limitation.

The RSVD Decision further limits the transportation allowance to the lesser of the approved rate or fifty percent (50%) of the CO_2's value at the sales point. See page 7, paragraph 5 and Attachment 4 footnote. In the days of record product prices and numerous CO_2 markets, the fifty percent (50%) cap might have been considered reasonable. With declining product prices and scarcity of CO_2 markets, however, the fifty percent (50%) cap on operating costs has become unreasonable. While product prices have decreased

considerably during the past few years, Mobil's operating costs during the same period have either increased or remained constant. CO_2 commodity prices are subject to competitive market forces and transportation costs tend to be higher as sales point distances increase from the McElmo Dome field. The increased distance to sales points renders transportation costs in excess of fifty percent (50%) of the aggregate CO_2 sales price. Mobil, therefore, asserts that RSVD's failure to recognize current market conditions so as to allow deductions for actual costs incurred is unreasonable, and RSVD's fifty percent (50%) cap on operating costs is arbitrary and capricious.

VI. Federal Income Taxes.

The RSVD Decision disallowed Federal income taxes from the Cortez CO_2 Pipeline "tariff calculation" of transportation costs. See page 2, paragraph 2 and page 6, paragraph 2. The tariff rate used by Mobil does not include Federal income taxes, since the tariff rate calculated under the 1941 Pipeline Consent Decree methodology would be considerably higher than $0.39/MCF based on current output. Mobil believes that Federal and state income taxes should be allowed as a cost component of the Cortez CO_2 Pipeline Company tariff, since to do otherwise would unfairly discriminate between CO_2 producers who are owners of the Cortez CO_2 Pipeline and CO_2 producers who are not owners. In addition, Mobil adopts the reasons set forth by Shell Western E&P Inc. ("SWEPI") in SWEPI's Statement of

Reasons Supporting Appeal dated October 9, 1986, filed with the Board of Land Appeals under Docket No. MMS-84-0013-MISC, a copy of which is attached hereto as Exhibit A and incorporated herein by this reference for all purposes.

VII. Standard of Review.

Mobil acknowledges that agency decisions are generally entitled to substantial deference. See, e.g., Chevron USA, Inc. v. National Resources Defense Council, Inc., 467 U.S. 837, 843-845 (1984). Mobil believes, however, that those portions of the RSVD Decision discussed herein should be reversed as arbitrary, capricious, an abuse of discretion, or contrary to law. See, 5 U.S.C. § 706(2)(A); Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 413-414 (1971). In addition, Mobil believes that the RSVD Decision fails to consider all relevant factors, including, without limitation, industry practice, standard accounting procedures, economic realities and current market conditions, and therefore should not be afforded substantial deference by the courts or any reviewing body.

VIII. Conclusion.

As set forth in detail above, the RSVD Decision incorrectly calculates the transportation allowances applicable to CO_2 produced from the McElmo Dome Unit. Mobil, therefore, respectfully requests that your office consider these Statement of Reasons and recalculate and approve such transportation allowances in accordance with the procedures outlined herein.

Respectfully submitted,

MOBIL PRODUCING TEXAS
AND NEW MEXICO INC.,
By its Agent
Mobil Exploration and
Producing Services, Inc.
P.O. Box 900
Dallas, Texas 75221

for R. D. Lee

John B. McWilliams,
General Counsel

1413P

United States Department of the Interi

attach. 17

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-OG:87-0095

MAY 2 2 1987

Memorandum

To: Chief, Division of Appeals

Through: Program Analyst (Litigation)

From: Chief, Royalty Valuation and Standards Division

Subject: Appeal by Mobil Producing Texas and New Mexico Inc. Concerning McElmo Dome Unit CO_2 Transportation Allowances

By letter dated February 3, 1987 (copy attached), Mobil Producing Texas and New Mexico Inc. (MPTM) filed an appeal to a Minerals Management Service (MMS) decision dated December 31, 1986 (copy attached). The December 31 decision approved transportation allowances pertaining to carbon dioxide (CO_2) production transported from the McElmo Dome Unit in southwestern Colorado to the Denver Unit, the Seminole-San Andres Unit, and the Wellman Unit, all of which are located in west Texas. The MPTM requested an additional 30 days in which to submit its Statement of Reasons in support of the appeal. By letter dated February 24, 1987, MMS's Royalty Valuation and Standards Division (RVSD), approved MPTM's request and granted additional time until March 7, 1987, to submit the Statement of Reasons in support of the appeal.

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Dolores and Montezuma Counties, Colorado. Shell Western Exploration and Production Inc. (SWEPI) is the operator of the unit. The MPTM is a working interest owner in the McElmo Dome Unit. The CO_2 is transported through the Cortez Pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects. The Cortez Pipeline is owned by the Cortez Pipeline Company, of which MPTM, SWEPI, and Conoco, Inc. are parent owners.

By decision dated December 31, 1986, MMS approved transportation allowances for the following pipeline segments: the Cortez Pipeline; MPTM's pipeline; and the Sheep Mountain Pipeline. The MMS-approved "tariff calculation" procedure for the Cortez Pipeline allowed certain transportation charges assessed by the Cortez Pipeline Company in accordance with a 1941 Pipeline Consent Decree. All components of the Cortez Pipeline Tariff were allowed to be deducted from the value of CO_2 prior to determining royalty with the exception of Federal and State income tax. The MMS-approved transportation allowance for MPTM's pipeline was computed based on actual allowable costs for

the pipeline segment. The Sheep Mountain Pipeline transportation allowance was based on an arm's-length agreement to cover transportation costs incurred in moving production through pipelines not owned by the lessee. The MPTM filed an appeal dated February 3, 1987, to MMS's decision of December 31, 1986. The MPTM's appeal addressed six issues in which it contends that MMS was in error in its December 31, 1986, decision. Five of the issues pertain to the transportation allowance granted for MPTM's pipeline and one of the issues pertains to the Cortez Pipeline Tariff. These issues are:

1) General Argument. The MMS's decision approved transportation allowances for CO_2 production transported from the McElmo Dome Unit based on information in the Conservation Division Manual (CDM). The MPTM argues that the CDM takes the form of a directive and materially modifies existing regulations and is not lawfully in effect since the CDM was not promulgated and published in compliance with 5 U.S.C. § 552.

   The MPTM's appeal stated that no notice or justification has been given for procedures which, if applied, could substantially affect MPTM's liability to the United States for royalties accruing with respect to the McElmo Dome Unit. The MPTM further states that ". . . since the CDM was not promulgated and published in a manner consistent with Section 552 of the Administrative Procedures Act, policy guidelines therein, to the extent adverse to MPTM, should be deemed void."

RVSD's Response

Onshore oil and gas regulations do not specifically address royalty requirements for transportation deductions for CO_2 production. The Code of Federal Regulations (CFR), 30 CFR 206.103, "Value Basis for Computing Royalties," provides (in part) that ". . . due consideration being given to the highest price paid for a part or for a majority of production . . . to the price received by the lessee, to posted prices, and to other relevant matters." "Other relevant matters" were considered by MMS. As a matter of fact, "other relevant matters" is the only regulatory authority for the approval of transportation allowances. The CDM was the procedural guide issued by the Conservation Division of the United States Geological Survey (USGS), predecessor to the MMS. The CDM provides the guidelines for determining the reasonable costs incurred by the lessee in transporting onshore production to the nearest sales outlet. The guidelines include transportation costs "as one of the relevant matters" in establishing value for royalty purposes.

2) Operating Costs. The MPTM's appeal stated that ad valorem taxes allowed by MMS as an expense item for MPTM's pipeline should not be considered in calculating operating costs since such taxes are not a cost of producing CO_2. The MPTM also challenges the limitation of operating costs to the lesser of the actual operating costs or 10 percent of the undepreciated initial investment.

The MPTM cites the CDM Section 647.5A.3B, which states in part:

> "Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which the operating costs are being computed."

The MPTM states that the ad valorem taxes comprise 57 percent of the total operating costs which are not established nor controlled by MPTM. In addition, MPTM argues that the limitation of operating costs to the lesser of the actual operating costs or 10 percent of the undepreciated initial investment results in discrimination against the owners of the Cortez Pipeline since no limitation is placed on producers who are not owners of the Cortez Pipeline.

RVSD's Response

The MMS's policy is to include ad valorem taxes attributable to the pipeline as an allowable operating cost. The CDM, Section 647.5A.3B, allows taxes (except income taxes) as an operating expense item. The CDM, Section 647.5A.3B, also specifies the limitation of operating costs to the lesser of the actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost for producer-owned and operated pipelines.

3) Rate of Return on Investment. The MPTM appeal stated that the prime interest rate used to calculate the rate of return on investment for MPTM's pipeline should have been 11.25 percent, as published in the Wall Street Journal on January 2, 1985. The MPTM further argues that MMS's use of the prime interest rate is unreasonable since such rate reflects short-term cost of money to bank's most favored customers and can fluctuate within a year.

   The MPTM recommends that the rate of return should be established by MMS and should be published in the Federal Register in February of each calendar year. To be consistent with industry practice, MPTM requests that MMS calculate the rate by multiplying: "i) the average of the twelve (12) rates for twenty-year Treasury Bills published in the Wall Street Journal on the first publication date of each month of the preceding calendar year by ii) one hundred fifty percent (150%)."

RVSD's Response

The MMS's policy is to use the prime interest rate as published in the Wall Street Journal in effect at the beginning of the year for which the initial allowance is granted. The CDM, Section 647.5A.3A, provides that "the

prime interest rate in effect at the time of initial allowance approval should be used." The prime interest rate published in the Wall Street Journal on January 2, 1985, was 10.75 percent, rather than 11.25 percent as cited by MPTM. However, this rate reflects the interest rate in effect for December 31, 1984. The prime interest rate published in the Wall Street Journal on January 3, 1985, reflecting the rate in effect for January 2, 1985, was 10.75 percent (see attachment). Therefore, the 10.75 percent prime interest rate used by MMS to calculate the allowable return on the depreciated investment was appropriate and in accordance with MMS's policy.

4) Compression Expenses. The MPTM's appeal stated that the disallowance of compression expenses for MPTM's pipeline segment is unreasonable since MMS fails to recognize that such expenses are production, operating, or maintenance in nature. The MPTM further argues that unusual operational circumstances exist at the McElmo Dome Unit; therefore, MPTM should be allowed to deduct compression related expenses for the purposes of calculating the transportation allowances.

The MPTM cites the Financial Accounting and Reporting by Oil & Gas Producing Companies, Financial Accounting Standards Board (Statement No. 19) which states that "if unusual physical or operational circumstances exist, it may be more appropriate to regard the production function as terminating at the first point at which oil, gas or gas liquids are delivered to a main pipeline, a common carrier, a refinery, or a marine terminal." The MPTM maintains that standard accounting practice allows compression related expenses to be deducted as a production cost. The MPTM points out that no market exists for CO_2 at the McElmo Dome Field; therefore, all CO_2 must be transported to remote locations. Costs associated with this transportation should be allowed since compression is the only method in which to transport the CO_2 to the Sheep Mountain Pipeline.

RVSD Response

Compression costs are not allowed as a deduction from Federal royalty. The CDM, Section 647.3A, Notice to Lessees and Operators No. 1 (NTL-1), and 43 CFR 3162.7 provide that the lessee is obligated to place lease production in marketable condition without deduction of costs for compressing the gas for market. Decisions by the Director, Geological Survey, and a supporting court decision, The California Company v. Secretary of the Interior, August 10, 1961, have upheld the principle that the lease operator is obligated to perform necessary field gathering, dehydration, and compression operations. The court made the distinction between "transportation" of gas and "conditioning" of gas and accepted the Secretary's definition of production as "gas conditioned for market."

5) Allowable Limitation. The MPTM states that the transportation allowance ceiling limitation of 50 percent of the royalty value of the CO_2 at the

sales point does not recognize current market conditions. This limitation pertains to the approved transportation allowances for the Cortez Pipeline, MPTM's pipeline, and Sheep Mountain Pipeline to each delivery point. The MPTM further provides that product prices have decreased considerably during the past few years, while MPTM's operating costs have increased or remained constant.

RVSD Response

The CDM, Section 647.5.3E provides that under no circumstances should the transportation costs exceed 50 percent of the products fair market value at the market competitive sales point. The RVSD allows the reasonable actual transportation costs as proper deductions in computing royalties. However, RVSD must comply with established regulations, guidelines, and procedures. Therefore, the MMS's decision dated December 31, 1986, cites the 50 percent limitation on transportation deductions for CO_2 moved to the marketing locations. The decision is based upon established procedures in the regulations and the CDM. However, the Secretary may grant relief from the 50 percent limitation provided the lessee can demonstrate unusual circumstances which warrant such action.

6) Federal Income Taxes. The Cortez Pipeline "tariff calculation" procedure allowed MPTM to deduct certain transportation charges assessed by the Cortez Pipeline Company in accordance with a 1941 Pipeline Consent Decree. All components of the tariff were allowed to be deducted from the value of CO_2 prior to determining royalty with the exception of Federal and State income tax. The MPTM appealed the exception of Federal and State income tax as a cost of transportation.

The MPTM's appeal stated that the tariff rate does not include Federal income tax since the tariff rate calculated under the 1941 Consent Decree would be considerably higher than $0.39/Mcf based on current output. In addition, MPTM adopts SWEPI's Statement of Reasons in support of SWEPI's appeal dated October 9, 1986.

RVSD's Response

The RVSD upholds its previous position with regard to Federal and State income taxes. In Williams' Oil and Gas Law, Vol. 3, § 604.6(b) clearly defines which costs may be considered as a cost of operation; "the current cost of operation has been held to include taxes (other than income taxes) payable by the owner of the working interests." In addition, in Matzen v. Hugoton Production Co., (321 P.2d 576), the Supreme Court of Kansas upheld evidence which established that "from an accounting standpoint, income tax is a sharing of profits, not a cost; that in cost accounting, income tax is never used as a factor in determining cost of operation, cost of sales, nor of any other item." The RVSD recommends that income tax should not be allowed as part of the cost of transportation as claimed by MPTM.

CONCLUSIONS

- For all reasons stated above, RVSD recommends that the transportation allowances approved in MMS's decision dated December 31, 1986, be upheld.

- The RVSD disagrees with all six issues presented by MPTM in support of the appeal. Therefore, RVSD recommends MPTM's appeal be denied.

William H. Feldmiller

William H. Feldmiller

3 Attachments

Mobil Producing Texas & New Mexico Inc.

attach. 15

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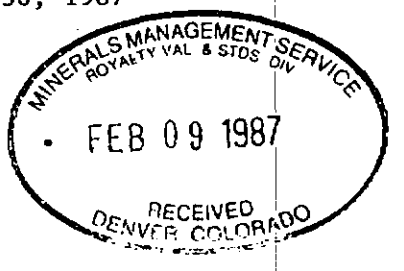
January 30, 1987



Mr. William H. Feldmiller
Minerals Management Service
Royalty Valuation and
Standards Division
P.O. Box 25165, MS653
Denver, Colorado 80225

1.96 CO2 TRANSPORTATION
ALLOWANCE REQUEST
MCELMO DOME (LEADVILLE)
UNIT

Dear Mr. Feldmiller:

Enclosed, as previously requested, are copies of the sales, exchange and transportation contracts as applicable for each Mobil Producing Texas and New Mexico Inc. (MPTM) CO2 delivery. Also enclosed is volume and value data for each delivery for the period January 1985 through August 1986. MPTM is requesting approval of transportation allowances for all other MPTM CO2 deliveries not previously approved by the MMS as shown on the attached exhibit.

Transportation allowances are requested from date of initial delivery as shown on the enclosed volume and value worksheet. Please address any questions relating to this request to the undersigned.

Very truly yours,

Hector Casas
Gas Accounting Supervisor

CAShirley:tm
Enclosures

cc: S. R. Hemmeline - S25-1
R. D. Lee - MEPSI
B. L. Marcum - Midland
G. S. Smith - Midland

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PROPRIETARY INFORMATION

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01-2

Pipeline Delivery Point	Disposition (Operator/Unit)	Transportation Allowance Requested	Current Rate
Cortez Pipeline Tatum Meter Station	Phillips-East Vacuum Unit	Cortez tariff	$0.39/MCF
McElmo Creek Unit Pipeline	Mobil-McElmo Creek Unit	SWEPI metering charge Cortez Tariff (applicable only to CO2 from non Hovenweep Facility sources)	$0.015/MCF $0.05/MCF
Cortez Pipeline Allred Meter Station	Sale to Amoco at the Central Basin Pipeline	Cortez tariff	$0.39/MCF
MPTM-Wasson Delivery Facility	Sale to Amoco for their in-kind requirements at the Willard Unit	Cortez tariff MPTM pipeline costs	$0.39/MCF $0.011049 /MCF
Cortez Pipeline Denver City Meter Station	Union of California Dollarhide Unit	Cortez tariff	$0.39/MCF
West Texas Pipeline South Wasson Clear-fork Unit Meter Station	Shell-South Wasson Clearfork Unit	Cortez tariff West Texas Pipeline transportation charges	$0.39/MCF See Contract CT-4346
Cortez - Allred Meter Station	Mobil-Mahoney Unit	Cortez tariff MPTM pipeline costs	$0.39/MCF $0.011049 /MCF

PROPRIETARY INFORMATION

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CAS

DATE: December 8, 1986

NORTH AMERICAN GAS

CARBON DIOXIDE METERING FACILITY AGREEMENT SUMMARY AND/OR SUPPLEMENT

CONTRACT NO: CF-8907 DATE: February 25, 1985

AFFILIATE: Mobil Producing Texas & New Mexico Inc. - Midland

SUPPLIER: Mobil Oil Corporation, Agent for the Superior Oil Co.

SUPPLY POINT: McElmo Dome (Leadville) Unit, Dolores & Montezuma Cos., Colorado (42-55210; CU-588)

METERING FACILITY: Hovenweep Facility, Montezuma Co., Colorado

OPERATOR: Shell Western E & P Inc.

DELIVERY POINT: McElmo Creek Unit, Aneth Field, San Juan County, Utah (56-15400; SOUT - 73B)

DISTRIBUTION:

Gas Accounting Administration Supervisor	- 203-DAC	Dallas	(1)
*Division Order & Title Section Supervisor -	- 203-DAC	Dallas	(1)
MEPSI - Regulatory Compliance Manager	- 204	Dallas	(1)
Division CO_2 & Gas Dev. Manager	- 127	Midland	(2)
Division Joint Interest Manager	- 127	Midland	(1)
Affiliate Gas Manager	- 007	Denver	(1)
Gas Accounting Supervisor	- S23-10	Houston	(1)
Production Acctg. Supervisor	- S23-5	Houston	(1)
Revenue Control Supervisor	- 31-1	Houston	(1)
CO2 Projects Manager	- S25-2	Houston	(1)
Other			( )
NAGas (original)			

* Cover Sheet Only

RECEIVED DEC 11 1986 GAS ACCTG.

NOTE:
The Agreement provides for Mobil's delivery of CO2 from McElmo Dome (Leadville) Unit to the McElmo Creek Unit Pipeline at the Hovenweep Facility. Mobil shall pay SWEPI a fee of $0.015/MCF of Carbon Dioxide metered and measured through the Facility each month. Term of the Agreement is from February 25, 1985 until the earlier of (a) the date 96,000 MCF of CO2 is delivered; or (b) the end of four months following the next succeeding month following initial deliveries hereunder.

Date of first delivery was February 1985; this Agreement therefore expired under its own terms July 1, 1985, although deliveries continued until it was replaced by an interim Letter Agreement (C-4314) dated 11/21/85.

ANALYST: VBHoward/MVanHess:hd
CO2DS/342/VBH

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PROPRIETARY INFORMATION

METERING FACILITY

AGREEMENT

HOVENWEEP FACILITY

THIS AGREEMENT is made and entered into this 25th day of February, 1985, by and between SHELL WESTERN E&P INC., a Delaware corporation, hereinafter called "SWEPI", and Mobil Oil Corporation, a Delaware corporation, hereinafter called "Mobil".

REFERENCE is made to the following:

A. SWEPI has installed and will operate a metering facility to measure and deliver CO_2 from McElmo Dome to the McElmo Creek Unit Pipeline at the Hovenweep Facility in Montezuma County, Colorado.

B. The installation and operation of the metering facilities referred to above shall therein and hereinafter be called "METERING FACILITY".

C. Mobil desires to deliver CO_2 from McElmo Dome to the McElmo Creek Unit Pipeline at the Hovenweep Facility in Montezuma County, Colorado, through the METERING FACILITY, and SWEPI has agreed to permit Mobil to deliver CO_2 through the METERING FACILITY as hereinafter set forth.

IN CONSIDERATION of the premises and of the mutual covenants herein contained, SWEPI and Mobil agree as follows:

SECTION 1. SCOPE OF AGREEMENT. The METERING FACILITY is owned by SWEPI. This Agreement is entered into for the sole purpose of facilitating Mobil's delivery of CO_2 from McElmo Dome to the McElmo Creek Unit Pipeline at the Hovenweep Facility in Montezuma County, Colorado.

SECTION 2. METERING FACILITY. SWEPI will permit Mobil to deliver CO_2 from McElmo Dome to the McElmo Creek Unit Pipeline at the Hovenweep Facility in Montezuma County, Colorado, through the METERING FACILITY.

SECTION 3. CHARGE

3.1 Fee. Mobil shall pay a fee to SWEPI each month, for each Mcf of CO_2 delivered by Mobil through the METERING FACILITY. Calculation of total volumes delivered by Mobil shall be based upon measurement at the METERING FACILITY. The rate shall be $0.015 per Mcf of carbon dioxide metered and measured at the METERING FACILITY. The term "cubic foot" is the amount of carbon dioxide necessary to fill one cubic foot of space at a base pressure of 14.73 psia and at a base temperature of 60 degrees Fahrenheit.

3.2 Billing Statement. SWEPI shall render to Mobil, on or before the tenth (10th) day of each month, a statement setting forth the total quantity of carbon dioxide delivered by Mobil through the METERING FACILITY during the preceding month.

3.3 Payment. Mobil shall make payment to SWEPI within twenty (20) days after receipt of the billing statement. In the event Mobil shall fail to pay any amount due SWEPI when the same is due, the interest thereon shall accrue at the rate of ten percent (10%) per annum from the date when such amount is due until the same is paid.

3.4 Accountability. Mobil shall have the right at reasonable business hours to examine the books, records, and measurement documents of SWEPI to the extent necessary to verify the accuracy of any statement, payment, calculation, or determination made pursuant to the provisions of this agreement for any calendar year within two calendar years following the end of such calendar year. If any such examination shall reveal, or if either party shall discover, any error or inaccuracy in its own

or the other party's statement, payment, calculation or determination, then proper adjustment and correction thereof shall be made as promptly as practicable thereafter.

SECTION 4. INDEMNITY.

A. By Mobil: To the maximum extent permitted by applicable law, but no further, Mobil shall indemnify and hold harmless SWEPI, its directors, employees, and agents, from and against any claim, suit, liability, judgement and expense, including attorney's fees and other costs of litigation, arising out of injury, disease or death of employees or agents of Mobil or damage to or loss of any property of Mobil resulting from or in connection with the condition or operation of the METERING FACILITY or the delivery of CO_2 owned by or metered for Mobil through the METERING FACILITY, except when the injury, disease, death, or damage is caused by negligence or fault, solely or concurrent, of a party otherwise indemnified.

B. By SWEPI: SWEPI shall indemnify and hold harmless Mobil, its directors, employees, and agents, from and against any loss, damage, claim suit, liability, judgement and expense, including attorney's fees and other costs of litigation, arising out of injury, disease or death of employees of agents of SWEPI or damage to or loss of any property of SWEPI resulting from or in connection with the condition or operation of the METERING FACILITY or the delivery of CO_2 owned by or metered for Mobil through the METERING FACILITY, except when the injury, disease, death, or damage is caused by negligence or fault, solely or concurrent, of a party otherwise indemnified.

SECTION 5. TERM. The Contract shall be effective as of the date hereof and, unless terminated pursuant to other provisions hereof, shall remain in full force and effect until the earlier of (a) the amount of 96,000 MCF of carbon dioxide is delivered or (b) at the end of four (4) months following the next succeeding month following initial deliveries hereunder.

SECTION 6. NOTICES. Notices and communications under this Agreement shall be deemed effective upon actual receipt by the addressee. All notices shall be in writing and shall be sent by prepaid mail or telegram addressed to the respective parties at the address stated below:

SWEPI	Mobil
Shell Western E&P Inc. ATTN Mid-Continent Division Production Manager P. O. Box 991 Houston, TX 77001	Mobil Oil Corporation ATTN Denver West Division Production Manager P. O. Box 5444 Denver, CO 80217

SECTION 7. ASSIGNMENT AND SUCCESSION. Both parties may assign this Agreement to an affiliate, subsidiary or pursuant to a merger or consolidation without prior written consent of the non-assigning party. All other assignments shall require the prior written consent of the non-assigning party, which shall not be unreasonably withheld.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date set forth hereinabove.

SHELL WESTERN E&P INC.

By: R H Nelson

Title: General Manager Natural Gas

Date: July 16, 1985

MOBIL OIL CORPORATION

By: D H Colin KGM

Title: Producing Operations Manager, Denver West

Date: June 24, 1985

PROPRIETARY INFORMATION

APPROVED
~~Land~~
OGC
Controllers
Jt. Int.
~~Title Reds~~

OF 1987

Exhibit 1

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC

MCELMO DOME CO2 PROJECT
MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE

SEGMENT	DENVER UNIT ($/MCF)	SEMINOLE-SAN ANDRES UNIT ($/MCF)	WELLMAN UNIT ($/MCF)	SO. WASSON C.F UNIT	DOLLARHIDE UNIT
MCELMO DOME UNIT TO DENVER UNIT/ALLRED STATION (CORTEZ PIPELINE)	$0.390000	$0.390000	$0.390000	$0.390000	$0.390000
ALLRED STATION TO DENVER CITY DELIVERY STATION (MPTM PIPELINE)	---	$0.084723	---	---	---
ALLRED STATION TO WELLMAN UNIT (MPTM PIPELINE)	---	---	$0.011480	---	---
DENVER CITY DELIVERY STATION TO SEMINOLE SAN ANDRES UNIT (SHEEP MTN. PIPELINE)	---	$0.035000	---	---	---
DENVER CITY CO2 DELIVERY STATION TO SO. WASSON CLEARFORK UNIT	---	---	---	$0.044620	---
DENVER CITY CO2 DELIVERY STATION TO DOLLARHIDE UNIT	---	---	---	---	$0.110000
TOTAL	$0.390000	$0.509723	$0.401480	$0.434620	$0.500000

Exhibit 2

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

MCELMO DOME CO2 PROJECT
MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - WELLMAN UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE * PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$1.437900	$0.718950	$0.401480	27.92%	0
FEB	N/A	N/A	N/A	N/A	N/A
MAR	N/A	N/A	N/A	N/A	N/A
APR	N/A	N/A	N/A	N/A	N/A
MAY	$0.999800	$0.499900	$0.401480	40.16%	0
JUN	$0.999800	$0.499900	$0.401480	40.16%	0
JUL	$0.999800	$0.499900	$0.401480	40.16%	0
AUG	$0.999800	$0.499900	$0.401480	40.16%	0
SEP	N/A	N/A	N/A	N/A	N/A
OCT	N/A	N/A	N/A	N/A	N/A
NOV	N/A	N/A	N/A	N/A	N/A
DEC	N/A	N/A	N/A	N/A	N/A

MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - EAST VACUUM UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$0.840000	$0.420000	$0.390000	46.43%	0
FEB	$0.840000	$0.420000	$0.390000	46.43%	0
MAR	$0.840000	$0.420000	$0.390000	46.43%	0
APR	$0.840000	$0.420000	$0.390000	46.43%	0
MAY	$0.840000	$0.420000	$0.390000	46.43%	0
JUN	$0.840000	$0.420000	$0.390000	46.43%	0
JUL	$0.840000	$0.420000	$0.390000	46.43%	0
AUG	$0.840000	$0.420000	$0.390000	46.43%	0
SEP	$0.840000	$0.420000	$0.390000	46.43%	0
OCT	$0.840000	$0.420000	$0.390000	46.43%	0
NOV	$0.840000	$0.420000	$0.390000	46.43%	0
DEC	$0.840000	$0.420000	$0.390000	46.43%	0

Exhibit 3

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

MCELMO DOME CO2 PROJECT
MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - SAN ANDRES UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$1.334991	$0.667496	$0.509723	38.18%	0
FEB	$1.334991	$0.667496	$0.509723	38.18%	0
MAR	$1.334991	$0.667496	$0.509723	38.18%	0
APR	$0.974760	$0.487380	$0.509723	52.29%	0.022343
MAY	$0.974760	$0.487380	$0.509723	52.29%	0.022343
JUN	$0.974760	$0.487380	$0.509723	52.29%	0.022343
JUL	$0.950062	$0.475031	$0.509723	53.65%	0.034692
AUG	$0.950062	$0.475031	$0.509723	53.65%	0.034692
SEP	$0.950062	$0.475031	$0.509723	53.65%	0.034692
OCT	$0.958343	$0.479172	$0.509723	53.19%	0.030552
NOV	$0.958343	$0.479172	$0.509723	53.19%	0.030552
DEC	$0.958343	$0.479172	$0.509723	53.19%	0.030552

MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - DENVER UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$1.126450	$0.563225	$0.390000	34.62%	0
FEB	$1.126450	$0.563225	$0.390000	34.62%	0
MAR	$1.126450	$0.563225	$0.390000	34.62%	0
APR	$0.769840	$0.384920	$0.390000	50.66%	0.005080
MAY	$0.769840	$0.384920	$0.390000	50.66%	0.005080
JUN	$0.769840	$0.384920	$0.390000	50.66%	0.005080
JUL	$0.732290	$0.366145	$0.390000	53.26%	0.023855
AUG	$0.732290	$0.366145	$0.390000	53.26%	0.023855
SEP	$0.732290	$0.366145	$0.390000	53.26%	0.023855
OCT	$0.739130	$0.369565	$0.390000	52.76%	0.020435
NOV	$0.739130	$0.369565	$0.390000	52.76%	0.020435
DEC	$0.739130	$0.369565	$0.390000	52.76%	0.020435

Exhibit 4

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

MCELMO DOME CO2 PROJECT
MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - DOLLARHIDE UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$0.930000	$0.465000	$0.500000	53.76%	0.035000
FEB	$0.930000	$0.465000	$0.500000	53.76%	0.035000
MAR	$0.930000	$0.465000	$0.500000	53.76%	0.035000
APR	$0.930000	$0.465000	$0.500000	53.76%	0.035000
MAY	$0.930000	$0.465000	$0.500000	53.76%	0.035000
JUN	$0.930000	$0.465000	$0.500000	53.76%	0.035000
JUL	$0.930000	$0.465000	$0.500000	53.76%	0.035000
AUG	$0.930000	$0.465000	$0.500000	53.76%	0.035000
SEP	$0.930000	$0.465000	$0.500000	53.76%	0.035000
OCT	$0.930000	$0.465000	$0.500000	53.76%	0.035000
NOV	$0.930000	$0.465000	$0.500000	53.76%	0.035000
DEC	$0.930000	$0.465000	$0.500000	53.76%	0.035000

MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - SOUTH WASSON CLEARFORK UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	N/A	N/A	N/A	N/A	N/A
FEB	N/A	N/A	N/A	N/A	N/A
MAR	N/A	N/A	N/A	N/A	N/A
APR	N/A	N/A	N/A	N/A	N/A
MAY	N/A	N/A	N/A	N/A	N/A
JUN	$0.903522	$0.451761	$0.434620	48.10%	0
JUL	$0.811000	$0.405500	$0.434620	53.59%	0.029120
AUG	$0.811000	$0.405500	$0.434620	53.59%	0.029120
SEP	$0.811000	$0.405500	$0.434620	53.59%	0.029120
OCT	$0.811000	$0.405500	$0.434620	53.59%	0.029120
NOV	$0.811000	$0.405500	$0.434620	53.59%	0.029120
DEC	$0.811000	$0.405500	$0.434620	53.59%	0.029120

Exhibit 5

CONTAINS COMPANY PROPRIETARY
INFORMATION FOR RELEASE ONLY TO
MOBIL EXPLORATION & PRODUCING U.S. INC.

MCELMO DOME CO2 PROJECT
MMS-APPROVED 1986 TRANSPORTATION ALLOWANCE - MAHONEY UNIT
PERCENTAGE IN EXCESS OF THE 50 PERCENT LIMITATION

MONTH	SALES PRICE ($/MCF)	50 % OF SALES PRICE	MMS APPROVED ALLOWANCE ($/MCF)	ALLOWANCE PERCENTAGE	$/MCF IN EXCESS OF 50% LIMIT
JAN	$0.840000	$0.420000	$0.401480	47.80%	0
FEB	$0.840000	$0.420000	$0.401480	47.80%	0
MAR	$0.820000	$0.410000	$0.401480	48.96%	0
APR	$0.613952	$0.306976	$0.401480	65.39%	0.094504
MAY	$0.613952	$0.306976	$0.401480	65.39%	0.094504
JUN	$0.613952	$0.306976	$0.401480	65.39%	0.094504
JUL	$0.591815	$0.295908	$0.401480	67.84%	0.105573
AUG	$0.591815	$0.295908	$0.401480	67.84%	0.105573
SEP	$0.591815	$0.295908	$0.401480	67.84%	0.105573
OCT	$0.591815	$0.295908	$0.401480	67.84%	0.105573
NOV	$0.591815	$0.295908	$0.401480	67.84%	0.105573
DEC	$0.591815	$0.295908	$0.401480	67.84%	0.105573

CORTEZ PIPELINE COMPANY

INCOME STATEMENT

DECEMBER 1986

M$

	DECEMBER 1986	YTD 1986	DECEMBER 1985	YTD 1985
THRUPUT MMCF	14,857	184,955	15,615	131,970
THRUPUT (MMCF PER DAY)	479	507	504	362
REVENUE				
OPERATING	$5,794	$72,079	$6,090	$51,467
TRUNK	-	-	-	-
GATHERING	5,794	72,079	6,090	51,467
TOTAL OPERATING REVENUE	10	88	27	214
INTEREST	5,804	72,167	6,117	51,681
TOTAL REVENUE				
COSTS				
OPERATING COSTS	14	168	12	199
POWER COST	(25) (1)	311	35	594
SUPPLIES, EXPENSE AND MAINTENANCE MATERIALS	110	1,220	96	1,329
OUTSIDE SERVICES	115	604	100	910
SALARIES, WAGES AND BENEFITS	38	478	43	473
OTHER	7	140	20	42
RENTALS	259	2,919	306	3,547
OTHER → operating expenses misc				
TOTAL OPERATING COSTS				
OTHER COSTS	4,691 X-4	56,475 X-4	4,787 X-4	56,606 X-4
INTEREST	534	2,484 (2)	403	2,333
DEPRECIATION	71	169	4	36
AD VALOREM TAX				
OTHER →				
TOTAL OTHER COSTS			X-4	
TOTAL COSTS			X-4	
NET INCOME(LOSS)	$		X-4	

01/20/87 • 13:40

(1) Reclassify Cortez Capital Corporation expenses originally charged to miscellaneous supplies and expense to better identify as outside services and other costs. Items transferred to other costs relate to issuance expense on commercial paper.

(2) Interest expense is $2,351M.

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO WELLMAN UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	1.4379	0.7189500	0.416205	0	29
FEB	N/A	N/A	N/A	N/A	N/A
MAR	N/A	N/A	N/A	N/A	N/A
APR	N/A	N/A	N/A	N/A	N/A
MAY	0.9998	0.4999000	0.416205	0	42
JUN	0.9998	0.4999000	0.416205	0	42
JUL	0.9998	0.4999000	0.416205	0	42
AUG	0.9998	0.4999000	0.416205	0	42
SEP	N/A	N/A	N/A	N/A	N/A
OCT	N/A	N/A	N/A	N/A	N/A
NOV	N/A	N/A	N/A	N/A	N/A
DEC	N/A	N/A	N/A	N/A	N/A

401480

40%

N/A = NOT APPLICABLE

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO EAST VACUUM UNIT AND AMOCO YATES:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE	
JAN	0.8400	0.4200000	0.404725	0.000000	.39	48
FEB	0.8400	0.4200000	0.404725	0.000000		48
MAR	0.8400	0.4200000	0.404725	0.000000		48
APR	0.8400	0.4200000	0.404725	0.000000		48
MAY	0.8400	0.4200000	0.404725	0.000000		48
JUN	0.8400	0.4200000	0.404725	0.000000		48
JUL	0.8400	0.4200000	0.404725	0.000000		48
AUG	0.8400	0.4200000	0.404725	0.000000		48
SEP	0.8400	0.4200000	0.404725	0.000000		48
OCT	0.8400	0.4200000	0.404725	0.000000		48
NOV	0.8400	0.4200000	0.404725	0.000000		48
DEC	0.8400	0.4200000	0.404725	0.000000		48

46

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO SEMINOLE SAN ANDRES UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	1.334991	0.6674955	0.524448	0	39
FEB	1.334991	0.6674955	0.524448	0	39
MAR	1.334990	0.6674950	0.524448	0	39
APR	0.974760	0.4873800	0.524448	0.037068	54
MAY	0.974760	0.4873800	0.524448	0.037068	54
JUN	0.974760	0.4873800	0.524448	0.037068	54
JUL	0.950062	0.4750310	0.524448	0.049417	55
AUG	0.950062	0.4750310	0.524448	0.049417	55
SEP	0.950062	0.4750310	0.524448	0.049417	55
OCT	0.958343	0.4791715	0.524448	0.045277	55
NOV	0.958343	0.4791715	0.524448	0.045277	55
DEC	0.958343	0.4791715	0.524448	0.045277	55

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO DENVER UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	1.12645	0.563225	0.404725	0	36
FEB	1.12645	0.563225	0.404725	0	36
MAR	1.12645	0.563225	0.404725	0	36
APR	0.76984	0.384920	0.404725	0.019805	53
MAY	0.76984	0.384920	0.404725	0.019805	53
JUN	0.76984	0.384920	0.404725	0.019805	53
JUL	0.73229	0.366145	0.404725	0.038580	55
AUG	0.73229	0.366145	0.404725	0.038580	55
SEP	0.73229	0.366145	0.404725	0.038580	55
OCT	0.73913	0.369565	0.404725	0.035160	55
NOV	0.73913	0.369565	0.404725	0.035160	55
DEC	0.73913	0.369565	0.404725	0.035160	55

51

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO DOLLARHIDE UNIT

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	0.9300	0.4650000	0.514725	0.049725	55
FEB	0.9300	0.4650000	0.514725	0.049725	55
MAR	0.9300	0.4650000	0.514725	0.049725	55
APR	0.9300	0.4650000	0.514725	0.049725	55
MAY	0.9300	0.4650000	0.514725	0.049725	55
JUN	0.9300	0.4650000	0.514725	0.049725	55
JUL	0.9300	0.4650000	0.514725	0.049725	55
AUG	0.9300	0.4650000	0.514725	0.049725	55
SEP	0.9300	0.4650000	0.514725	0.049725	55
OCT	0.9300	0.4650000	0.514725	0.049725	55
NOV	0.9300	0.4650000	0.514725	0.049725	55
DEC	0.9300	0.4650000	0.514725	0.049725	55

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO SOUTH WASSON CLEARFORK UNIT

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS		ALLOWANCE PERCENTAGE
JAN	N/A	N/A	N/A	N/A		N/A
FEB	N/A	N/A	N/A	N/A		N/A
MAR	N/A	N/A	N/A	N/A		N/A
APR	N/A	N/A	N/A	N/A		N/A
MAY	N/A	N/A	N/A	N/A		N/A
JUN	0.903522	0.4517610	0.449345	0.000000		50
JUL	0.811000	0.4055000	0.449345	0.043845	.434620	55
AUG	0.811000	0.4055000	0.449345	0.043845		55
SEP	0.811000	0.4055000	0.449345	0.043845		55
OCT	0.811000	0.4055000	0.449345	0.043845		55
NOV	0.811000	0.4055000	0.449345	0.043845		55
DEC	0.811000	0.4055000	0.449345	0.043845		55

54

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATION
1986 TRANSPORTATION ALLOWANCE

CO2 TO MAHONEY UNIT

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	0.840000	0.4200000	0.4162	0.000000	50
FEB	0.840000	0.4200000	0.4162	0.000000	50
MAR	0.820000	0.4100000	0.4162	0.006205	51
APR	0.613952	0.3069760	0.4162	0.109229	68
MAY	0.613952	0.3069760	0.4162	0.109229	68
JUN	0.613952	0.3069760	0.4162	0.109229	68
JUL	0.591815	0.2959075	0.4162	0.120298	70
AUG	0.591815	0.2959075	0.4162	0.120298	70
SEP	0.591815	0.2959075	0.4162	0.120298	70
OCT	0.591815	0.2959075	0.4162	0.120298	70
NOV	0.591815	0.2959075	0.4162	0.120298	70
DEC	0.591815	0.2959075	0.4162	0.120298	70

.401-60

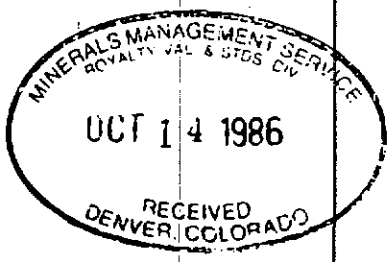
68

attach. 13

Shell Oil Company

2(
P.O. Box 576
Houston, Texas 77001

October 9, 1986



F5-12

CERTIFIED MAIL -
RETURN RECEIPT REQUESTED

Board of Land Appeals
Office of Hearings and Appeals
4015 Wilson Boulevard
Arlington, VA 22203

Subject: Statement of Reasons Supporting Appeal
Docket No. MMS-84-0013-MISC
Shell Western E&P Inc.
Appeal of Disallowance of Federal and
State Income Tax Components of Transportation
Allowance Deductions
McElmo Dome (Leadville) Unit
Dolores and Montezuma Counties, Colorado

Gentlemen:

Shell Western E&P Inc. (SWEPI) hereby files its Statement of Reasons in support of its September 9, 1986 Notice of Appeal of the Decision of the Division of Appeals, Office of Program Review, Minerals Management Service dated August 6, 1986, which was served on SWEPI on August 15, 1986.

FACTS

SWEPI is the Operator of the McElmo Dome (Leadville) Unit[1] (Unit) located in Dolores and Montezuma Counties, Colorado. Unitized substances are all oil and gas, including carbon dioxide (CO_2) within or produced from the Mississippian Leadville formation. The vast majority of the CO_2 produced by SWEPI from said Unit is transported by the Cortez Pipeline Company to various units in Texas where SWEPI sells or uses the CO_2 in connection with enhanced oil recovery projects.

The Cortez Pipeline Company, a general partnership of Shell Cortez Pipeline Company (50%), Mobil Cortez Pipeline Company

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[1]This Unit was approved by the U. S. Department of Interior, Bureau of Land Management on March 29, 1983, effective April 1, 1983.

(37%), and HNG Cortez Pipeline Company (13%), owns the 500-mile, 30 inch CO_2 pipeline which transports CO_2 from the Unit to West Texas (Cortez CO_2 pipeline). The Cortez CO_2 pipeline is operated by Shell Pipe Line Corporation as a common carrier pipeline.

Although not entirely producer owned, the Cortez CO_2 pipeline is essentially producer owned due to the speculative nature and cost (approximately — X-4 ———) of such pipeline. These characteristics were not conducive to ownership by parties who were neither producers of CO_2 from the Unit nor purchasers of CO_2 for enhanced recovery projects. In addition to transporting CO_2 for SWEPI, the Cortez CO_2 pipeline transports CO_2 for other non-pipeline owner producers of CO_2 at the Unit.

Neither the Interstate Commerce Commission nor the Federal Energy Regulatory Commission elected to exercise jurisdiction over the transportation of CO_2 in interstate commerce through the Cortez CO_2 pipeline. Notwithstanding the refusal by such agencies to exercise jurisdiction over such pipeline, Cortez Pipeline Company elected to publish a tariff which is consistent with the tariff methodology historically used by pipeline companies under the 1941 Consent Decree in the case of United States v. The Atlantic Refining Company, et al. The Cortez Pipeline Company tariff methodology includes federal and state income taxes as a component of cost which is to be used in determining the rate per MCF to be charged to producers for the transportation of CO_2 from the Unit to West Texas.

The Royalty Valuation and Standards Division (RVSD) of the Minerals Management Service (MMS) has disallowed those costs pertaining to federal and state income taxes for purposes of determining that portion of the Cortez CO_2 pipeline tariff that SWEPI will be allowed as a transportation deduction for royalty purposes.[2] This disallowance of costs was upheld by the August 6, 1986 Decision of the Division of Appeals, Office of Program Review, MMS.

---

[2]The Cortez Pipeline Company has charged a flat tariff rate of $0.39/MCF for the first three years of operation. The tariff rate calculated under the 1941 Consent Decree methodology is considerably higher than $0.39/MCF based on current thruput.

ARGUMENT

SWEPI does not dispute the authority of the MMS to establish the reasonable value of the CO_2 produced from the Unit for the purpose of computing the royalty payable to the MMS. Neither does SWEPI dispute the authority of the MMS to determine the factors to be considered in computing transportation allowances for royalty valuation purposes.

What SWEPI does dispute is the application of a MMS policy guideline which, according to the RVSD, is applicable to a producer-owned pipeline transporting only that producer's production, to the Cortez CO_2 pipeline. Although the Cortez CO_2 pipeline is in part owned by producers of CO_2 from the Unit, the Cortez CO_2 pipeline also transports CO_2 produced from the Unit by producers who are not owners of the Cortez CO_2 pipeline. SWEPI believes that the application of the MMS policy guideline in circumstances where such guideline is not required and where such application results in undue discrimination between producers of CO_2 who are owners of the Cortez CO_2 pipeline and those producers of CO_2 who are not owners of the Cortez CO_2 pipeline is arbitrary and capricious.

The authority cited by the August 6, 1986 MMS Decision denying SWEPI's appeal stands for the proposition that an agency's interpretation of the statute under which it acts must be given great deference by the courts. SWEPI does not argue with such holding. However, where the agency applies an unpublished internal policy guideline to facts which do not square with the parameters of the policy guideline, and the result is not reasonable, no deference should be given to such interpretation by the courts or any reviewing body.

The result reached by applying the MMS policy guideline applicable to producer-owned pipelines transporting such producers' production only, to the Cortez CO_2 pipeline is not reasonable since it is unduly discriminatory to producers of CO_2 who are also owners of the Cortez CO_2 pipeline.

First, the Cortez CO_2 pipeline tariff is constrained by competition and is currently no higher than it would be if the transportation of CO_2 was subject to the jurisdiction of a regulatory agency. If such transportation of CO_2 was subject to regulation, the MMS policy guideline would allow the entire tariff to be deducted as a transportation allowance for royalty purposes. Approval of the tariff where the pipeline is regulated and disapproval of such tariff where the pipeline is not regulated produces an unreasonable

result that discriminates against SWEPI vis-a-vis the other producers of CO_2 from the Unit that are not owners of the Cortez CO_2 pipeline. SWEPI will be required to pay a higher royalty to the MMS than will other producers who will be permitted to deduct the full Cortez CO_2 pipeline tariff as a transportation allowance. Such a distinction without a rational difference is unreasonable.

Further, the application of the MMS policy guideline to the Cortez CO_2 pipeline results in an unreasonable administrative burden for both SWEPI and the MMS. If SWEPI markets CO_2 in excess of its Unit share, as permitted under the Unit Operating Agreement and as is currently the situation, SWEPI will be required to pay royalty for all CO_2 it produces at a higher rate than it would be if such CO_2 had been produced by a producer without an interest in the Cortez CO_2 pipeline. Every two years, overproduced working interest owners, such as SWEPI, are required to cash balance CO_2 over production with the underproduced working interest owners. At such balancing, SWEPI would be discovered to have overpaid royalty on the CO_2 attributable to the underproduced working interest owners and refunds would have to be sought from both the MMS and the private lessors. This accounting burden is the result of an unreasonable application of a MMS policy guideline in circumstances where such policy guideline was not applicable.

CONCLUSION

For the reasons set forth above, SWEPI requests that the August 6, 1986 Decision of the MMS to disallow federal and state taxes as a cost component of the Cortez Pipeline Company tariff be reversed.

Respectfully submitted,

William G. Riddoch

William G. Riddoch
Senior Counsel
Shell Oil Company
On behalf of Shell Western E&P Inc.
(713) 870-3625

cc: Certificate of Service

CERTIFICATE OF SERVICE

The Undersigned hereby certifies that a true copy of the Statement of Reasons in support of Shell Western E&P Inc.'s Notice of Appeal of the August 6, 1986 Decision of the MMS regarding the Disallowance of Federal and State Tax Components of Transportation Allowance Deduction was sent by CERTIFIED MAIL-RETURN RECEIPT REQUESTED this 9th day of October, 1986 to the following parties:

Associate Solicitor
Division of Energy and Resources
United States Department of the Interior
Washington, D.C. 20240

Regional Solicitor
Rocky Mountain Region
U. S. Department of the Interior
P. O. Box 25007
Denver Federal Center
Denver, Colorado 80225

Mr. David A. Schuenke
Acting Chief, Division of Appeals
Office of Program Review
Minerals Management Service
United States Department of the Interior
Washington, D.C. 20240

Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
U. S. Department of the Interior
P. O. Box 25165
Denver, Colorado 80225
Mail Stop 653

William G. Riddoch

William G. Riddoch
Senior Counsel
Shell Oil Company
On behalf of Shell Western
E&P Inc.

CTCC8628004

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

Mail Stop 653

Attach. 14

IN REPLY
REFER TO:

MMS-RVS-OG:85-0889

F.E.C
DEC 31 1985 GAS ACCTG

ENCLOSURE CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL PRODUCING TEXAS & NEW MEXICO INC.

Mobil Producing Texas & New Mexico Inc.
Attention: Mr. Hector Casas
Nine Greenway Plaza - Suite 2700
Houston, Texas 77046

Gentlemen:

By letter dated October 28, 1985, you requested approval of transportation allowances pertaining to CO_2 production transported from the McElmo Dome Unit in southwestern Colorado to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit all of which are located in west Texas.

The information you submitted has been reviewed. We have approved, subject to future audit, 1985 transportation allowances as outlined in Attachment 4 to the Findings and Conclusions.

The allowances approved for 1985 are to be used as the tentative allowances for production during calendar year 1986 and until the next annual adjustment. Pertinent data for calculation of the actual 1986 transportation allowances must reach our office by April 1, 1987.

When submitting the data for a transportation allowance, you must include copies of all current sales contracts or any subsequent amendments covering disposition of your interest in the production from the lease. Also, you should list the names and addresses of the other working interest owners on whose behalf you are tendering royalty payments. The Minerals Management Service (MMS) will then forward a copy of the transportation allowance letter to each of the listed companies. This should reduce the number of separate allowance requests. For those working interest owners who are reporting and paying royalties on their own behalf, a separate transportation allowance must be requested.

Enclosed is a copy of our Findings and Conclusions showing the basis for our approval of the transportation allowances.

You have the right to appeal this decision. Please refer to the enclosure for the royalty adjustments and appeals procedure.

If there are any questions, please call (303) 231-3395.

Sincerely,

for William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

2 Enclosures

THIS DOCUMENT CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL PRODUCING TEXAS & NEW MEXICO INC.

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION

Findings and Conclusions on McElmo Dome Unit CO_2 Transportation Allowances

BACKGROUND

Carbon dioxide (CO_2) is produced from the McElmo Dome Unit in Montezuma County, Colorado. Shell Western E & P Inc. (SWEPI) is the operator of the unit. Mobil Producing Texas & New Mexico Inc. (MPTM) is a small share working-interest owner in the McElmo Dome Unit. The CO_2 is transported through the Cortez Pipeline to oil fields in west Texas where it is used in enhanced oil recovery projects. The Cortez Pipeline is owned by the Cortez Pipeline Company, of which MPTM, SWEPI, and Conoco are parent owners.

By letter dated October 28, 1985, MPTM requested approval of transportation allowances for CO_2 production transported from the McElmo Dome Unit in southwestern Colorado to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit all of which are located in west Texas. Minerals Management Service (MMS), by letters dated December 26, 1985, and May 7, 1986, requested additional information on the data submitted in the October 28 request.

The MMS will require MPTM to establish CO_2 value for McElmo Dome CO_2 delivered to each unit based on the arm's-length CO_2 sales and purchase contract(s) in existence for each unit. By letter dated August 8, 1986, MMS requested MPTM to submit a proposed valuation procedure for the establishment of value(s) for royalty purposes, of CO_2 disposed under any contracts covering disposition of MPTM's portion of CO_2 from the McElmo Dome Unit. A royalty valuation procedure for CO_2 production from the McElmo Dome Unit will be established by MMS pending receipt of MPTM's proposed valuation procedure. The transportation allowances for CO_2 production from the McElmo Dome Field will be addressed separately from the valuation procedure as agreed upon in the September 11, 1986, meeting between representatives from Royalty Valuation and Standards Division (RVSD) and Dean Lee (MPTM). This approval will address the transportation allowances for CO_2 production from the McElmo Dome Unit to the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit. In the Findings and Conclusions, the transportation allowances are discussed by pipeline segments which include the following: the Cortez Pipeline; MPTM's pipeline; and the Sheep Mountain Pipeline.

THIS DOCUMENT CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL PRODUCING TEXAS & NEW MEXICO INC.

FINDINGS

The Cortez Pipeline

- The MPTM has requested a 1985 transportation allowance for CO_2 transported through the Cortez Pipeline from the McElmo Dome Unit to the Denver Unit in Yoakum and Gaines Counties, Texas. The MPTM submitted a copy of the "Cortez Pipeline Company Letter Tariff" which charges MPTM $0.39/Mcf for CO_2 transported through the Cortez Pipeline. The Cortez Pipeline Company is a general partnership owned by SWEPI, MPTM, and ~~Conoco~~. The Cortez Pipeline Company owns a 500 mile, 30-inch pipeline ultimately capable of transporting approximately 1,000,000 Mcf/day of CO_2.

- The MMS's decision of March 29, 1984, approved the costs incurred in the Cortez Pipeline Tariff, with the exception of income tax, as a transportation allowance for the shipment of CO_2 to the Denver Unit. The approved "tariff calculation" procedure allowed certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 Pipeline Consent Decree. All components of the tariff were allowed to be deducted from Federal royalty with the exception of state and Federal income tax. Shell is appealing the issue regarding income tax.

MPTM's Pipeline

- Deliveries of CO_2 to the Seminole San Andres Unit are via the Cortez Pipeline and the Arco-operated Sheep Mountain Pipeline. A pipeline segment and pump connecting these two pipelines is operated by MPTM. The MPTM's pipeline segment extends from the Allred Station, located on Cortez Pipeline, to the Denver City delivery station, located on the Sheep Mountain Pipeline, and to the Wellman Unit. The MPTM initially submitted an estimated transportation cost of $0.09/Mcf for MPTM's pipeline segment. However, by letter dated May 29, 1986, MPTM provided actual cost data for their 1985 transportation allowance for CO_2 transportation from the Allred Station to the Denver City delivery station and the Wellman Unit. Therefore, a 1985 allowance will be approved. Thereafter, MPTM should submit actual cost data for each year by April of the following year.

- The transportation allowance costs submitted by MPTM for its pipeline segment are broken into four major components: Depreciation, Expenses, Interest, and Throughput. Each major component will be discussed separately in detail.

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Depreciation

- The MPTM has used a 10 percent salvage value in calculating depreciation. The CDM states, " . . . unless otherwise justified by the lessee, a salvage value of 10 percent should be applied to tangible items when determining the depreciable investment cost to be used in allowance calculation. . . ."

- As stated above, MMS bases allowable depreciation on the actual, out-of-pocket costs incurred for real property and equipment integral to the pipeline. The MPTM's request shows as-spent capital on the pipeline of X-4. This figure represents costs incurred for constructing the pipeline. All the cost categories represent MMS-acceptable pipeline capital expenditures.

Expenses

- The CDM allows certain operating expenses in the calculation of a transportation allowance. Section 647.5A.3B states in part:

  "Operating costs are those nondepreciable expenditures required to operate and maintain the pipeline system and shall be limited to the lesser of the following values: actual operating costs or 10 percent of the undepreciated initial or adjusted investment cost as of the beginning of the year for which the operating costs are being computed."

- The MPTM's submittal details the costs MPTM considers to be pertinent to the expense item of the transportation allowance calculation. The MPTM's actual operating costs exceeded 10 percent of the undepreciated initial investment. Therefore, the total MMS-allowable operating expenses used in the calculation of the transportation allowance for MPTM's pipeline was 10 percent of the undepreciated initial investment.

- The transportation allowance costs submitted by MPTM are broken into nine major groups: Operating Labor; Maintenance Labor; Operating Supplies, Utilities and Fuel Purchased; Services Purchased; Maintenance Supplies; Sales and Use Taxes; Other Direct Expenses; Indirect Expenses; and Ad Valorem Taxes. On September 15, 1986, Mr. Charles Shirley, a representative of MPTM was contacted by Ms. Theresa Walsh (RVSD). The operating expenses were discussed in detail and are within the criteria of MMS-allowable costs. The following is a discussion of the expense groups.

- O & M Costs -- The operating and maintenance (O & M) labor are comprised of direct wages paid to employees while engaged in maintaining, operating,

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or repairing the line. The O & M supplies are comprised of capital expenditures for miscellaneous parts associated with repair and maintenance of the pipeline. The category descriptions for O & M costs represent MMS-acceptable pipeline expenses.

- Services Purchased -- Services purchased are comprised of electrical and other energy purchase costs necessary for operation of pumps. These services are within MMS-acceptable operating costs.

- Direct and Indirect Expenses -- The direct expense includes foreman expense, insurance, and taxes on pipeline and equipment, etc. It is MMS's policy to allow actual overhead costs limited to 10 percent of operating costs. The MPTM's indirect expense (overhead) is less than 10 percent of allowable operating costs. Therefore, MPTM's overhead figure is acceptable.

- Ad Valorem Taxes -- Taxes (except income taxes) are allowed by MMS as an expense item. Only those taxes attributable to the pipeline will be allowed. The MPTM's request included a total figure of ad valorem taxes allocated to their pipeline segment.

Interest

- The CDM Section 647.5A.3A states in part:

> "Unless otherwise justified, the prime interest rate in effect at the time of initial allowance approval should be used as the rate of allowable return on the depreciated investment. Once established, the rate will be continuous (fixed) over the life of the pipeline."

It is MMS's policy to use the prime interest rate, as published in the Wall Street Journal, in effect at the beginning of the year for which the initial allowance is granted. This rate then remains fixed for the remainder of the 20-year expected life of the project. The interest rate on January 8, 1985, was 10.75 percent. This rate will be used for calculating the allowable return on the depreciated investment.

Throughput

- The MPTM submittal provided actual throughput for 1985. These figures represent CO_2 transported in MPTM's pipeline from the Allred Station to

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the Denver City delivery station and from the Allred station to the Wellman Unit.

Calculation of MPTM's CO_2 Pipeline Transportation Allowance

- Attachment 1 is the MMS-computed, 20-year depreciation schedule. An investment figure of X-4 a salvage of 10 percent and a prime interest rate of 10.75 percent were used as discussed above.

- Attachment 2 provides a summary of the MMS-allowable costs and the 10 percent overhead calculation.

- In accordance with MMS's practice and policy, the 1985 transportation allowances for MTPM's pipeline are calculated as shown in Attachment 3. The approved allowance rates based on allowable actual costs are $0.048812/Mcf for CO_2 transported to the Denver City delivery station and $0.011049/Mcf transported to the Wellman Unit.

Sheep Mountain Pipeline

- A portion of MPTM's McElmo Dome CO_2 production is transported to the Seminole San Andreas Unit via the Cortez Pipeline, MPTM's pipeline, and the Sheep Mountain Pipeline. The MPTM requested a transportation allowance for CO_2 production transported through the Sheep Mountain Pipeline to the Seminole Andreas Unit.

- X-4 is an X-4 of the southern segment of the Sheep Mountain Pipeline System which begins in New Mexico and extends to the Seminole San Andreas Unit, Gaines County, Texas. The arm's-length "Carbon Dioxide Transportation Agreement" was negotiated between MPTM and X-4 on X-4 to transport MPTM's portion of CO_2 production from the Denver City delivery station, located on the Sheep Mountain Pipeline to the Seminole San Andreas Unit. The MPTM is charged a transportation of X-4 /Mcf of CO_2 measured at the delivery station on the Sheep Mountain Pipeline.

- The CDM, Section 647.5.3C states in part:

  "Generally, if the lessee/operator is transporting production under an arm's-length agreement by the only mode available to him, then these costs may be allowed even though they may be higher than other modes of transportation."

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- The CDM, Section 647.5C.3 states in part:

  "Allowances will be granted to cover transportation costs incurred in moving production through pipelines owned by parties other than the lessee. The allowances will be limited to . . . actual charges to the lessee for transporting production, pursuant to an arm's-length contract."

CONCLUSIONS

The Cortez Pipeline

- The Cortez Pipeline "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by MPTM is acceptable, with the exception that, for royalty purposes, state and Federal income tax are not to be considered in computing transportation costs. Accordingly, state and Federal income tax should be eliminated before transportation costs are computed.

MPTM's Pipeline

- The MPTM's pipeline transportation allowance will be computed annually based on actual allowable costs, consistent with the MMS's established policy. The MPTM should submit actual cost data for each year by April of the following year.

- The pipeline O & M costs (including power necessary to operate the pipeline) represent MMS-accepted operating costs. All compression-related O & M costs, however, will be disallowed.

- Only those ad valorem taxes attributable to the pipeline will be allowed.

- It is MMS's policy to require actual overhead costs (not to exceed 10 percent of the allowable costs) in computing a transportation allowance. The MPTM's overhead costs did not exceed 10 percent of the allowable costs; therefore, the overhead figure is acceptable.

- The allowable return on the depreciated investment will be based on the prime interest rate in effect at the beginning of the year for which the initial allowance is granted. This rate was 10.75 percent on January 8, 1985.

THIS DOCUMENT CONTAINS COMPANY PROPRIETARY INFORMATION FOR RELEASE ONLY TO MOBIL PRODUCING TEXAS & NEW MEXICO INC.

- Attachments 1 and 2 detail all costs allowed by MMS for MPTM's pipeline. Attachment 3 details the calculated 1985 allowance for MPTM's pipeline.

The Sheep Mountain Pipeline

- It is MMS's policy to grant transportation allowances to cover transportation costs incurred in moving production through pipelines not owned by the lessee. Therefore, the transportation cost of $0.035/Mcf charged to MPTM, pursuant to an arm's-length agreement, for transporting CO_2 production through the Sheep Mountain Pipeline is an acceptable transportation allowance.

- Attachment 4 details the MMS-approved transportation allowances for CO_2 transported from the McElmo Dome Unit to the following delivery points; the Denver Unit, the Seminole San Andreas Unit, and the Wellman Unit. The 1985 transportation allowances are broken into pipeline segments to each of the units.

- The CDM, Section 647.5.3E states, "Under no circumstances should transported costs exceed 50 percent of the product's fair market value at the market competitive sales point."

- The 1985 allowances which MPTM may deduct will be the lesser of the approved allowance (the sum of the approved transportation allowances for the pipeline segments to each delivery point) or 50 percent of the value of the CO_2 at the sales point.

United States Department of the Inte

attach 12

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

AUG 6 1986

MMS-84-0013-MISC	:	McElmo Dome (Leadville) Unit, Montezuma and Dolores Counties, Colorado
Shell Western E&P Inc.	:	Transportation Allowance Used to Compute Royalty Values
Appellant	:	Appeal Denied

Shell Western E&P Inc. (SWEPI) filed an appeal pursuant to 30 CFR Part 290 challenging the March 29, 1984, letter from the Minerals Management Service (MMS), Chief, Royalty Valuation and Standards Division, establishing the guidelines to be used to compute the royalty on production from the McElmo Dome Unit in southwestern Colorado.

Facts

By application dated December 9, 1983, SWEPI presented proposals concerning the valuation for royalty purposes of production from the McElmo Dome Unit.

The production from the McElmo Dome Unit is carbon dioxide (CO2). The CO2 is produced in southwestern Colorado, transported via the Cortez Pipeline Company over 500 miles to the Denver Unit in Texas where it is reinjected into oil reservoirs as part of a tertiary oil recovery project. The Appellant and others are the lessees under the oil and gas leases in the McElmo Dome Unit where the CO2 is produced; they own the Cortez Pipeline Company, and they are the lessees in the Denver Unit in Texas employing the tertiary recovery process.

The March 29, 1984, decision of the Chief, Royalty Valuation and Standards Division, approved all components of the tariff proposal presented by SWEPI with the exception of State and Federal income tax. SWEPI disputes in this appeal the fact that Federal and State income taxes were disallowed.

Lessor's Authority to Establish Royalty Value

The Mineral Lands Leasing Act, as amended, 30 U.S.C. § 181 et seq., specifies that the royalty obligation of an oil and gas lease is a function of the "value" of the production from the lease. See 30 U.S.C. § 226. The MMS regulations at 30 CFR §§ 206.103, 206.105, and 206.106 also specify that the "value" of oil and gas production is used to compute the royalty. Therefore, under the applicable statute and regulations, the "value" of the production from an oil and gas lease is used to compute the royalty paid by the lessee to MMS. The statutes, regulations, and other rules dealing with gas also apply to CO2 because CO2 is a gas.

The Mineral Lands Leasing Act in 30 U.S.C. § 189 further provides:

> The Secretary of the Interior is authorized to prescribe necessary and proper rules and regulations and do any and all things necessary to carry out and accomplish the purposes of [the Mineral Lands Leasing Act] * * *.

The regulations published under that law include provisions authorizing the Secretary to establish reasonable values for the purpose of computing royalties. In particular 43 CFR § 3130.3-1(d) provides:

> The Secretary may establish reasonable values for purposes of computing royalty rates on any or all oil, gas, natural gasoline, and other liquid products obtained from gas, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. In appropriate cases, this will be done after notice to the parties and opportunity to be heard.

Also, 30 CFR § 206.103 provides:

> § 206.103 Value basis for computing royalties.
>
> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the [Secretary's delegate] * * *.

The lease documents also specifically reserve for the Secretary the authority to set the value of production for royalty purposes. Section 2(d) of the Federal oil and gas lease provides:

> It is expressly agreed that the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty on any or all oil, gas, natural gasoline, and other products obtained from gas * * *.

Therefore, it is clear under the statute, the applicable regulations, and the lease documents that the Secretary of the Interior has the authority to establish the value of the CO2 on a Federal lease for the purpose of computing the royalty under that lease. Also, it is clear that "The Secretary of the Interior possesses considerable discretion for determining what is the value of production." Amoco Production Co., 78 IBLA 93, 96 (December 19, 1983). See also Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), upheld by 10th Circuit, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 105 S. Ct. 93 (1984). Congress intentionally granted the Secretary this discretion. See Footnote 1 to California Company v. Seaton, 187 F.Supp. 445 (D.D.C. 1960):

> Congress in enacting the 1954 amendment to section 17, while attempting to set rules, recognized the difficulty in trying to set up legislative rules. House Report No. 2238, U.S. Code Cong. & Adm. News, 1954, p. 2696: 'It is recognized that a certain amount of administrative discretion and flexibility are necessary. Oil and gas are found under a great variety of types of terrain and localities. Many different and highly technical factors may be controlling in different cases. Legislative rules and standards which would be fair and equitable in one case might well prevent any operations at all in another. Therefore, the Secretary of Interior must have administrative discretion to deal with particular problems in particular areas as they arise.'

The Secretary's broad authority to compute the royalty value is recognized by the Interior Board of Land Appeals.

> The United States, as lessor of an oil and gas lease, is entitled to its royalty based on "the reasonable value" of the gas as set by the Secretary. Where a party challenges a determination as to the value of gas produced, the party must establish that the methodology used in the Government's computation is, in fact, erroneous.

Amoco Production Co., 78 IBLA 93 (December 19, 1983).

This broad authority vested in the Secretary includes the authority to establish a proper transportation allowance.

> The Secretary of the Interior has discretionary authority to determine the factors to be considered in computing transportation allowances for royalty valuation purposes.

Shell Oil Co., 52 IBLA 15 (January 5, 1981), 88 I.D. 1.

The U.S. Supreme Court has held that the Secretary's interpretation must be respected by the courts if that interpretation is reasonable in spite of the fact that other interpretations may also be reasonable. See Udall v. Tallman, 380 U.S. 1, 16 (1965). See also McLaren v. Fleisher, 256 U.S. 477, 481 (1921); and Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 413-414 (1945).

> When faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration. To sustain the Commission's application of this statutory term, we need not find that its construction is the only reasonable one or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.

Tallman at 16-18. See also Unemployment Compensation Commission of Territory of Alaska et al. v. Aragan, 329 U.S. 143 (1946); Gray v. Powell, 314 U.S. 402 (1941); Universal Battery Co. v. United States, 281 U.S. 580 (1930). In

order for the Appellant to prevail in this appeal, it must establish that the methodology used by MMS and its predecessor agencies for years was in fact erroneous. It is insufficient for Appellant to establish simply that there may be other reasonable values.

Appellant's Argument

The MMS computed the transportation allowance in accordance with its procedures that were reduced to writing 10 years ago. The only aspect of the MMS computation that the Appellant disagrees with is that MMS does not recognize as a valid deduction the State and Federal income tax that a pipeline company claims is attributable to the pipeline, if the pipeline is owned by an entity that is related to the lessee. The Appellant argues that the other producers that are not related to the pipeline entity will be able to deduct the whole pipeline tariff, whereas the Appellant will be able to deduct less than that amount since the portion of the tariff attributable to income taxes of the Appellant will not be recognized as a cost. The Appellant asserts that this disparity in computing the royalty is unfair because it results in a different royalty value assigned to different lessees producing from the same source.

Analysis

Income tax is not recognized by MMS as an expense for purposes of determining a transportation allowance involving a pipeline which is not wholly independent of the lessee/producer. This has been the policy of MMS and its predecessor agencies for 10 years, Conservation Division Manual (CDM 647.5).*

*By Secretarial Order No. 3071, dated January 19, 1982, as amended May 10, 1982, all minerals management functions previously exercised by the Conservation Division, U.S. Geological Survey, were transferred to the Department's Minerals Management Service. By Secretarial Order No. 3087, dated December 3, 1982, as amended February 7, 1983, the onshore, nonroyalty management functions of the Minerals Management Service were transferred to the Department's Bureau of Land Management.

This policy is premised on the impossibility of accurately allocating the correct tax burden to the pipeline, as well as the other activities of the pipeline/producer. An inflated pipeline tariff in those circumstances would benefit the lessee in providing for a greater reduction from royalty (and thereby depriving the lessor of its full royalty entitlement). The MMS adopted the policy of limiting the transportation allowance to actual costs exclusive of income tax. The MMS policy is a reasonable measure intended to eliminate the potential for abuse that could result from expense manipulation between pipelines and production facilities not wholly independent of each other.

Even though the Appellant could arguably devise an alternative procedure that may be reasonable, that does not sustain the Appellant's burden. The lessor is empowered under the statute, regulations, and the lease contracts to unilaterally establish a reasonable royalty value. The policy established by the lessor has been in place and applied uniformly for 10 years. The policy is intended to preclude abuse and overcome audit burdens that would be imposed under other policies. The policy and the results derived therefrom are not erroneous.

Conclusion

The MMS ordered the Appellant to pay additional royalties based upon a methodology that has been required by MMS and its predecessor agencies for over a decade. The courts have repeatedly upheld the lessor's right to compute the royalty value as provided in the controlling statutes, regulations, and lease contracts. The Appellant has not shown the MMS policy to be erroneous. Therefore, the MMS order is affirmed and the appeal is denied.

The Appellant may appeal this decision to the Interior Board of Land Appeals pursuant to 30 CFR Part 290 and 43 CFR §§ 4.411 and 4.413. Copies of 43 CFR §§ 4.411 and 4.413 are enclosed for reference.

Wm D Bettenberg
Director

Enclosures

Attachment B

A-4362

CARBON DIOXIDE SALE AND PURCHASE CONTRACT

X-4

WASSON (SAN ANDRES) FIELD

GAINES AND YOAKUM COUNTIES, TEXAS

ARTICLE	TITLE	PAGE
I	DEFINITIONS	1
II	SCOPE OF CONTRACT	4
III	QUANTITIES	8
IV	PRICES, TAXES AND EXCESS ROYALTIES	11
V	DELIVERY POINT AND PRESSURES	15
VI	MEASUREMENT	16
VII	MEASURING EQUIPMENT AND TESTING	17
VIII	QUALITY	19
IX	ACCOUNTING	21
X	FORCE MAJEURE	22
XI	NOTICES	25
XII	SUCCESSORS AND ASSIGNS	25
XIII	TERM	26
XIV	GOVERNMENTAL REGULATION	27
XV	MISCELLANEOUS	27

Attachment E

EXHIBIT "B"

Carbon Dioxide Sale

and

Purchase Contract

dated

July 1, 1986

between

X-4

Attachment B

Where:

P = Applicable price ($/Mcf)

4.2 Cortez Line Tariff Reimbursement. In addition to the payments from Buyer to Seller pursuant to Sections 4.1, 4.3, 4.4 and 4.5, Buyer agrees to reimburse Seller for a transportation charge F.O.B.

Attachment B

Denver City, Texas, equal to the lesser of (1) the applicable, actual tariff of the Cortez Operator in effect from time to time or (2) the maximum transportation charge as set out below:

YEAR	MAXIMUM TRANSPORTATION CHARGE $/MCF
1986	
1987	
1988	X-4
1989	

On January 1, 1990 and on the first day of each subsequent year, this maximum transportation charge shall be increased over the then existing charge by X-4 per Mcf.

The Cortez Line tariff shall be the applicable tariff as charged by the Cortez Operator. Seller shall furnish to Buyer from time to time a copy of the current tariff applicable to the operation of the Cortez Line.

4.3 Tax Liability. Seller shall pay or cause to be paid all taxes and assessments imposed on Seller with respect to the Carbon Dioxide delivered hereunder prior to its delivery to Buyer, and Buyer shall pay or cause to be paid all taxes and assessments imposed on Buyer with respect to the Carbon Dioxide delivered hereunder after its receipt by Buyer. Neither party shall be responsible or liable for any taxes or other statutory charges levied or assessed on or against any of the facilities of the other party which are used for the purpose of carrying out the provisions of this Contract.

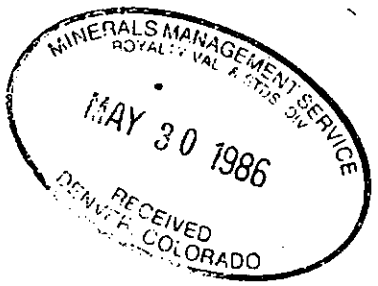
4.4 Tax Reimbursement. Subject to the conditions hereinafter set forth, Buyer shall pay to Seller 50 percent of any additional tax

Mobil Producing Texas & New Mexico Inc.

Attach 11

May 29, 1986

United States Department
of the Interior
Minerals Management Service
Mail Stop 653
P.O. Box 25165
Denver, Colorado 80225



Attn: William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

1.96 McElmo Dome Unit
Request for CO_2
Transportation Allowance
MMS-RVS-OG: 85-0889

Gentlemen:

In response to your letter dated May 7, 1986, enclosed are Mobil Producing Texas & New Mexico Inc.'s (MPTM) transportation costs from the Cortez Pipeline operated Allred Station to the Wellman Unit and Sheep Mountain Pipeline Denver City Delivery Station via MPTM's Wasson Facility. Also attached are copies of the CO_2 purchase contracts for the Denver, Seminole San Andres and Wellman Units.

We have been informed by personnel for Cortez Pipeline that they do not maintain transportation data in the form you have requested and we have therefore, been unable to collect and forward the data in that format.

However, the basis for deriving MPTM's transportation costs can be readily explained. Specifically, Cortez's posted tariff is established in accordance with historic methodology used in establishing oil pipeline tariffs. Accordingly, MPTM's transportation costs consist of the posted tariff as established under such methodology. A copy of the Cortez Pipeline transportation tariff is enclosed for your review.

We trust the foregoing information together with the attachments hereto are responsive to your request and will be sufficient for securing approval of the transportation allowance. However, if you require the information in the specific format requested in your letter we request an extension of time since (i) the data is unavailable from Cortez in that form and (ii) we would appreciate the opportunity to further discuss the matter with you since it is unclear to us why the transportation charges actually paid under the posted Cortez tariff would not constitute an adequate basis for determining the transportation allowance. Please let us know if you have any questions.

Very truly yours,

Hector Casas
Gas Accounting Supervisor

CAS

Enclosure

MOBIL PRODUCING TEXAS & NEW MEXICO INC.
WASSON CO2 DELIVERY STATION
1985 OPERATING COSTS

Operating Labor	$ 15,900.70
Maintenance Labor	5,075.66
Operating Supplies, Utilities & Fuel Purchased	74,250.01
Services Purchased	24,837.92
Maintenance Supplies	4,406.64
Sales and Use Taxes	2,560.09
Other Direct Expense	31,109.45
Indirect Expense	1,801.08
	$ 159,941.55
Ad valorem tax	211,020.62
Depreciation	X-4
Total Expense	$ 4

Cost Applied To Seminole San Andres Unit 80% (Pumped)	Cost Applied To Wellman & Mahoney Units 20% (Free Flow)
X-4	X-4

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-OG:85-0889

MAY 7 1986

CERTIFIED MAIL -
RETURN RECEIPT REQUESTED

Mobil Producing Texas & New Mexico Inc.
Attention: Mr. Hector Casas
Nine Greenway Plaza, Suite 2700
Houston, Texas 77046

Gentlemen:

By letter dated October 28, 1985, you requested approval of transportation allowances for CO_2 production in Yoakum and Gaines Counties, Texas. Pursuant to a telephone conversation between Ms. Theresa Walsh, of this office, and Mr. Charles Shirley, of your office, on February 26, 1986, additional information is required before any determinations can be made by the Minerals Management Service (MMS).

The policy and procedures of MMS require that a computation of the unit value of CO_2, for royalty purposes, at the McElmo Dome Unit be accomplished by (1) establishing the fair market value of the CO_2 at the Denver Unit, the Seminole-San Andres Unit, and the Wellman Unit, (2) deducting, therefrom, the cost of transporting the gas from the McElmo Dome Unit to the Denver Unit, the Seminole-San Andres Unit, and the Wellman Unit, and (3) adding, thereto, any other reimbursements that may be received as "gross proceeds" by Mobil as a Federal lessee. This "netback method" is a procedure for valuing oil or gas at the lease or unit when the first arm's-length sale has taken place downstream. The procedure defines value of the lease product by using the proceeds received at the point of sale and considering the costs involved in transporting the lease product to the point of sale.

The following information will be required before MMS can consider your request:

1) The costs involved in transporting CO_2 from the Allred Station to a delivery point on the Sheep Mountain Pipeline;

2) The costs involved in transporting CO_2 from the Allred Station to the Wellman Unit; and

3) Copies of contracts covering the sales of CO_2 at the Denver Unit, the Seminole-San Andres Unit, and the Wellman Unit.

The following pipeline transportation cost data should be included in conjunction with the netback calculation of CO_2 value for royalty purposes:

1. Capital Costs of Pipeline and Associated Equipment

   Include a list of major capital expenditures by category--item description, date of purchases, original cost, salvage value, depreciable life, and depreciation method; a schematic diagram of the pipeline (Colorado to Texas) depicting pipeline sizes, ownership, meter points, sales points, branches, purchasing units, and mileage.

2. Pipeline Operating and Maintenance Costs

   Include a description of individual categories of operating expenses, costs by category, and the methods of derivation, where applicable, by category (e.g., labor costs for pipeline operation, fuel, utilities, materials, rent, supplies, maintenance parts, maintenance labor, etc.).

3. Overhead Costs

   Include a breakdown by major cost category. According to current onshore MMS policy, overhead cannot exceed 10 percent of direct operating and maintenance costs.

4. Ad Valorem Taxes

   Include a breakdown of ad valorem taxes.

5. Rate of Return on Undepreciated Capital Investment

   Include an explanation of the source of the interest rate you propose to use and the costs to which it is applied.

If production is injected at more than one point along the pipeline, the needed information on capital costs should be broken down by pipeline segment. Also, please include information on monthly pipeline throughput (by segments, if appropriate). If additional guidance is required to determine pipeline transportation cost data, please refer to the Conservation Division Manual, U.S. Geological Survey (a procedural guide used by the predecessor to MMS), Section 647.5A.1, copy enclosed.

Please submit the requested data by June 1, 1986. If you are unable to meet this requirement, you must submit a request with sufficient justification to obtain an MMS-approved time extension. Otherwise, we will close out our files and cease consideration of your transportation allowance request.

If there are any questions, please call (303) 231-3395.

Sincerely,

William H. Feldmiller

William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

Enclosure

Cortez Pipeline Company

P.O. Box 2648
Houston, Texas 77001

January 14, 1986

Mobil Cortez Pipeline Inc.
ATTN Mr. E. M. Gott
c/o Mobil Producing Texas
& New Mexico Inc.
Nine Greenway Plaza
Suite 2700
Houston, TX 77046

Gentlemen:

SUBJECT: TARIFF LETTER

This will certify that Cortez Pipeline Company CO_2 Letter Tariff No. 1 (copy attached) was effective April 15, 1984, and remains in effect as of this date.

Very truly yours,

R. M. Armstrong
Chairman, Partnership Committee

Attachment

PROPRIETARY INFORMATION

RECEIVED
JAN 20 1986
E. M. Gott
Manager
CO-2 Project

BPN08601401

CORTEZ PIPELINE COMPANY
P. O. Box 2648
Houston, Texas 77252

TO ALL CONCERNED:

Effective April 15, 1984, the trunk line tariff rate on movement of CO_2 will be as follows:

FROM	TO	RATE (¢/MSCF)
McElmo Dome Field, Montezuma County, Colorado	Allred Station and Denver City Meter Station, Yoakum County, Texas	39

The Rules and Regulations governing the movement of CO_2 are as follows:

ITEM 1 - *Definitions*

"Carrier" as herein used means Cortez Pipeline Company.

"Shipper" as herein used means the party or parties who contract with Carrier for receipt and delivery under the terms of this letter tariff.

"CO_2" as herein used means a stream of CO_2 meeting specifications issued by Carrier.

"MSCF" as herein used means Thousand Standard Cubic Feet.

"Reception Point" as herein used means a mutually-acceptable location at each point described in any applicable letter tariff at which Carrier agrees to receive CO_2 from Shipper.

"Delivery Point" as herein used means the point at which CO_2 is delivered to Shipper.

ITEM 2 - *Quality*

No CO_2 will be accepted for injection into the system unless its kind and quality are the same as that being received by Carrier and the delivery of such CO_2 will not result in any damages to the quality or characteristics of other deliveries. All CO_2 accepted shall be delivered to Carrier's reception point and shall meet all specifications required by Carrier.

Carrier shall be under no obligation to deliver the identical CO_2 received but may make delivery out of Carrier's pipeline stream of substantially like CO_2.

Shipper shall be responsible for maintaining the quality of CO_2 and shall perform applicable tests to insure that the product delivered conforms to Carrier's specifications. Should the analyses indicate that the product delivered does not meet the specifications required by Carrier, Shipper agrees, either voluntarily or upon notification of Carrier, to stop delivery of such off-specification product to Carrier until such time as it is determined by additional testing that the product meets the specifications for CO_2 issued by Carrier.

Shipper shall indemnify and hold Carrier harmless from any loss sustained by other Shippers or by Carrier by reason of contamination or damage to CO_2 in Carrier's custody, or by reason of damage to Carrier's pipeline or associated facilities caused by failure of the materials accepted for delivery to be CO_2 as prescribed by specifications issued by Carrier.

ITEM 3 - *Receipts and Delivery Specifications*

CO_2 shall be received by Carrier at pressures, pumping rates, and temperatures in accordance with operating conditions at the time of receipt. CO_2 shall be delivered to Shipper at pressures, pumping rates, and temperatures in accordance with operating conditions at the time of delivery. CO_2 will be accepted for delivery only when Shipper has provided the necessary facilities required to receive such CO_2 at delivery point.

ITEM 4 - *Gauging, Testing, and Volume Corrections*

CO_2 received by Carrier for delivery may be tested by Carrier prior to its receipt from Shipper. Quantities shall be measured by meter in MSCF at 14.65 psiA and 60° Fahrenheit.

Carrier shall account to each Shipper for all CO_2 received. Any overages or shortages not due to the negligence of Carrier (see Item 9 of this letter tariff) will be allocated on a monthly accrual basis among Shippers in the proportion that the total quantity delivered from the line for each Shipper bears to the total quantity delivered from the line for all Shippers.

ITEM 5 - *Apportionment When Tenders Are in Excess of Facilities*

When there shall be tendered to the Carrier for delivery more CO_2 than can be currently delivered, the service furnished by Carrier shall be apportioned among all Shippers in proportion to the amounts tendered by each; provided, that in making such apportionment, no tender for delivery shall be considered beyond the amount which the party requesting the delivery will have available during the current month.

ITEM 6 - *Application of Rates and Charges*

CO_2 accepted for delivery shall be subject to the rates and charges in effect on the date of receipt of such CO_2 by Carrier. Delivery charges and all other lawful charges will be collected on the basis of total MSCF of CO_2 delivered.

ITEM 7 - *Payment for Delivery and Other Charges*

Shipper shall pay the delivery and all other lawful charges accruing on CO_2 which has been received and, if required, shall pay the same before delivery. CO_2 accepted for delivery shall be subject to a first lien for all such charges.

ITEM 8 - *Liens and Unpaid Charges*

When any CO_2 tendered for delivery hereunder is involved in litigation, or the ownership of which may be in dispute, or which may be encumbered by lien or charge of any kind, Carrier may require of Shippers an indemnity bond to protect it against all loss.

ITEM 9 - *Liability of Carrier*

Carrier, while in possession of any of the CO_2 herein described, shall not be liable for any loss thereof, damage thereto, or delay except to the extent that liability therefor is imposed on Carrier by law. In case of loss of CO_2 for which Carrier is not responsible, Shipper shall bear the loss. All such CO_2 losses shall be accounted for as provided in Item 4 of this letter tariff.

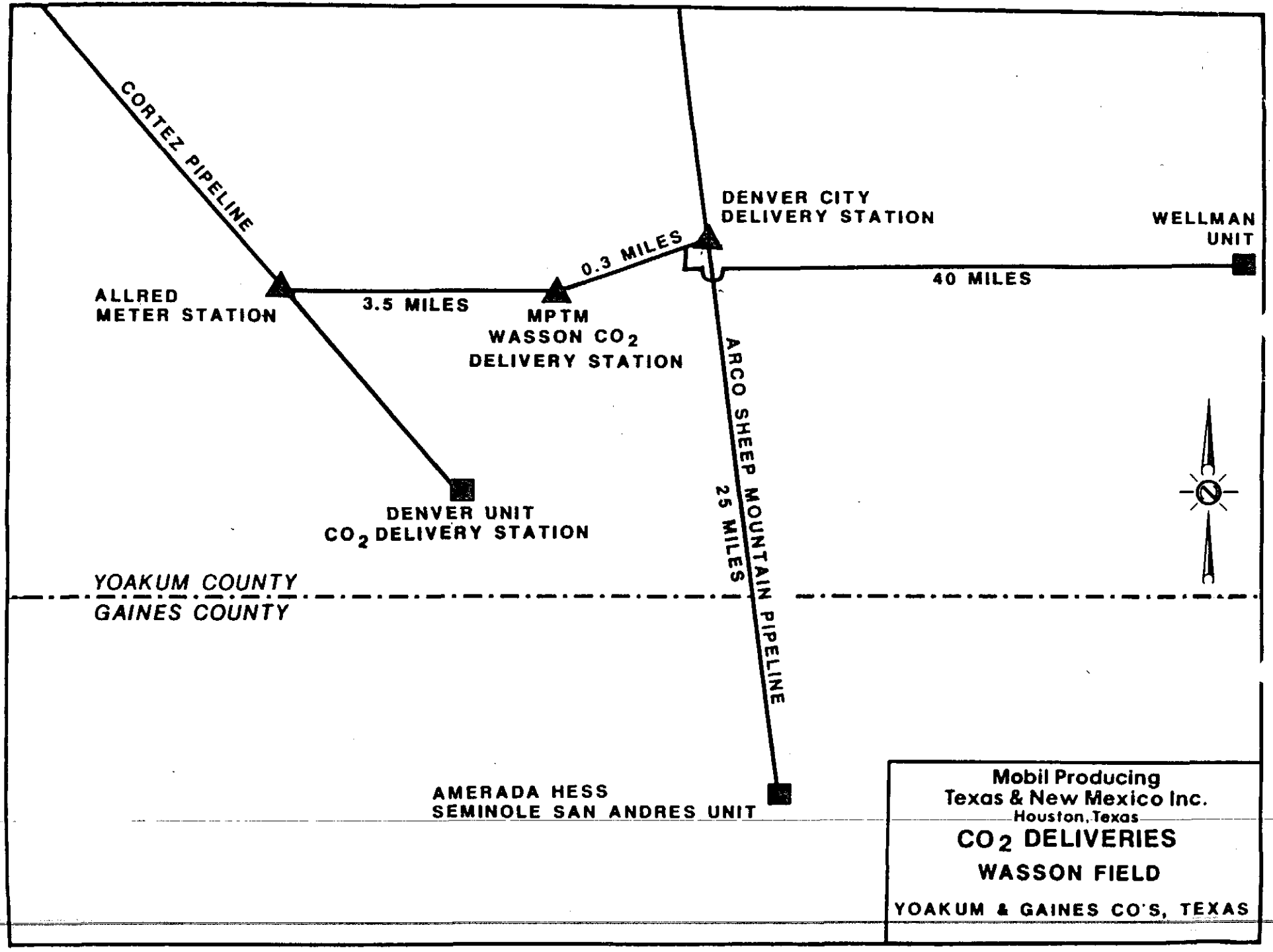
ITEM 10 - *Claims, Suits, and Time for Filing*

As a condition precedent to recovery for loss, damage, or delay in deliveries, claims must be filed in writing with Carrier within nine (9) months after delivery of the CO_2, or, in case of failure to make delivery, then within nine (9) months after a reasonable time for delivery has elapsed; and suits arising out of such claims shall be instituted against Carrier only within two (2) years from the time when Carrier delivers, or tenders delivery of, the CO_2, or, in case of failure to make or tender delivery, then within two (2) years after a reasonable time for delivery has elapsed. Where claims are not filed or suits are not instituted thereon in accordance with the foregoing provisions, Carrier will not be liable and such claims will not be paid.

ITEM 11 - *Applicable Laws, Rules, and Regulations*

Shippers will be required to comply with all applicable laws, rules, and regulations as may be imposed by governmental authorities regarding shipment of CO_2.

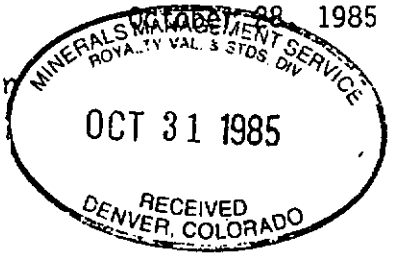
R. M. Armstrong, Chairman
Partnership Committee


CORTEZ PIPELINE
ALLRED
METER STATION
3.5 MILES
MPTM
WASSON CO_2
DELIVERY STATION
0.3 MILES
DENVER CITY
DELIVERY STATION
WELLMAN
UNIT
40 MILES
ARCO SHEEP MOUNTAIN PIPELINE
25 MILES
DENVER UNIT
CO_2 DELIVERY STATION
YOAKUM COUNTY
GAINES COUNTY
AMERADA HESS
SEMINOLE SAN ANDRES UNIT
Mobil Producing
Texas & New Mexico Inc.
Houston, Texas
CO_2 DELIVERIES
WASSON FIELD
YOAKUM & GAINES CO'S, TEXAS

Mobil Producing Texas & New Mexico Inc.

OCTOBER 28, 1985

NINE GREENWAY PLAZA-SUITE 2700
HOUSTON, TEXAS 77046



United States Department of Interior
Mineral Management Services
P. O. Box 36165, Mail Stop 653
Lakewood, Colorado 80225

Attn: Mr. William H. Feldmiller

1.96.01 REQUEST FOR APPROVAL
OF JANUARY 1, 1984-JULY 31, 1985
TRANSPORTATION ALLOWANCE FOR
CO2 PRODUCTION IN YOAKUM AND
GAINES COUNTY, TEXAS

Dear Mr. Feldmiller:

Based on the attached tariff document issued by our carrier Cortez Pipeline Company, Mobil Producing TX. & N.M. Inc. (MPTM) requests approval of a transportation allowance for CO2 produced and transported from the McElmo Dome field to the Denver Unit in Yoakum and Gaines Counties, Texas. This tariff also covers CO2 transported from the Allred Station to the Seminole-San Andres Unit in Gaines County, Texas. Our cost of transportation as working interest owner is represented by the attached tariff document.

Also, MPTM requests approval of the Wasson Facility handling charge for CO2 transported from the Allred Station to the Wellman Unit and from the Allred Station to a delivery point on the Sheep Mountain Pipeline. A cost study of this handling cost will be made upon completion of the initial calendar year of operation, which will be December, 1985. Pending this cost study, approval of an estimated handling cost of X-4/MCF is requested. Additionally, approval is requested for the Sheep Mountain Pipeline transportation charge for CO2 transported from the Sheep Mountain pipeline to the Seminole-San Andres Unit. Our cost of transportation through the portion of the Sheep Mountain Pipeline is X-4 /MCF and is supported by the attached Carbon Dioxide Transportation Agreement between X-4 and MPTM.

Please call Karen Martin at 713-871-5894 if you have questions or need additional information.

Very truly yours,

L. R. Amsberry
Oil & Gas Accounting Manager

KLMartin:mrj
Attachment
B/9

cc: John De Luca - DAC

Shell Western E&P Inc
Attn: M. L. Blanton
P. O. Box 991
Houston, Texas 77001

CORTEZ PIPELINE COMPANY
P. O. Box 2648
Houston, Texas 77252

TO ALL CONCERNED:

Effective April 15, 1984, the trunk line tariff rate on movement of CO_2 will be as follows:

FROM	TO	RATE (¢/MSCF)
McElmo Dome Field, Montezuma County, Colorado	Allred Station and Denver City Meter) Station, Yoakum County, Texas	39

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R. M. Armstrong, Chairman
Partnership Committee

CARBON DIOXIDE

TRANSPORTATION AGREEMENT

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EXHIBIT:

EXHIBIT A

CARBON DIOXIDE

TRANSPORTATION AGREEMENT

This Agreement made and entered into this ——— X-4 ——— X-4 by and between MOBIL PRODUCING TEXAS & NEW MEXICO INC., a corporation (hereinafter referred to as "MPTM"), and ——— X-4 ——— a corporation (hereinafter referred to as X-4).

W I T N E S S E T H:

WHEREAS, X-4 is an undivided owner of thirty percent (30%) of the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System which begins in the State of New Mexico in the vicinity of Section 31, Township 19 North, Range 32 East, N.M.P.M., and extends in a southerly direction to the vicinity of the Seminole-San Andres Unit, Gaines County, Texas; and

WHEREAS, MPTM is a working interest owner in the ——— X-4 ——— X-4 located in ——— X-4 ——— such Unit constituting an enhanced oil recovery project associated with the use of carbon dioxide for increased hydrocarbon recovery; and

WHEREAS, X-4 in its capacity as Operator of the Seminole-San Andres Unit, and MPTM, in its capacity as a working interest owner in said Unit, have entered into a Carbon Dioxide In-Kind Delivery Contract dated ——— X-4 ———, wherein MPTM has agreed to deliver its unit participation share of the estimated cumulative volumes of carbon dioxide required for use in the enhanced oil recovery project; and

WHEREAS, MPTM desires that X-1 accept delivery of carbon dioxide into the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System for MPTM's account and redeliver equivalent quantities of carbon dioxide to MPTM as hereinafter set forth, and X-4 agrees to perform such service for MPTM as hereinafter set forth.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements herein contained, the parties hereto covenant and agree as follows:

I.

DEFINITIONS

1.1 The word "day" means a period beginning at 7:00 a.m. (local time) on a calendar day and ending at 7:00 a.m. (local time) on the next succeeding calendar day. The date of a day shall be that of its beginning.

1.2 The word "month" means a period beginning at 7:00 a.m. (local time) on the first day of a calendar month and ending at 7:00 a.m. (local time) on the first day of the next succeeding calendar month.

1.3 The term "carbon dioxide" means a substance primarily composed of molecules containing one (1) atom of carbon and two (2) atoms of oxygen.

1.4 The term "cubic foot" is the amount of carbon dioxide which would occupy one (1) cubic foot of space at a base pressure of 14.65 psia and at a base temperature of sixty degrees (60°) Fahrenheit.

1.5 "Mcf" means one thousand (1,000) cubic feet of carbon dioxide.

1.6 The term "psia" means pounds per square inch absolute.

1.7 The term "psig" means pounds per square inch gauge.

1.8 The term "Project" means the Seminole-San Andres Unit enhanced oil recovery project which includes all unit operations associated with use of carbon dioxide for increased hydrocarbon recovery.

1.9 "Source Field" means that area(s) from which MPTM shall obtain carbon dioxide to satisfy its unit participation share of the estimated cumulative volumes of carbon dioxide required for use in the Project.

1.10 "Carbon Dioxide Pipeline System" means the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System which begins in the State of New Mexico in the vicinity of Section 31, Township 19 North, Range 32 East, N.M.P.M., and extending for approximately Two Hundred Twenty Four (224) miles in a southerly direction to the vicinity of the Seminole-San Andres Unit, Gaines County, Texas; and to X-4 undivided — X-4 ——— X-4 ———

1.11 The term "capacity" means, and is limited to,

X-4

1.12 "Working Interest Owners" mean the signatories to that certain Unit Operating Agreement for the Seminole-San Andres Unit dated March 1, 1969, and amended effective November 1, 1970, and as it may be hereafter amended, and their heirs, successors and assigns.

1.13 "Maximum Daily Quantity" means MPTM's daily share of carbon dioxide volumes required to satisfy its share of cumulative volumes of carbon dioxide utilized on a daily basis by the Project.

II.

SCOPE OF AGREEMENT

2.1 X-4 and MPTM agree that this Agreement is being entered into for the sole purpose of providing transportation for MPTM's share of cumulative volumes of carbon dioxide projected to be utilized in the Project pursuant to that certain Carbon Dioxide In-Kind Delivery Contract dated —— X-4 —— by and between X-4 in its capacity a: X-4

X-4

It is recognized that the Carbon Dioxide Pipeline System is a private pipeline owned and operated for the purpose of transporting carbon dioxide to selected delivery points where such commodity may be utilized for unit operations associated with the use of carbon dioxide for increased hydrocarbon recovery, and that X-4 willingness to enter into this Agreement is predicated upon MPTM's working interest participation in the Project, and its desire to supply its own carbon dioxide requirements for such Project. Therefore, MPTM acknowledges that due to the desire and intent of —— X-4 —— to retain a private carrier status as to the Carbon Dioxide Pipeline System, its request for transportation of carbon dioxide has been granted with the understanding that MPTM shall not during the entire term of this Agreement divert any portion of the carbon dioxide delivered for transportation by X-4, nor shall it cause the carbon dioxide to be utilized for any purpose other than to fulfill its commitment under the Carbon Dioxide In-Kind Delivery Contract referred to above.

In addition to the restrictions imposed above, MPTM agrees that this Agreement is expressly limited to a portion of the X-4 X-4 in the Carbon Dioxide Pipeline System, and that MPTM's rights hereunder are personal contract rights with X-4 not applicable nor enforceable against any other X-4 in the Carbon Dioxide Pipeline System or to the capacity which they retain separately by virtue of such X-4 Therefore, this Agreement shall involve the delivery and redelivery of carbon dioxide within and by virtue of X-4 separate X-4 of capacity within the Carbon Dioxide Pipeline System, and not otherwise.

III.

QUANTITY

3.1 Quantity: Subject to the terms and limitations hereof, MPTM will deliver or cause to be delivered to X-4 and X-4 will accept for transportation and transport hereunder a quantity of carbon dioxide up to Maximum Daily Quantity requirements pursuant to the terms and provisions of that certain Carbon Dioxide In-Kind Delivery Contract referred to in Article II. It is projected that MPTM's own pipeline facilities from its Source Field to the Carbon Dioxide Pipeline System will be completed on or about April 1, 1984, thus enabling it to make the in-kind carbon dioxide deliveries to X-4 pursuant to this Agreement. Based upon present estimates of X-4 of deliveries, MTPM's cumulative in-kind carbon dioxide requirements will be approximately 73,328,500 Mcf; with a peak delivery of approximately 28,600 Mcf per day. Therefore, this Agreement

is being entered into to facilitate MPTM's in-kind carbon dioxide requirements for the Project, and X-4 will accept, transport and redeliver such quantities of carbon dioxide as may be required to satisfy such requirements subject to the terms and conditions above and hereinafter set forth.

3.2 Adjustment of Deliveries for Transportation: X-4 will notify MPTM monthly, ten (10) days in advance, of its Maximum Daily Quantities required to meet MPTM's share of Project needs for carbon dioxide for the next succeeding month. Such notice shall be given by X-4 in its capacity as ——— X-4 ——— and X-4 and MPTM agree to fully cooperate with one another in adjusting monthly and daily deliveries hereunder. X-4 will give twenty-four (24) hours prior telephone or telecopier notice of such additional changes in Project requirements as may be necessary to balance deliveries to the Project with actual Project requirements. Upon receipt of such notice, given to MPTM at the location and number set forth below, MPTM shall undertake whatever measures are required to conform its deliveries to X-4 revised requirements and shall notify X-4 at the location numbers set forth below as soon as practicable if it is unable to adjust deliveries to the quantities requested:

Mobil Producing Texas & New Mexico Inc.
P. O. Box 66
Denver City, Texas 79323
Attention: George Hughes

Telephone: (806) 592-2234

In the event of an emergency which poses danger to life or property, no prior notice shall be necessary before partial or total shutdown by either party, but notice of such shutdown, and the reason therefor shall be given as soon as practicable thereafter to MPTM as set

out above, and to X-4 by telephone or telecopier at the location and number set out below:

X-4

In the event a shutdown becomes necessary for either party on a non-emergency basis, such party will give at least twenty-four (24) hours prior notice to the other.

IV.

POINT OF DELIVERY AND POINT OF REDELIVERY

4.1 Point of Delivery: The Point of Delivery for all carbon dioxide delivered to X-4 for transportation hereunder shall be the Northeast Quarter of the Southeast Quarter of the Northeast Quarter (NE/4 SE/4 NE/4), Section 764, ——— X-4 ———

4.2 Point of Redelivery: Carbon dioxide redelivered hereunder by X-4 shall be redelivered for MPTM's account at the outlet side of X-4 meter at a mutually agreed to point of connection with X-4 facilities in the ——— X-4 ———

V.

DELIVERY PRESSURE

5.1 Point of Delivery: All carbon dioxide delivered by or for the account of MPTM to X-4 hereunder shall be delivered at pressures sufficient

to enter the Carbon Dioxide Pipeline System against working pressures maintained therein from time to time, not to exceed 2,500 psig.

5.2 Point of Redelivery: All carbon dioxide redelivered by X-4 to MPTM or for its account shall be delivered at pressures sufficient to enter the Project facilities located near ——— X-4 ———

5.3 Compression: In the event compression of the carbon dioxide becomes necessary to effectuate the pressures required at the Point of Delivery, MPTM shall install, operate and maintain such compression facilities as may be required, and it shall be solely responsible for any costs or expenses related to such compression facilities for the entire term of this Agreement.

VI.

QUALITY SPECIFICATIONS

6.1 Quality Specifications: The carbon dioxide delivered to X-4 by MPTM for transportation through the Carbon Dioxide Pipeline System shall contain not less than ninety six percent (96%) carbon dioxide and shall meet the following specifications, which herein are collectively called "Quality Specifications":

(a) Water. The carbon dioxide shall not contain any free water nor more than twelve (12) pounds of water vapor per 1,000 Mcf.

(b) Hydrogen Sulphide and Sulphur. The carbon dioxide shall not contain more than ten parts per million by weight of hydrogen sulphide nor more than ten (10) parts per million of total sulphur.

(c) Oxygen. The carbon dioxide shall not contain more than ten (10) parts per million by weight of oxygen.

6.2 Testing: MPTM shall perform or cause to have performed chromatography tests to determine on a monthly basis the quality of carbon dioxide at or near the Delivery Point. MPTM shall promptly furnish X-4 with copies of all test results. MPTM shall insure that X-4 is given reasonable notice of all such tests in order that X-4 may have its representative present, if X-4 so desires. Also, MPTM agrees that representatives of Atlantic Richfield Company, as Operator of the Carbon Dioxide Pipeline System, shall likewise be entitled to copies of tests and the right to view all testing procedures. X-4 will submit copies of test results to Atlantic Richfield Company and keep it informed as to dates upon which testing is to occur.

6.3 Failure to Meet: If any carbon dioxide fails to meet the Quality Specifications required at the Delivery Point, X-4 shall have the right to waive such failure and to continue to receive such carbon dioxide. If X-4 elects not to accept such carbon dioxide, then, within thirty (30) days of notice of X-4 election as aforesaid, MPTM shall notify X-4 whether it will treat the carbon dioxide to meet the Quality Specifications. If MPTM declines to undertake such treatment, then the parties may terminate this Agreement by thirty (30) days' prior written notice to the other, and on the effective date of termination all rights and obligations of X-4 and MPTM hereunder shall cease.

VII.

MEASUREMENT AND COMPUTATION OF VOLUMES

7.1 Measuring Stations: A metering station shall be installed at the Delivery Point. The metering station shall consist of a turbine type meter(s), on-line thermometer(s), densi meter(s) and other auxilliary devices for mass measurement. The measuring station so installed shall be constructed in accordance with the specifications prescribed by the American Petroleum Institute, "Manual of Petroleum Measurement Standards" dated July, 1976, as amended. Due to the fact that the carbon dioxide Pipeline System is operated by the Atlantic Richfield Company, MPTM agrees that it shall coordinate the physical installation and site location of the measuring station with Atlantic Richfield Company; and that actual installation shall be performed by Atlantic Richfield Company. MPTM shall bear all costs and expenses incurred in the installation or modification of the metering station. The measuring station shall be accessible at all reasonable times to inspection and examination by X-4 MPTM and Atlantic Richfield Company, but the reading, calibration, adjustment and operation of the Carbon Dioxide Pipeline System measuring equipment shall be performed and supervised by Atlantic Richfield Company.

In addition to the Delivery Point measuring station, MPTM acknowledges and agrees that transported volumes of carbon dioxide for MPTM's account will be measured at the Redelivery Point through a measuring station installed, operated and supervised by Atlantic Richfield Company, in its capacity as Operator of the Carbon Dioxide Pipeline System. This measuring station has been installed to measure and account for all volumes

of carbon dioxide purchased by the Unit for utilization in the Project and also for measurement of volumes of carbon dioxide delivered in-kind by Working Interest Owners. The Redelivery measuring station shall be accessible at all reasonable times to inspection and examination by MPTM, but the reading, calibration and adjustment of the Redelivery measuring station shall be performed and supervised by Atlantic Richfield Company, in its capacity as Operator of the Carbon Dioxide Pipeline System. MPTM agrees that it shall be responsible for its initial allocated share of all costs and expenses associated with the installation of the Redelivery measuring station.

7.2 Metering Calibration: All measuring equipment shall be calibrated by the parties responsible pursuant to Paragraph 7.1, at least once each month at the expense of the parties as previously set forth. X-1 shall give MPTM notice of each such calibration test (notice by Atlantic Richfield Company as to Delivery Point calibration shall be deemed sufficient) in sufficient time to enable MPTM, if it so chooses, to have its representative present. X-1 further agrees to furnish MPTM with copies of all calibration results.

7.3 Meter Repair and Adjustments: If upon any such calibration the measuring equipment is found to be within 0.50% accurate, such equipment shall be considered correct in computing deliveries and redeliveries. If upon any calibration the measuring equipment shall be found to be inaccurate by an amount exceeding 0.50% error, proper repairs and adjustments shall be made immediately, and any previous reading of such equipment shall be corrected to zero error for any period which is known definitely

or agreed upon, but in case the period is not known definitely or agreed upon, then for one-half (1/2) of the period of time elapsed since the date of the last calibration.

7.4 Measuring Equipment out of Service: If for any reason any measuring equipment is out of service or needs repair so that the volume of carbon dioxide delivered or redelivered cannot be ascertained or computed from the reading thereof, the volume of carbon dioxide delivered or redelivered during the period such equipment is out of service or out of repair shall be estimated on the basis of the best data available, using the first of the following methods which is feasible: (i) by using the registration of check equipment, if installed and accurately registering; (ii) by correcting the error in the equipment, if the percentage of error is ascertainable by calibration test or mathematical calculations; or (iii) by estimating the volume of delivery, using as a basis the volumes delivered during preceding periods under similar conditions when the equipment was registering accurately.

7.5 Check Measuring Equipment: In the event MPTM desires to install, maintain, and operate check measuring equipment at the Redelivery Point, MPTM agrees that it shall first obtain the consent of X-4 and, if necessary, that of Atlantic Richfield Company. If the required consent is obtained, MPTM agrees to install, maintain and operate such check measuring equipment in a manner as to not interfere with the operation of existing measuring meters or other operations.

7.6 Volume Determination: The volume of carbon dioxide discharged from the Carbon Dioxide Pipeline System at the Delivery and Redelivery Points shall be determined as follows:

(a) The unit of measurement shall be the amount of carbon dioxide which would occupy one (1) cubic foot of space when such carbon dioxide is at a temperature of sixty degrees (60°) Fahrenheit, and a pressure of fourteen and sixty-five hundredths (14.65) pounds per square inch absolute.

(b) Metered volume will be obtained by developing a turbine meter factor at line conditions by use of a mechanical displacement prover. This meter factor will be applied to the gross metered volume. The resulting net metered volume will then be multiplied by a constant and the measured density to obtain pounds-mass, which will then be converted to standard cubic feet as hereinbefore defined.

(c) The exact method to be used for calculating conversions between volume and mass is set out in detail in Exhibit A, which is attached and incorporated into this Agreement for all purposes.

7.7 Inspection of Charts and Records: The charts and records from the measuring equipment shall remain the property of the party owning such equipment and shall be kept by such party on file for a period of not less than two (2) years. At any time within such period, such party shall, upon request of the other party, submit to such party charts and records from the measuring equipment, together with calculations therefrom, for inspection and verification, subject to return within thirty (30) days from receipt thereof.

VIII.

POSSESSION OF CARBON DIOXIDE

8.1 Prior to Redelivery: MPTM shall be in exclusive control and possession of the carbon dioxide delivered and redelivered hereunder, and responsible for any damage or injury caused thereby prior to delivery of the carbon dioxide to X-4 by MPTM at the point of delivery provided herein, and after redelivery of the carbon dioxide to MPTM or for its account by X-4 at the point of redelivery provided herein.

8.2 After Delivery: After delivery of the carbon dioxide by or for the account of MPTM to X-4 and until redelivery by X-4 to MPTM or for its account, X-4 shall be in exclusive control thereof and responsible for any injury or damage caused thereby.

IX.

RATES

9.1 Transportation Fee: MPTM shall pay a fee to X-4 each month, for each Mcf of carbon dioxide delivered to X-4 by MPTM for transportation within the Carbon Dioxide Pipeline System. Calculation of total volumes transported by X-4 for MPTM's account shall be based upon inlet measurement at the measuring station at Point of Delivery, and in accordance with Article VII. hereof; with MTPM agreeing that any shrinkage or line loss of carbon dioxide enroute to the Point of Redelivery shall be borne exclusively by MPTM. Transportation shall be undertaken by X-4 for MPTM at the following rates:

(a) X-4 per Mcf of carbon dioxide metered and measured at the Point of Delivery.

(b) The rate herein provided for shall be a fixed rate applicable and enforceable during the entire term of this Agreement.

X.

WARRANTY OF TITLE

10.1 Each party hereto hereby warrants to the other that at the time of delivery and redelivery of carbon dioxide hereunder it will have good title or the legal right to deliver or redeliver such carbon dioxide, and that such carbon dioxide shall be free and clear of all liens or adverse claims; and each party agrees with respect to the carbon dioxide delivered or redelivered by it, to indemnify the other against all suits, actions, debts, accounts, damages, costs (including attorneys' fees), losses and expenses arising from or out of any adverse claims of any and all persons to or against said carbon dioxide.

XI.

BILLINGS, ACCOUNTING, PAYMENT AND REPORTS

11.1 Billing Period: For the purpose of accounting for the carbon dioxide delivered by MPTM to X-4 for transportation hereunder the day shall begin at 7:00 a.m. (local time) and extend to 7:00 a.m. (local time) of the next following day, and the month or billing month shall begin at 7:00 a.m. (local time) on the first day of the calendar month and extend to 7:00 a.m. (local time) on the first day of the next following calendar month.

11.2 Billing Statements: X-4 shall render to MPTM, on or before the twentieth (20th) day of each calendar month, a statement setting forth the

XII.

TAXES

12.1 Payment of Taxes: MPTM shall pay or cause to be paid all taxes and assessments imposed on MPTM with respect to the carbon dioxide delivered, transported and redelivered pursuant to this Agreement. Neither party shall be responsible or liable for any taxes or other statutory charges levied or assessed against any of the facilities of the other party used for the purpose of carrying out the provisions of this Agreement.

XIII.

TERM

13.1 Basic Term: This Agreement shall be effective as of the date hereof, and, unless terminated pursuant to other provisions hereof, shall remain in full force and effect until — X-4 —— In this regard, X-4 and MPTM stipulate and agree that initial tenders of carbon dioxide by MPTM to X-4 for transportation by X-4 are not expected to occur until X-4 X-4 During the interim period prior to the tender of actual deliveries to X-4 agrees to reserve sufficient capacity within the Carbon Dioxide Pipeline System to accommodate performance under this Agreement; provided however, that in the event MPTM is not in a position to commence deliveries by —— X-4 ——both MPTM and X-4 reserve the right to terminate this Agreement by the giving of thirty (30) days' prior written notice to the other party. Furthermore, notwithstanding the basic term of this Agreement, X-4 may also effectuate early termination of this Agreement after initial commencement of deliveries by MPTM, in the event X-4 in its

capacity as Operator of the Seminole-San Andres Unit, determines X-4 ~~X-4~~ that operations of the Project dictate that in-kind deliveries of carbon dioxide are no longer required or in the best interests of Project operations. In the event early termination of this Agreement is warranted based upon the facts recited, X-4 shall provide MPTM with sixty (60) days' prior written notice advising MPTM of its election to terminate this Agreement. Thereafter, neither X-4 nor MPTM shall have any further obligations or liabilities under this Agreement except for obligations or liabilities previously incurred prior to termination.

XIV.

LAWS, REGULATIONS AND FORCE MAJEURE

14.1 Laws and Regulations: This Agreement shall be subject to all valid and applicable laws, orders, rules, and regulations of any duly constituted governmental authority.

14.2 Force Majuere: In the event either party hereto is rendered unable, wholly or in part, by force majeure to carry out its obligations under this Agreement (other than the obligation to make payments pursuant to Article XI. hereof), it is agreed that upon notice and reasonably full particulars of such force majeure given by one party to the other in writing, including telecopier communication, within a resonable time after the occurrence of the cause relied upon, then the obligations hereunder of the party giving such notice, so far as affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period, provided that such cause shall, so far as possible, be remedied with all reasonable dispatch.

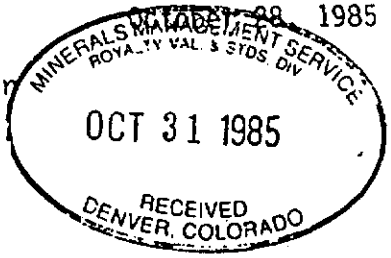
total quantity of carbon dioxide delivered to it by MPTM during the preceding billing month, together with a separate statement for any charges incurred by X-4 by virtue of modification or installation of the measuring station(s) at the Points of Delivery or Redelivery.

11.3 Payment: MPTM agrees to make payment to X-4 within fifteen (15) days after receipt of the billing statement. In the event MPTM shall fail to pay any amount due X-4 when the same is due, then interest thereon shall accrue at the rate of twelve percent (12%) per annum from the date when such amount is due until the same is paid. Should MPTM fail to pay any amount due X-4 within ninety (90) days from the date same is due (plus any interest due thereon) then, in addition to any other right or remedies available to X-4 shall have the right to terminate this Agreement by giving written notice of such intent to MPTM at least thirty (30) days prior to the date X-4 desires to terminate this Agreement.

11.4 Auditing: Each party shall have the right during reasonable business hours to exam.ne the books, records, and measurement documents of the other party to the extent necessary to verify the accuracy of any statement, credit, calculation, or determination made pursuant to the provisions of this Agreement for any calendar year within two (2) calendar years following the end of such calendar year. If any such examination shall reveal, or if either party shall discover, any error or inaccuracy in its own or the other party's statement, credit, calculation, or determination, then proper adjustment and correction thereof shall be made as promptly as practicable thereafter.

Mobil Producing Texas & New Mexico Inc.

OCTOBER 28, 1985



NINE GREENWAY PLAZA SUITE 2700
HOUSTON, TEXAS 77046

United States Department of Interior
Mineral Management Services
P. O. Box 36165, Mail Stop 653
Lakewood, Colorado 80225

Attn: Mr. William H. Feldmiller

1.96.01 REQUEST FOR APPROVAL
OF JANUARY 1, 1984-JULY 31, 1985
TRANSPORTATION ALLOWANCE FOR
CO2 PRODUCTION IN YOAKUM AND
GAINES COUNTY, TEXAS

Dear Mr. Feldmiller:

Based on the attached tariff document issued by our carrier Cortez Pipeline Company, Mobil Producing TX. & N.M. Inc. (MPTM) requests approval of a transportation allowance for CO2 produced and transported from the McElmo Dome field to the Denver Unit in Yoakum and Gaines Counties, Texas. This tariff also covers CO2 transported from the Allred Station to the Seminole-San Andres Unit in Gaines County, Texas. Our cost of transportation as working interest owner is represented by the attached tariff document.

Also, MPTM requests approval of the Wasson Facility handling charge for CO2 transported from the Allred Station to the Wellman Unit and from the Allred Station to a delivery point on the Sheep Mountain Pipeline. A cost study of this handling cost will be made upon completion of the initial calendar year of operation, which will be December, 1985. Pending this cost study, approval of an estimated handling cost of $X-4$/MCF is requested. Additionally, approval is requested for the Sheep Mountain Pipeline transportation charge for CO2 transported from the Sheep Mountain pipeline to the Seminole-San Andres Unit. Our cost of transportation through the portion of the Sheep Mountain Pipeline is $X-4$/MCF and is supported by the attached Carbon Dioxide Transportation Agreement between $X-4$ and MPTM.

Please call Karen Martin at 713-871-5894 if you have questions or need additional information.

Very truly yours,

L. R. Amsberry
Oil & Gas Accounting Manager

KLMartin:mrj
Attachment
B/9

cc: John De Luca - DAC

Shell Western E&P Inc
Attn: M. L. Blanton
P. O. Box 991
Houston, Texas 77001

CORTEZ PIPELINE COMPANY
P. O. Box 2648
Houston, Texas 77252

TO ALL CONCERNED:

Effective April 15, 1984, the trunk line tariff rate on movement of CO_2 will be as follows:

FROM	TO	RATE (¢/MSCF)
McElmo Dome Field, Montezuma County, Colorado	Allred Station and) Denver City Meter) Station, Yoakum) County, Texas)	39

The Rules and Regulations governing the movement of CO_2 are as follows:

ITEM 1 - *Definitions*

"Carrier" as herein used means Cortez Pipeline Company.

"Shipper" as herein used means the party or parties who contract with Carrier for receipt and delivery under the terms of this letter tariff.

"CO_2" as herein used means a stream of CO_2 meeting specifications issued by Carrier.

"MSCF" as herein used means Thousand Standard Cubic Feet.

"Reception Point" as herein used means a mutually-acceptable location at each point described in any applicable letter tariff at which Carrier agrees to receive CO_2 from Shipper.

"Delivery Point" as herein used means the point at which CO_2 is delivered to Shipper.

ITEM 2 - *Quality*

No CO_2 will be accepted for injection into the system unless its kind and quality are the same as that being received by Carrier and the delivery of such CO_2 will not result in any damages to the quality or characteristics of other deliveries. All CO_2 accepted shall be delivered to Carrier's reception point and shall meet all specifications required by Carrier.

Carrier shall be under no obligation to deliver the identical CO_2 received but may make delivery out of Carrier's pipeline stream of substantially like CO_2.

Shipper shall be responsible for maintaining the quality of CO_2 and shall perform applicable tests to insure that the product delivered conforms to Carrier's specifications. Should the analyses indicate that the product delivered does not meet the specifications required by Carrier, Shipper agrees, either voluntarily or upon notification of Carrier, to stop delivery of such off-specification product to Carrier until such time as it is determined by additional testing that the product meets the specifications for CO_2 issued by Carrier.

Shipper shall indemnify and hold Carrier harmless from any loss sustained by other Shippers or by Carrier by reason of contamination or damage to CO_2 in Carrier's custody, or by reason of damage to Carrier's pipeline or associated facilities caused by failure of the materials accepted for delivery to be CO_2 as prescribed by specifications issued by Carrier.

ITEM 3 - *Receipts and Delivery Specifications*

CO_2 shall be received by Carrier at pressures, pumping rates, and temperatures in accordance with operating conditions at the time of receipt. CO_2 shall be delivered to Shipper at pressures, pumping rates, and temperatures in accordance with operating conditions at the time of delivery. CO_2 will be accepted for delivery only when Shipper has provided the necessary facilities required to receive such CO_2 at delivery point.

ITEM 4 - *Gauging, Testing, and Volume Corrections*

CO_2 received by Carrier for delivery may be tested by Carrier prior to its receipt from Shipper. Quantities shall be measured by meter in MSCF at 14.65 psiA and 60° Fahrenheit.

Carrier shall account to each Shipper for all CO_2 received. Any overages or shortages not due to the negligence of Carrier (see Item 9 of this letter tariff) will be allocated on a monthly accrual basis among Shippers in the proportion that the total quantity delivered from the line for each Shipper bears to the total quantity delivered from the line for all Shippers.

ITEM 5 - *Apportionment When Tenders Are in Excess of Facilities*

When there shall be tendered to the Carrier for delivery more CO_2 than can be currently delivered, the service furnished by Carrier shall be apportioned among all Shippers in proportion to the amounts tendered by each; provided, that in making such apportionment, no tender for delivery shall be considered beyond the amount which the party requesting the delivery will have available during the current month.

ITEM 6 - *Application of Rates and Charges*

CO_2 accepted for delivery whall be subject to the rates and charges in effect on the date of receipt of such CO_2 by Carrier. Delivery charges and all other lawful charges will be collected on the basis of total MSCF of CO_2 delivered.

ITEM 7 - *Payment for Delivery and Other Charges*

Shipper shall pay the delivery and all other lawful charges accruing on CO_2 which has been received and, if required, shall pay the same before delivery. CO_2 accepted for delivery shall be subject to a first lien for all such charges.

ITEM 8 - *Liens and Unpaid Charges*

When any CO_2 tendered for delivery hereunder is involved in litigation, or the ownership of which may be in dispute, or which may be encumbered by lien or charge of any kind, Carrier may require of Shippers an indemnity bond to protect it against all loss.

ITEM 9 - *Liability of Carrier*

Carrier, while in possession of any of the CO_2 herein described, shall not be liable for any loss thereof, damage thereto, or delay, except to the extent that liability therefor is imposed on Carrier by law. In case of loss of CO_2 for which Carrier is not responsible, Shipper shall bear the loss. All such CO_2 losses shall be accounted for as provided in Item 4 of this letter tariff.

ITEM 10 - *Claims, Suits, and Time for Filing*

As a condition precedent to recovery for loss, damage, or delay in deliveries, claims must be filed in writing with Carrier within nine (9) months after delivery of the CO_2, or, in case of failure to make delivery, then within nine (9) months after a reasonable time for delivery has elapsed; and suits arising out of such claims shall be instituted against Carrier only within two (2) years from the time when Carrier delivers, or tenders delivery of, the CO_2, or, in case of failure to make or tender delivery, then within two (2) years after a reasonable time for delivery has elapsed. Where claims are not filed or suits are not instituted thereon in accordance with the foregoing provisions, Carrier will not be liable and such claims will not be paid.

ITEM 11 - *Applicable Laws, Rules, and Regulations*

Shippers will be required to comply with all applicable laws, rules, and regulations as may be imposed by governmental authorities regarding shipment of CO_2.

R. M. Armstrong, Chairman
Partnership Committee

CARBON DIOXIDE

TRANSPORTATION AGREEMENT

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EXHIBIT:

EXHIBIT A

CARBON DIOXIDE

TRANSPORTATION AGREEMENT

This Agreement made and entered into this ——— X-4 ——— X-4 by and between MOBIL PRODUCING TEXAS & NEW MEXICO INC., a corporation (hereinafter referred to as "MPTM"), and ——— X-4 ——— corporation (hereinafter referred to as X-4).

W I T N E S S E T H:

WHEREAS, X-4 is an undivided owner of thirty percent (30%) of the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System which begins in the State of New Mexico in the vicinity of Section 31, Township 19 North, Range 32 East, N.M.P.M., and extends in a southerly direction to the vicinity of the Seminole-San Andres Unit, Gaines County, Texas; and

WHEREAS, MPTM is a working interest owner in the ——— X-4 ——— X-4 located in ——— X-4 ——— such Unit constituting an enhanced oil recovery project associated with the use of carbon dioxide for increased hydrocarbon recovery; and

WHEREAS, X-4 in its capacity as Operator of the Seminole-San Andres Unit, and MPTM, in its capacity as a working interest owner in said Unit, have entered into a Carbon Dioxide In-Kind Delivery Contract dated ——— X-4 ———, wherein MPTM has agreed to deliver its unit participation share of the estimated cumulative volumes of carbon dioxide required for use in the enhanced oil recovery project; and

WHEREAS, MPTM desires that X-4 accept delivery of carbon dioxide into the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System for MPTM's account and redeliver equivalent quantities of carbon dioxide to MPTM as hereinafter set forth, and X-4 agrees to perform such service for MPTM as hereinafter set forth.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements herein contained, the parties hereto covenant and agree as follows:

I.

DEFINITIONS

1.1 The word "day" means a period beginning at 7:00 a.m. (local time) on a calendar day and ending at 7:00 a.m. (local time) on the next succeeding calendar day. The date of a day shall be that of its beginning.

1.2 The word "month" means a period beginning at 7:00 a.m. (local time) on the first day of a calendar month and ending at 7:00 a.m. (local time) on the first day of the next succeeding calendar month.

1.3 The term "carbon dioxide" means a substance primarily composed of molecules containing one (1) atom of carbon and two (2) atoms of oxygen.

1.4 The term "cubic foot" is the amount of carbon dioxide which would occupy one (1) cubic foot of space at a base pressure of 14.65 psia and at a base temperature of sixty degrees (60°) Fahrenheit.

1.5 "Mcf" means one thousand (1,000) cubic feet of carbon dioxide.

1.6 The term "psia" means pounds per square inch absolute.

1.7 The term "psig" means pounds per square inch gauge.

1.8 The term "Project" means the Seminole-San Andres Unit enhanced oil recovery project which includes all unit operations associated with use of carbon dioxide for increased hydrocarbon recovery.

1.9 "Source Field" means that area(s) from which MPTM shall obtain carbon dioxide to satisfy its unit participation share of the estimated cumulative volumes of carbon dioxide required for use in the Project.

1.10 "Carbon Dioxide Pipeline System" means the Southern Segment of the Sheep Mountain Carbon Dioxide Pipeline System which begins in the State of New Mexico in the vicinity of Section 31, Township 19 North, Range 32 East, N.M.P.M., and extending for approximately Two Hundred Twenty Four (224) miles in a southerly direction to the vicinity of the Seminole-San Andres Unit, Gaines County, Texas; and to X-4 undivided — X-4 — X-4

1.11 The term "capacity" means, and is limited to,

X-4

1.12 "Working Interest Owners" mean the signatories to that certain Unit Operating Agreement for the Seminole-San Andres Unit dated March 1, 1969, and amended effective November 1, 1970, and as it may be hereafter amended, and their heirs, successors and assigns.

1.13 "Maximum Daily Quantity" means MPTM's daily share of carbon dioxide volumes required to satisfy its share of cumulative volumes of carbon dioxide utilized on a daily basis by the Project.

II.

SCOPE OF AGREEMENT

2.1 X-4 and MPTM agree that this Agreement is being entered into for the sole purpose of providing transportation for MPTM's share of cumulative volumes of carbon dioxide projected to be utilized in the Project pursuant to that certain Carbon Dioxide In-Kind Delivery Contract dated —— X-4 —— by and between X-4 in its capacity a: X-4

X-4

It is recognized that the Carbon Dioxide Pipeline System is a private pipeline owned and operated for the purpose of transporting carbon dioxide to selected delivery points where such commodity may be utilized for unit operations associated with the use of carbon dioxide for increased hydrocarbon recovery, and that X-4 willingness to enter into this Agreement is predicated upon MPTM's working interest participation in the Project, and its desire to supply its own carbon dioxide requirements for such Project. Therefore, MPTM acknowledges that due to the desire and intent of —— X-4 —— to retain a private carrier status as to the Carbon Dioxide Pipeline System, its request for transportation of carbon dioxide has been granted with the understanding that MPTM shall not during the entire term of this Agreement divert any portion of the carbon dioxide delivered for transportation by X-4, nor shall it cause the carbon dioxide to be utilized for any purpose other than to fulfill its commitment under the Carbon Dioxide In-Kind Delivery Contract referred to above.

In addition to the restrictions imposed above, MPTM agrees that this Agreement is expressly limited to a portion of the X-4 X-4 in the Carbon Dioxide Pipeline System, and that MPTM's rights hereunder are personal contract rights with X-4 not applicable nor enforceable against any other X-4 in the Carbon Dioxide Pipeline System or to the capacity which they retain separately by virtue of such X-4 Therefore, this Agreement shall involve the delivery and redelivery of carbon dioxide within and by virtue of X-4 separate X-4 of capacity within the Carbon Dioxide Pipeline System, and not otherwise.

III.

QUANTITY

3.1 Quantity: Subject to the terms and limitations hereof, MPTM will deliver or cause to be delivered to X-4 and X-4 will accept for transportation and transport hereunder a quantity of carbon dioxide up to Maximum Daily Quantity requirements pursuant to the terms and provisions of that certain Carbon Dioxide In-Kind Delivery Contract referred to in Article II. It is projected that MPTM's own pipeline facilities from its Source Field to the Carbon Dioxide Pipeline System will be completed on or about April 1, 1984, thus enabling it to make the in-kind carbon dioxide deliveries to X-4 pursuant to this Agreement. Based upon present estimates of X-4 of deliveries, MTPM's cumulative in-kind carbon dioxide requirements will be approximately 73,328,500 Mcf; with a peak delivery of approximately 28,600 Mcf per day. Therefore, this Agreement

is being entered into to facilitate MPTM's in-kind carbon dioxide requirements for the Project, and X-4 will accept, transport and redeliver such quantities of carbon dioxide as may be required to satisfy such requirements subject to the terms and conditions above and hereinafter set forth.

3.2 Adjustment of Deliveries for Transportation: X-4 will notify MPTM monthly, ten (10) days in advance, of its Maximum Daily Quantities required to meet MPTM's share of Project needs for carbon dioxide for the next succeeding month. Such notice shall be given by X-4 in its capacity as ——— X-4 ——— and X-4 and MPTM agree to fully cooperate with one another in adjusting monthly and daily deliveries hereunder. X-4 will give twenty-four (24) hours prior telephone or telecopier notice of such additional changes in Project requirements as may be necessary to balance deliveries to the Project with actual Project requirements. Upon receipt of such notice, given to MPTM at the location and number set forth below, MPTM shall undertake whatever measures are required to conform its deliveries to X-4 revised requirements and shall notify X-4 at the location numbers set forth below as soon as practicable if it is unable to adjust deliveries to the quantities requested:

Mobil Producing Texas & New Mexico Inc.
P. O. Box 66
Denver City, Texas 79323
Attention: George Hughes

Telephone: (806) 592-2234

In the event of an emergency which poses danger to life or property, no prior notice shall be necessary before partial or total shutdown by either party, but notice of such shutdown, and the reason therefor shall be given as soon as practicable thereafter to MPTM as set

out above, and to X-4 by telephone or telecopier at the location and number set out below:

X-4

In the event a shutdown becomes necessary for either party on a non-emergency basis, such party will give at least twenty-four (24) hours prior notice to the other.

IV.

POINT OF DELIVERY AND POINT OF REDELIVERY

4.1 Point of Delivery: The Point of Delivery for all carbon dioxide delivered to X-4 for transportation hereunder shall be the Northeast Quarter of the Southeast Quarter of the Northeast Quarter (NE/4 SE/4 NE/4), Section 764, ——— X-4 ———

4.2 Point of Redelivery: Carbon dioxide redelivered hereunder by X-4 shall be redelivered for MPTM's account at the outlet side of X-4 meter at a mutually agreed to point of connection with X-4 facilities in the ——— X-4 ———

V.

DELIVERY PRESSURE

5.1 Point of Delivery: All carbon dioxide delivered by or for the account of MPTM to X-4 hereunder shall be delivered at pressures sufficient

to enter the Carbon Dioxide Pipeline System against working pressures maintained therein from time to time, not to exceed 2,500 psig.

5.2 Point of Redelivery: All carbon dioxide redelivered by X-4 to MPTM or for its account shall be delivered at pressures sufficient to enter the Project facilities located near ———— X-4 ————

5.3 Compression: In the event compression of the carbon dioxide becomes necessary to effectuate the pressures required at the Point of Delivery, MPTM shall install, operate and maintain such compression facilities as may be required, and it shall be solely responsible for any costs or expenses related to such compression facilities for the entire term of this Agreement.

VI.

QUALITY SPECIFICATIONS

6.1 Quality Specifications: The carbon dioxide delivered to X-4 by MPTM for transportation through the Carbon Dioxide Pipeline System shall contain not less than ninety six percent (96%) carbon dioxide and shall meet the following specifications, which herein are collectively called "Quality Specifications":

(a) Water. The carbon dioxide shall not contain any free water nor more than twelve (12) pounds of water vapor per 1,000 Mcf.

(b) Hydrogen Sulphide and Sulphur. The carbon dioxide shall not contain more than ten parts per million by weight of hydrogen sulphide nor more than ten (10) parts per million of total sulphur.

(c) Oxygen. The carbon dioxide shall not contain more than ten (10) parts per million by weight of oxygen.

6.2 Testing: MPTM shall perform or cause to have performed chromatography tests to determine on a monthly basis the quality of carbon dioxide at or near the Delivery Point. MPTM shall promptly furnish X-4 with copies of all test results. MPTM shall insure that X-4 is given reasonable notice of all such tests in order that X-4 may have its representative present, if X-4 so desires. Also, MPTM agrees that representatives of Atlantic Richfield Company, as Operator of the Carbon Dioxide Pipeline System, shall likewise be entitled to copies of tests and the right to view all testing procedures. X-4 will submit copies of test results to Atlantic Richfield Company and keep it informed as to dates upon which testing is to occur.

6.3 Failure to Meet: If any carbon dioxide fails to meet the Quality Specifications required at the Delivery Point, X-4 shall have the right to waive such failure and to continue to receive such carbon dioxide. If X-4 elects not to accept such carbon dioxide, then, within thirty (30) days of notice of X-4 election as aforesaid, MPTM shall notify X-4 whether it will treat the carbon dioxide to meet the Quality Specifications. If MPTM declines to undertake such treatment, then the parties may terminate this Agreement by thirty (30) days' prior written notice to the other, and on the effective date of termination all rights and obligations of X-4 and MPTM hereunder shall cease.

VII.

MEASUREMENT AND COMPUTATION OF VOLUMES

7.1 Measuring Stations: A metering station shall be installed at the Delivery Point. The metering station shall consist of a turbine type meter(s), on-line thermometer(s), densi meter(s) and other auxilliary devices for mass measurement. The measuring station so installed shall be constructed in accordance with the specifications prescribed by the American Petroleum Institute, "Manual of Petroleum Measurement Standards" dated July, 1976, as amended. Due to the fact that the carbon dioxide Pipeline System is operated by the Atlantic Richfield Company, MPTM agrees that it shall coordinate the physical installation and site location of the measuring station with Atlantic Richfield Company; and that actual installation shall be performed by Atlantic Richfield Company. MPTM shall bear all costs and expenses incurred in the installation or modification of the metering station. The measuring station shall be accessible at all reasonable times to inspection and examination by X-4 MPTM and Atlantic Richfield Company, but the reading, calibration, adjustment and operation of the Carbon Dioxide Pipeline System measuring equipment shall be performed and supervised by Atlantic Richfield Company.

In addition to the Delivery Point measuring station, MPTM acknowledges and agrees that transported volumes of carbon dioxide for MPTM's account will be measured at the Redelivery Point through a measuring station installed, operated and supervised by Atlantic Richfield Company, in its capacity as Operator of the Carbon Dioxide Pipeline System. This measuring station has been installed to measure and account for all volumes

of carbon dioxide purchased by the Unit for utilization in the Project and also for measurement of volumes of carbon dioxide delivered in-kind by Working Interest Owners. The Redelivery measuring station shall be accessible at all reasonable times to inspection and examination by MPTM, but the reading, calibration and adjustment of the Redelivery measuring station shall be performed and supervised by Atlantic Richfield Company, in its capacity as Operator of the Carbon Dioxide Pipeline System. MPTM agrees that it shall be responsible for its initial allocated share of all costs and expenses associated with the installation of the Redelivery measuring station.

7.2 Metering Calibration: All measuring equipment shall be calibrated by the parties responsible pursuant to Paragraph 7.1, at least once each month at the expense of the parties as previously set forth. X-4 shall give MPTM notice of each such calibration test (notice by Atlantic Richfield Company as to Delivery Point calibration shall be deemed sufficient) in sufficient time to enable MPTM, if it so chooses, to have its representative present. X-4 further agrees to furnish MPTM with copies of all calibration results.

7.3 Meter Repair and Adjustments: If upon any such calibration the measuring equipment is found to be within 0.50% accurate, such equipment shall be considered correct in computing deliveries and redeliveries. If upon any calibration the measuring equipment shall be found to be inaccurate by an amount exceeding 0.50% error, proper repairs and adjustments shall be made immediately, and any previous reading of such equipment shall be corrected to zero error for any period which is known definitely

or agreed upon, but in case the period is not known definitely or agreed upon, then for one-half (1/2) of the period of time elapsed since the date of the last calibration.

7.4 Measuring Equipment out of Service: If for any reason any measuring equipment is out of service or needs repair so that the volume of carbon dioxide delivered or redelivered cannot be ascertained or computed from the reading thereof, the volume of carbon dioxide delivered or redelivered during the period such equipment is out of service or out of repair shall be estimated on the basis of the best data available, using the first of the following methods which is feasible: (i) by using the registration of check equipment, if installed and accurately registering; (ii) by correcting the error in the equipment, if the percentage of error is ascertainable by calibration test or mathematical calculations; or (iii) by estimating the volume of delivery, using as a basis the volumes delivered during preceding periods under similar conditions when the equipment was registering accurately.

7.5 Check Measuring Equipment: In the event MPTM desires to install, maintain, and operate check measuring equipment at the Redelivery Point, MPTM agrees that it shall first obtain the consent of X-4 and, if necessary, that of Atlantic Richfield Company. If the required consent is obtained, MPTM agrees to install, maintain and operate such check measuring equipment in a manner as to not interfere with the operation of existing measuring meters or other operations.

7.6 Volume Determination: The volume of carbon dioxide discharged from the Carbon Dioxide Pipeline System at the Delivery and Redelivery Points shall be determined as follows:

(a) The unit of measurement shall be the amount of carbon dioxide which would occupy one (1) cubic foot of space when such carbon dioxide is at a temperature of sixty degrees (60°) Fahrenheit, and a pressure of fourteen and sixty-five hundredths (14.65) pounds per square inch absolute.

(b) Metered volume will be obtained by developing a turbine meter factor at line conditions by use of a mechanical displacement prover. This meter factor will be applied to the gross metered volume. The resulting net metered volume will then be multiplied by a constant and the measured density to obtain pounds-mass, which will then be converted to standard cubic feet as hereinbefore defined.

(c) The exact method to be used for calculating conversions between volume and mass is set out in detail in Exhibit A, which is attached and incorporated into this Agreement for all purposes.

7.7 Inspection of Charts and Records: The charts and records from the measuring equipment shall remain the property of the party owning such equipment and shall be kept by such party on file for a period of not less than two (2) years. At any time within such period, such party shall, upon request of the other party, submit to such party charts and records from the measuring equipment, together with calculations therefrom, for inspection and verification, subject to return within thirty (30) days from receipt thereof.

VIII.

POSSESSION OF CARBON DIOXIDE

8.1 Prior to Redelivery: MPTM shall be in exclusive control and possession of the carbon dioxide delivered and redelivered hereunder, and responsible for any damage or injury caused thereby prior to delivery of the carbon dioxide to X-4 by MPTM at the point of delivery provided herein, and after redelivery of the carbon dioxide to MPTM or for its account by X-4 at the point of redelivery provided herein.

8.2 After Delivery: After delivery of the carbon dioxide by or for the account of MPTM to X-4 and until redelivery by X-4 to MPTM or for its account, X-4 shall be in exclusive control thereof and responsible for any injury or damage caused thereby.

IX.

RATES

9.1 Transportation Fee: MPTM shall pay a fee to X-4 each month, for each Mcf of carbon dioxide delivered to X-4 by MPTM for transportation within the Carbon Dioxide Pipeline System. Calculation of total volumes transported by X-4 for MPTM's account shall be based upon inlet measurement at the measuring station at Point of Delivery, and in accordance with Article VII. hereof; with MTPM agreeing that any shrinkage or line loss of carbon dioxide enroute to the Point of Redelivery shall be borne exclusively by MPTM. Transportation shall be undertaken by X-4 for MPTM at the following rates:

(a) X-4 per Mcf of carbon dioxide metered and measured at the Point of Delivery.

(b) The rate herein provided for shall be a fixed rate applicable and enforceable during the entire term of this Agreement.

X.

WARRANTY OF TITLE

10.1 Each party hereto hereby warrants to the other that at the time of delivery and redelivery of carbon dioxide hereunder it will have good title or the legal right to deliver or redeliver such carbon dioxide, and that such carbon dioxide shall be free and clear of all liens or adverse claims; and each party agrees with respect to the carbon dioxide delivered or redelivered by it, to indemnify the other against all suits, actions, debts, accounts, damages, costs (including attorneys' fees), losses and expenses arising from or out of any adverse claims of any and all persons to or against said carbon dioxide.

XI.

BILLINGS, ACCOUNTING, PAYMENT AND REPORTS

11.1 Billing Period: For the purpose of accounting for the carbon dioxide delivered by MPTM to X-4 for transportation hereunder the day shall begin at 7:00 a.m. (local time) and extend to 7:00 a.m. (local time) of the next following day, and the month or billing month shall begin at 7:00 a.m. (local time) on the first day of the calendar month and extend to 7:00 a.m. (local time) on the first day of the next following calendar month.

11.2 Billing Statements: X-4 shall render to MPTM, on or before the twentieth (20th) day of each calendar month, a statement setting forth the

total quantity of carbon dioxide delivered to it by MPTM during the preceding billing month, together with a separate statement for any charges incurred by X-4 by virtue of modification or installation of the measuring station(s) at the Points of Delivery or Redelivery.

11.3 Payment: MPTM agrees to make payment to X-4 within fifteen (15) days after receipt of the billing statement. In the event MPTM shall fail to pay any amount due X-4 when the same is due, then interest thereon shall accrue at the rate of twelve percent (12%) per annum from the date when such amount is due until the same is paid. Should MPTM fail to pay any amount due X-4 within ninety (90) days from the date same is due (plus any interest due thereon) then, in addition to any other right or remedies available to X-4 shall have the right to terminate this Agreement by giving written notice of such intent to MPTM at least thirty (30) days prior to the date X-4 desires to terminate this Agreement.

11.4 Auditing: Each party shall have the right during reasonable business hours to examine the books, records, and measurement documents of the other party to the extent necessary to verify the accuracy of any statement, credit, calculation, or determination made pursuant to the provisions of this Agreement for any calendar year within two (2) calendar years following the end of such calendar year. If any such examination shall reveal, or if either party shall discover, any error or inaccuracy in its own or the other party's statement, credit, calculation, or determination, then proper adjustment and correction thereof shall be made as promptly as practicable thereafter.

XII.

TAXES

12.1 Payment of Taxes: MPTM shall pay or cause to be paid all taxes and assessments imposed on MPTM with respect to the carbon dioxide delivered, transported and redelivered pursuant to this Agreement. Neither party shall be responsible or liable for any taxes or other statutory charges levied or assessed against any of the facilities of the other party used for the purpose of carrying out the provisions of this Agreement.

XIII.

TERM

13.1 Basic Term: This Agreement shall be effective as of the date hereof, and, unless terminated pursuant to other provisions hereof, shall remain in full force and effect until — X-4 —— In this regard, X-4 and MPTM stipulate and agree that initial tenders of carbon dioxide by MPTM to X-4 for transportation by X-4 are not expected to occur until X-4 X-4 During the interim period prior to the tender of actual deliveries to X-4 agrees to reserve sufficient capacity within the Carbon Dioxide Pipeline System to accommodate performance under this Agreement; provided however, that in the event MPTM is not in a position to commence deliveries by —— X-4 ——both MPTM and X-4 reserve the right to terminate this Agreement by the giving of thirty (30) days' prior written notice to the other party. Furthermore, notwithstanding the basic term of this Agreement, X-4 may also effectuate early termination of this Agreement after initial commencement of deliveries by MPTM, in the event X-4 in its

capacity as Operator of the Seminole-San Andres Unit, determines X-4 ~~X-4~~ that operations of the Project dictate that in-kind deliveries of carbon dioxide are no longer required or in the best interests of Project operations. In the event early termination of this Agreement is warranted based upon the facts recited, X-4 shall provide MPTM with sixty (60) days' prior written notice advising MPTM of its election to terminate this Agreement. Thereafter, neither X-4 nor MPTM shall have any further obligations or liabilities under this Agreement except for obligations or liabilities previously incurred prior to termination.

XIV.

LAWS, REGULATIONS AND FORCE MAJEURE

14.1 Laws and Regulations: This Agreement shall be subject to all valid and applicable laws, orders, rules, and regulations of any duly constituted governmental authority.

14.2 Force Majuere: In the event either party hereto is rendered unable, wholly or in part, by force majeure to carry out its obligations under this Agreement (other than the obligation to make payments pursuant to Article XI. hereof), it is agreed that upon notice and reasonably full particulars of such force majeure given by one party to the other in writing, including telecopier communication, within a resonable time after the occurrence of the cause relied upon, then the obligations hereunder of the party giving such notice, so far as affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period, provided that such cause shall, so far as possible, be remedied with all reasonable dispatch.

The term "force majeure" as employed herein means acts of God, strikes, lockouts or other industrial disturbances, acts of the public enemy, wars, insurrections, riots, lightning, earthquakes, fires, storms, floods, restraints of government, federal or state, civil or military, and of people, civil disturbances, explosions, breakage or accident to machinery, equipment or lines of pipe, the necessity or desirability for making repairs to or alterations of machinery, equipment or lines of pipe, and any other cause or causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome. Such term shall likewise include (a) in those instances where either party hereto is required to obtain servitudes, rights-of-way grants, permits or licenses to enable such party to perform hereunder, the inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such servitudes, rights-of-way grants, permits or licenses, and (b) in those instances where either party hereto is required to furnish materials and supplies for the purpose of constructing or maintaining facilities or is required to secure permits or permissions from any governmental agency to enable such party to perform hereunder, the inability of such party to acquire, or the delays on the part of such party in acquiring, at reasonable cost and after the exercise of reasonable diligence, such materials and supplies, permits and permissions; provided, however, the term "force majeure" does not mean or include any cause which by the exercise of reasonable diligence the party claiming suspension could overcome. Settlement of strikes, lockouts or other labor disputes shall be entirely within the discretion of the party

having the difficulty and the above requirements, that any force majeure must be remedied with all reasonable dispatch and must not be a cause which can be prevented by the exercise of reasonable diligence, shall not require the settlement or prevention of strikes, lockouts or other labor disputes by acceding to the demand of opposing parties when such course is inadvisable in the sole discretion of the party having the difficulty.

14.3 Extended Force Majeure. If, after deliveries have commenced hereunder, an event of force majeure affects the amounts of deliveries by MPTM or the receipts by X-4 for a consecutive period of 365 days, then, at anytime after such period prior to the time such event has been remedied, the party not claiming force majeure may, upon prior written notice to the other and without further liabilities hereunder, cancel this Agreement as to the amount of deliveries or receipts, as the case may be, so affected by such event of force majeure.

XV.

SUCCESSORS AND ASSIGNS

15.1 This Agreement shall bind and benefit the parties hereto and their heirs, administrators, successors and assigns, provided that no conveyance or transfer of any interest of either party shall be binding upon the other party until such other party has been furnished with written notice and a true copy of such conveyance or transfer, it being agreed, however, that no assignment by either party shall serve to relieve such party of any obligation to the other party hereunder unless and until such party's assignee is approved in writing by the other party.

Any assignment by MPTM hereunder, if any, shall require that such assignee take subject to the terms and provisions of this Agreement and for the purposes expressed within Section 2.1, and not otherwise.

XVI.

NOTICES

16.1 All notices, statements, and other communication required or permitted to be given hereunder, except that covered by Article III., shall be in writing and shall be deemed to have been effectively given when deposited in the United States mail, postage prepaid and registered, or delivered by Western Union Telegram with charges prepaid, as the case may be, and addressed as follows:

X - 4

Mobil Producing Texas & New Mexico, Inc.
9 Greenway Plaza
Suite 2700
Houston, Texas 77046
Attention: CO_2 Manager

as the case may be, or to such other address as either party shall, respectively, hereafter designate in writing.

XVII.

MISCELLANEOUS

17.1 Waiver: No waiver by either party hereto of any one or more defaults by the other under this Agreement shall operate or be construed as a waiver of any future default or defaults whether of a like or different character.

17.2 Topical Headings: The topical headings used herein are inserted for convenience only and shall not be construed as having any substantive significance or meaning whatsoever or as indicating that all of the provisions of this Agreement relating to any particular topic are to be found in any particular Article.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed in duplicate originals, as of the day and year first above written.

X-4

ATTEST:

X-4

X-4

ATTEST:

By: R B Altman

R. B. Altman
Assistant Secretary

MOBIL PRODUCING TEXAS & NEW MEXICO INC.

By: [signature]

Its: Attorney-In-Fact

APPROVED	
JT. INT.	
CONTR.	
N. GAS	
ENGR.	
LEGAL	
LAND	
TITLE R	

EXHIBIT A
CARBON DIOXIDE TRANSPORTATION AGREEMENT

1. A composite sample of the metered carbon dioxide will be accumulated in a flow-paced composite sampler.

2. At regularly scheduled intervals not exceeding once during each month, the composite sample so accumulated will be analyzed to determine composition.

3. The molecular weight (MW) of the carbon dioxide will be calculated from the compositional analysis.

4. The compressibility factor (Z) of the carbon dioxide will be determined from compositional analysis or be calculated according to NGPA Publication 2172-72.

5. The specific volume ($\bar{V}$) of the carbon dioxide will be calculated as follows:

$$\bar{V} = (379.49/MW) \times (14.696/14.650) \times (Z)$$

WHERE:

$\bar{V}$ = Specific volume, cubic feet per pound, at pipeline definition conditions of 14.650 psia and 60° F.

379.49 = Gas constant at standard pressure and temperature of 14.696 psia and 60° F.

MW = Molecular weight of the carbon dioxide.

Z = Compressibility factor at 14.65 psia and 60° F.

6. The conversion of metered pounds-mass to cubic feet will be calculated as follows:

$$MCF = (W/1000)\ (\bar{V})$$

WHERE:

MCF = 1000 standard cubic feet of carbon dioxide.

W = pounds-mass of carbon dioxide.

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATIO I-2
1985 TRANSPORTATION ALLOWANCE

CO2 TO EAST VACUUM UNIT AND AMOCO YATES:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS		ALLOWANCE PERCENTAGE
					MMS	
JAN	0.0000	0.0000000	0	0.000000		0
FEB	0.0000	0.0000000	0	0.000000		0
MAR	0.0000	0.0000000	0	0.000000		0
APR	0.0000	0.0000000	0	0.000000		0
MAY	0.0000	0.0000000	0	0.000000		0
JUN	0.0000	0.0000000	0	0.000000		0
JUL	0.0000	0.0000000	0	0.000000		0
AUG	0.0000	0.0000000	0	0.000000		0
SEP	0.8400	0.4200000	0.588376	0.168376	-33	70
OCT	0.8400	0.4200000	0.588376	0.168376		70
NOV	0.8400	0.4200000	0.588376	0.168376		70
DEC	0.8400	0.4200000	0.588376	0.168376		70

46%

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATIO
1985 TRANSPORTATION ALLOWANCE

CO2 TO SEMINOLE SAN ANDRES UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
					MMS
JAN	1.368492	0.6842460	0.669552	0	49
FEB	1.368492	0.6842460	0.669552	0	49
MAR	1.368492	0.6842460	0.669552	0	49
APR	1.368492	0.6842460	0.669552	0	49
MAY	1.336950	0.6684750	0.669552	0.0010770	50
JUN	1.336695	0.6683475	0.669552	0.0012045	50
JUL	1.328745	0.6643725	0.669552	0.0051795	50
AUG	1.328745	0.6643725	0.669552	0.0051795	50
SEP	1.328745	0.6643725	0.669552	0.0051795	50
OCT	1.336244	0.6681220	0.669552	0.0014300	50
NOV	1.338682	0.6693410	0.669552	0.0002110	50
DEC	1.338682	0.6693410	0.669552	0.0002110	50

- 473612

357.

MONTHS WHERE TRANSPORTATION ALLOWANCE EXCEED 50% LIMITATIO I-4
1985 TRANSPORTATION ALLOWANCE

CO2 TO DENVER UNIT:

MONTH	SALES PRICE	50% OF SALES PRICE	ALLOWANCE	EXCESS	ALLOWANCE PERCENTAGE
JAN	1.15378	0.576890	0.588376	0.011486	51
FEB	1.15378	0.576890	0.588376	0.011486	51
MAR	1.15378	0.576890	0.588376	0.011486	51
APR	1.12645	0.563225	0.588376	0.025151	52
MAY	1.12645	0.563225	0.588376	0.025151	52
JUN	1.12645	0.563225	0.588376	0.025151	52
JUL	1.12645	0.563225	0.588376	0.025151	52
AUG	1.12645	0.563225	0.588376	0.025151	52
SEP	1.12645	0.563225	0.588376	0.025151	52
OCT	1.12645	0.563225	0.588376	0.025151	52
NOV	1.12645	0.563225	0.588376	0.025151	52
DEC	1.12645	0.563225	0.588376	0.025151	52

MMS
-39
34%

MCELMO DOME - 1985
MOBIL'S REVISED REQUESTED ALLOWANCE

SCHEDULE A

ALLOWANCE ($/MCF)

SEGMENT	DENVER UNIT	SEMINOLE-SAN ANDRES UNIT	WELLMAN UNIT
MCELMO DOME UNIT TO DENVER UNIT/ALLRED STATION (CORTEZ PIPELINE)	$0.588376	$0.588376	$0.588376
ALLRED STATION TO DENVER CITY DELIVERY STATION (MPTM PIPELINE)	---	$0.046176	---
ALLRED STATION TO WELLMAN UNIT	---	---	$0.010452
DENVER CITY DELIVERY STATION TO SEMINOLE SAN ANDRES UNIT - (SHEEP MTN. PIPELINE)	---	$0.035000	---
	$0.588376	$0.669552	$0.598828

Shell Oil Company

200 North Dairy Ashford
P.O. Box 576
Houston, Texas 77001

September 9, 1985

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
SEP 12 1985
RECEIVED
DENVER, COLORADO

Norman J. Hess, Chief
Division of Appeals
Office of Program Review
Minerals Management Service
United States Department of the Interior
Washington, D.C. 20240

Subject: Your File Reference LMS-Mail Stop 623
Docket No. MMS-84-0013-MISC
Shell Western E&P Inc. Appeal of Disallowance of Federal and State Income Tax Components of Transportation Allowance Deductions -
McElmo Dome (Leadville) Unit
Dolores and Montezuma Counties, Colorado

Dear Mr. Hess:

Shell Western E&P Inc. ("SWEPI") hereby submits its comments and response to the May 6, 1985 Royalty Valuation and Standards Division ("RVSD") report with respect to the subject Appeal. The RVSD report was received by SWEPI on July 12, 1985.

INTRODUCTION

In SWEPI's comments dated February 7, 1985 with respect to its Appeal of the disallowance by the RVSD of certain transportation costs which pertain to state and federal income taxes, the issue presented was whether the position of the RVSD was a rational position supported by any applicable authorities or other basis. The report of the

RVSD filed on May 6, 1985 revealed that the sole basis for such disallowance was the application to the Cortez CO_2 pipeline of a MMS guideline pertaining to producer-owned pipelines transporting only that producer's production to a sales point.

Thus, the issue in this Appeal has now focused on the following: Should a MMS policy guideline pertaining to a producer-owned pipeline transporting only that producer's production be extended to the Cortez CO_2 pipeline simply because such pipeline is in part producer-owned and because the interstate transportation of CO_2 is not subject to federal regulation?

The RVSD report revealed the following:

> "Under the Pipeline General Section, the CDM [Conservation Division Manual] advises 'in general, tariff rates established by a State or Federal regulatory body may be accepted as establishing the reasonable cost of transportation.'"[1/]

1/ A copy of the referenced sections of the Conservation Division Manual was not attached to the copy of the RVSD report received by SWEPI. Although SWEPI has not seen the CDM, for the purposes of these comments and response, SWEPI relies on the RVSD characterization of the guidelines contained in the CDM. SWEPI hereby requests a copy of the Conservation Division Manual and for permission to supplement its comments after receipt of such document, if required.

> "In situations where a third-party pipeline, generally a common carrier, imposes a tariff on a producer under arm's-length conditions, MMS will approve the entire tariff, regardless of how such tariff is derived, as the producer's actual cost of transportation that may be deducted from Federal royalty."
>
> "In general, if a pipeline is producer-owned and transporting that producer's production only to a sales point, MMS requires submittal of detailed cost data to justify transportation expenses. In these situations, it has been, and is, MMS policy to deny income tax as a legitimate cost of transportation in those cases where these costs can be identified." (Emphasis added) (Page 3, RVSD report dated May 6, 1985).

Thus, RVSD recognizes and acknowledges that transportation costs, which include income taxes as a cost component, may be deducted as a transportation allowance in computing federal royalties in certain cases. However, in this case the RVSD finds, solely on the basis of a MMS policy guideline contained in an internal document, that deduction of all such transportation costs is not permitted. SWEPI believes this to be an improper application of the MMS internal policy guideline by the RVSD under these circumstances, resulting in undue discrimination against SWEPI, and respectfully submits the following in support of its position.

FACTS

The Cortez Pipeline Company, a general partnership of Shell Cortez Pipeline Company (50%), Mobil Cortez Pipeline Company

(37%), and HNG Cortez Pipeline Company (13%), owns the 500-mile, 30-inch CO_2 pipeline (Cortez CO_2 pipeline) which transports CO_2 from the McElmo Dome Unit to markets in West Texas. The Cortez CO_2 pipeline is operated by Shell Pipe Line Corporation as a common carrier pipeline and currently has a published tariff of $0.39/MCF.

The Cortez CO_2 pipeline is essentially producer owned due to the speculative nature and the cost of such a pipeline, approximately —— X·4 —— These characteristics were not conducive to ownership by parties who had not already invested in CO_2 production facilities at McElmo Dome, at a cost of approximately $200 million, as well as CO_2 injection facilities and recovery plant at the Denver Unit, at a cost of approximately $220 million. The Cortez CO_2 pipeline, however, does transport CO_2 for producers in the McElmo Dome (Leadville) Unit who are not owners of such pipeline.

Cortez Pipeline Company sought determinations from both the Interstate Commerce Commission (ICC) [2/] and the Federal Energy Regulatory Commission (FERC) [3/] as to whether the

---

2/ Petition of Cortez Pipeline Company dated April 14, 1980.

3/ Application of Cortez Pipeline Company for Declaratory Order that Pipeline Project is Non-Jurisdictional dated December 18, 1978.

interstate transportation of CO_2 by pipeline was subject to either agency's jurisdiction. Both the ICC and FERC declined to assert jurisdiction over the pipeline transportation of CO_2.

Although not subject to federal rate regulation, Cortez Pipeline Company has published a tariff that is consistent with the tariff methodology historically used by pipeline companies under the 1941 Consent Decree in the case of United States v. The Atlantic Refining Company, et al. and the published tariff reflects such methodology.

ARGUMENT

If the Cortez Pipeline Company tariff for the transportation of CO_2 were filed with, and subject to the jurisdiction of one of these regulatory agencies, the tariff rate would have been approved in its entirety by the MMS as a reasonable cost of transportation which would be deductible for purposes of computing royalty. (See page 3, RVSD report dated May 6, 1985).

However, simply because the transportation of CO_2 is not subject to the jurisdiction of a regulatory agency, the RVSD

has disregarded the fact that the tariff adopted by the Cortez Pipeline Company is consistent with the 1941 Consent Decree methodology. The arbitrary application of the MMS policy guideline pertaining to producer-owned pipelines by the RVSD has resulted in undue discrimination against the producer-owners of the Cortez CO_2 pipeline, a common carrier. The producer-owners are subjected to liability for a higher royalty payment to the MMS than are other producers of CO_2 from the McElmo Dome (Leadville) Unit or from other CO_2 sources who transport CO_2 through the Cortez CO_2 pipeline, but who do not own an interest in the Cortez CO_2 pipeline, solely because the transportation of CO_2 is not regulated. Such a distinction based solely on the non-regulatory nature of the Cortez CO_2 pipeline, without having considered the fact that the tariff is the same tariff that would be in effect if such pipeline were regulated, is clearly discriminatory. The action of the RVSD creates a distinction without a rational basis and constitutes an abuse of discretion.

Quite apart from the legal issues involved are the practical considerations that result from the arbitrary application of the MMS policy guideline by the RVSD. SWEPI is the Operator

of the McElmo Dome (Leadville) Unit and has a working interest of about 44 percent. The Unit Agreement permits the small working interest owners - parties who have no ownership in the Cortez CO_2 pipeline - to share in CO_2 sales contracts made by SWEPI or Mobil, the largest working interest owners in the Unit. By the application to the Cortez CO_2 pipeline of a MMS policy guideline that is applicable to producer-owned pipelines transporting only that producer's production (See page 3, RVSD report dated May 6, 1985), SWEPI, who has undertaken to pay royalty for all other working interest owners (except Mobil), will be required to compute royalties for those producers transporting CO_2 through the Cortez CO_2 pipeline on a basis which differs according to the producer's interest in such pipeline. Such unwarranted distinction is an added administrative and accounting burden to SWEPI and adds to the undue discrimination suffered by SWEPI.

Further, if SWEPI markets CO_2 production in excess of its Unit share, as permitted under the Unit Operating Agreement, and as is currently occurring, SWEPI will be required to pay royalty at a higher rate for all CO_2 it produces and sells than would be the situation if the CO_2 was produced and sold by a producer who did not own an interest in the Cortez CO_2 pipeline. Every two years, overproduced working interest

owners are required to cash balance CO_2 overproduction with those underproduced working interest owners who so elect. At such balancing, SWEPI, as an overproduced working interest owner, would be found to have overpaid the royalty attributable to the non-pipeline owning producers' share of production. Refunds would then have to be sought from the MMS for such overpayments. The accounting and administrative burden associated herewith for both the producers and the MMS will have been the result of the arbitrary application of MMS policy by the RVSD to circumstances not supporting adoption of such policy.

CONCLUSION

The disallowance by the RVSD of the federal and state income tax portion of the Cortez Pipeline Company tariff in the computation of royalties is based solely on the misapplication of a MMS policy guideline concerning producer-owned pipelines transporting only that producer's production. It is inappropriate to apply such policy guideline to the Cortez Pipeline Company, a common carrier, under the circumstances described above. The result of arbitrarily applying such policy guideline under these circumstances constitutes undue discrimination between SWEPI and other working interest owners in the McElmo Dome

(Leadville) Unit or in other CO_2 sources who are not owners of the Cortez CO_2 pipeline.

For the reasons contained in SWEPI's Appeal, comments previously submitted, and the foregoing, SWEPI requests that the decision of the RVSD to disallow federal and state income taxes as a cost component of the Cortez Pipeline Company tariff be reversed.

Respectfully submitted,

William G. Riddoch

William G. Riddoch
Senior Counsel
Shell Oil Company
On behalf of Shell Western
E&P Inc.

WGR:NC

cc: Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
Minerals Management Service
Department of the Interior
P. O. Box 25165
Denver, Colorado 80225
Denver, Colorado 80225
Mail Stop 653
Re: MMS-RVS-O&G:85-0120

CO2 TRANSPORTED FROM ALLRED STATION TO DENVER CITY DELIVERY STATION:
1985 ALLOWANCE

COSTS	ALLOWANCE COSTS APPROVED BY MMS	COSTS- REVISED REQUEST
OPERATING EXPENSE	$148,621.60 (1)	$127,953.24 (2)
RETURN ON INVESTMENT	— X-4 —	— X-4 —
DEPRECIATION		
	— X-4 —	— X-4 —
VOLUME TO DENVER STATION	7,840,214	7,840,214
RATE	0.048812	0.046176

(1) $185,777 X .8 = $148,621.60
(2) X-4
DOES NOT INCLUDE AD VALOREM TAX
(3)
(4) X-4

CO2 TRANSPORTED FROM ALLRED STATION TO THE WELLMAN UNIT:
1985 ALLOWANCE

COSTS	ALLOWANCE COSTS APPROVED BY MMS	COSTS-REVISED REQUEST
OPERATING EXPENSE	$37,155.40 (1)	$31,988.31 (2)
RETURN ON INVESTMENT	— X-4 —	— X-4 —
DEPRECIATION		
VOLUME TO WELLMAN UNIT	8,659,034	8,659,034
RATE	0.011049	0.010452

(1) — X-4 — = $37,155.40
(2) ~~= $31,988.31~~
DOES NOT INCLUDE AD VALOREM TAX → error Mobil = 0
(3) X-4
(3)

On July 24, 1990, called Gay Anderson (Mobil) She confirmed that there was not (0) any ad valorem tax for 1985; therefore, the operating costs did not exceed 10% of the undepreciated investment.

Lu Bayani

1985 OPERATING EXPENSES, MPTM CO2 PIPELINE

OPERATING LABOR	$15,900.70
MAINTENANCE LABOR	$5,075.66
OPERATING SUPPLIES, UTILITIES & FUEL PURCHASED	$74,250.01
SERVICES PURCHASED	$24,837.92
MAINTENANCE SUPPLIES	$4,406.64
SALES AND USE TAXES	$2,560.09
OTHER DIRECT EXPENSE	$31,109.45
INDIRECT EXPENSE	$1,801.08
TOTAL OPERATING EXPENSES	$159,941.55

EIGHTY PERCENT OF THE COSTS APPLY TO THE SEMINOLE SAN ANDREAS UNIT AND TWENTY PERCENT APPLY TO THE WELLMAN UNIT.

United States Department of the Interior
MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225
Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-O&G:85-0120

MAY 6 1985

Memorandum

To: Chief, Division of Appeals, Office of Program Review

Through: Chief, Office of Resource Management and Compliance Support

From: Chief, Royalty Valuation and Standards Division

Subject: Appeal by Shell Oil Company Concerning Income Tax as a Deductible Cost of Transportation from Federal Royalty, McElmo Dome CO_2 Unit, Colorado (Division of Appeals Docket Number MMS-84-0013-MISC)

Introduction

By letter dated May 1, 1984, (copy attached), Shell Western E&P, Inc. (SWEPI), filed an appeal to an MMS decision dated March 29, 1984, (copy attached). The MMS decision allowed SWEPI to deduct, from Federal royalty, certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 Pipeline Consent Decree. All components of the tariff were allowed to be deducted from Federal royalty with the exception of State and Federal income tax. SWEPI has appealed the exception of income tax as a cost of transportation.

Background

By application dated December 9, 1983, (copy attached), SWEPI presented proposals concerning the valuation, for royalty purposes, of carbon dioxide (CO_2) gas produced by SWEPI from the McElmo Dome Unit in southwestern Colorado. The gas is transported from the unit approximately 530 miles to the Denver Unit in West Texas for use in a tertiary oil recovery project. The gas is being transported to the Denver Unit by the Cortez Pipeline Co., which is owned by Shell Cortez Pipeline Co., Mobil Cortez Pipeline Co., and Continental Cortez Pipeline Co. SWEPI contends that the Cortez Pipeline is a common carrier pipeline.

By letter dated March 29, 1984, MMS advised SWEPI that all components of the tariff were allowable to be deducted from Federal royalty with the exception of State and Federal income tax. SWEPI has appealed the exception of income tax as a cost of transportation by their letter of May 1, 1984.

By letter dated September 10, 1984, (copy attached), the Royalty Valuation and Standards Division (RVSD) filed a report to the Office of Program Review, regarding the appeal by SWEPI. RVSD recommended that its previous position be upheld on the basis of William and Meyers Oil and Gas Law, Vol. 3, § 604.6(b) and Matzen vs. Hugoton Production Co., (321 P. 2d 576), In those references (copies attached) income tax was clearly excluded as a cost of operation.

By letter dated February 7, 1985, (copy attached), SWEPI filed additional comments in response to the RVSD report of September 10, 1984. SWEPI established arguments on the following main issues:

(1) The MMS decision to deny income tax as a deductible cost of transportation constituted a departure from previous MMS determinations on the same subject.

(2) The MMS report of September 10, 1984, is not supported by any authorities which are relevant to the issue presented in the SWEPI appeal.

(3) The decisions of the Department of Interior, general oil and gas law, and other authorities support the position that reasonable costs of transporting production from the field to the market are allocable to the royalty interest.

Previous MMS Determinations on Income Tax as a Cost of Transportation

Transportation allowances are provided for in Title 30, Code of Federal Regulations, Part 206.103:

> "The value of production for the purpose of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for part or for a majority of production of like-quality in the same field, to prices received by the lessee, to posted prices, and to other relevant matters...." (Emphasis added.)

The reasonable actual costs incurred by the lessee or operator in transporting lease production to the nearest available market place is one of the relevant matters to be considered in establishing royalty values.

The Conservation Division Manual (CDM 647.5) provides standard guidelines for determining allowable pipeline transportation deductions for royalty purposes for Federal and Indian onshore lands. According to the CDM, transportation allowances may be approved for moving production through the following pipelines:

(1) Producer-owned and operated pipelines (CDM 647.5A);

(2) Producer-owned (by production payments) pipelines which are not operated by the lessee (CDM 647.5B); and

(3) Pipelines owned by parties other than the lessee (CDM 647.5C).

Under the Pipeline General Section, the CDM advises "in general, tariff rates established by a State or Federal regulatory body may be accepted as establishing the reasonable cost of transportation."

Since Shell owns a major interest of the Cortez Pipeline Company through its subsidiary, Shell Cortez Pipeline Company, RVSD feels that the CDM guidelines under "producer-owned and operated pipelines," 647.5A, are most applicable in this case.

In this section, guidance is provided on which operating costs are allowable as part of the total pipeline transportation cost to be deducted from Federal royalty including:

> "Intangible and direct costs in the following or like categories which can be shown to the satisfaction of the Supervisor to be part of the operating costs: Insurance (hazard, liability, workman's compensation, etc.); Taxes (Social Security, property taxes assessed on the pipeline and other equipment approved as pipeline investment items, etc. <u>However, corporate income taxes are not an allowable deduction</u>);...." (Emphasis added.)

Section 647.5C, "Third-party Pipelines" provides that allowances will be limited to the lesser of the following:

> "A. The cost of transporting production to market via the least expensive mode available;
>
> "B. Tariff established by State or Federal regulatory agencies; or
>
> "C. Actual charges to the lessee for transporting production, pursuant to an arm's-length contract."

SWEPI contends that the MMS decision to deny income tax as a deductible cost of transportation constituted a departure from previous MMS determinations on transportation allowances. In general, if a pipeline is producer-owned and transporting that producer's production only to a sales point, MMS requires submittal of detailed cost data to justify transportation expenses. In these situations, it has been, and is, MMS policy to deny income tax as a legitimate cost of transportation in those cases where these costs can be identified. Therefore, SWEPI's claim of arbitrariness on the part of MMS is unsubstantiated.

In situations where a third-party pipeline, generally a common carrier, imposes a tariff on a producer under arm's-length conditions, MMS will approve the entire tariff, regardless of how such tariff is derived, as the producer's actual cost of transportation that may be deducted from Federal royalty. In the OCS Gulf of Mexico oil transportation systems, MMS historically has

allowed Federal Energy Regulatory Commission (FERC) tariffs (which generally include income tax) as transportation allowances; however, only in situations where the pipeline is owned and operated by a nonaffiliated party. If a pipeline is a common carrier, and carries both affiliated and nonaffiliated production, it is MMS policy to accept a published tariff for the nonaffiliated production, but to require actual cost data to justify an allowance for affiliated production.

MMS Report of September 10, 1984, is not Supported by Relevant Authorities

The MMS report of September 10, 1984, cited two authorities which it believed were relevant to the issue of income tax as a transportation cost: Matzen vs. Hugoton Production Co. (copy attached), and William and Meyers Oil and Gas Law, Vol. 3, § 604.6(b) (copy attached). Both of these references explicitly state that income tax is not a cost of operation.

SWEPI points out that in William and Meyers Oil and Gas Law the section on income tax is in reference to "costs of paying production" and cannot be taken out of context and applied to "costs subsequent to production," i.e., transportation costs. SWEPI contends that this section "identifies the party whose income taxes are not to be included in the current cost of operations, i.e., the owner of the working interests, and not a common carrier pipeline."

RVSD feels that because SWEPI is a major working interest holder in the Cortez Pipeline, this section of Oil and Gas Law applies to SWEPI's situation. As stated before, if the Cortez Pipeline were shipping CO_2 from a nonaffiliated party as a common carrier, MMS policy would be to allow the full tariff rate as the actual cost of transportation from our lessee to the nonaffiliated common carrier. In all of SWEPI's discussions, SWEPI fails to distinguish between these two situations.

Similarly, SWEPI points out that in Matzen vs. Hugoton Production Co. the case involves "income taxes of a lessee, and the instant appeal involves income taxes of a common carrier pipeline. The former is not, and the latter is, a proper component of transportation expense deductible from lessor royalty."

Again, RVSD believes that because of SWEPI's interest in the Cortez Pipeline, SWEPI's responsibilities as a lessee extend to include the pipeline. RVSD believes that SWEPI is not a common carrier of its own production.

The Decisions of Other Authorities Support Transportation Costs as Deductible from the Royalty Interest

SWEPI references several other authorities which discuss reasonable costs of transporting production from the field to the market that are allocable to the royalty interest; the Department of Interior, the Internal Revenue Service, Northern Natural Gas vs. Grounds (copy attached), Ashland Oil, Inc., vs. Phillips Petroleum Co. (copy attached), and the 1941 Pipeline Consent Decree.

SWEPI cites two Department of Interior decisions which support the deduction of transportation costs in the computation of royalties; Shell Oil Co., 70 I.D. 393 (1963), and C&K Petroleum, Inc., 27 I.B.L.A. 15, 20 (1976). In both of these decisions it was recognized that transportation costs are "proper deductible expenses in the computation of royalties."

RVSD agrees that reasonable actual transportation costs, in general, are proper deductible expenses in the computation of royalties; however, SWEPI fails to demonstrate in this discussion that the Department of Interior determined that income tax is a cost of transportation to be deducted from Federal royalty in a producer-owned pipeline situation.

In Northern Natural Gas Co. vs. Grounds the validity of the "net-back" valuation method was established. RVSD agrees completely with the "net-back" valuation method; however, once again SWEPI fails to demonstrate the validity of applying income tax as a cost of transportation to be deducted from Federal royalty in a producer-owned pipeline situation. In Northern the issue of income tax is not mentioned.

In Ashland Oil, Inc., vs. Phillips Petroleum Co. the "net-back" valuation method was again established as a valid valuation methodology, and allowed certain "treatment" and "processing" costs to be deducted from payments. SWEPI fails, however, to establish the pertinence of this case to the issue of income tax. The income tax issue is not mentioned anywhere in Ashland. Also, the Ashland case does not involve a producer-owned pipeline. RVSD feels that these two court cases have no pertinence whatsoever to the issue of income tax.

SWEPI's discussion of the 1941 Pipeline Consent Decree points out that, historically, income taxes have been a valid cost component in published tariffs. RVSD disputes the proposal, however, that in a producer-owned pipeline system the income tax portion should be allowed to be deducted from Federal royalty. Once again, SWEPI offers no concrete argument that income tax should be an allowable deduction from Federal royalty in a producer-owned pipeline system. SWEPI does not distinguish a third-party pipeline from a producer-owned pipeline. MMS does.

Finally, SWEPI references the Internal Revenue Service Wellhead Evaluation Formula (also known as the "Fiske Formula"). This formula is, essentially, a net-back formula for determining wellhead value of natural gas when there is no market for unprocessed gas at the wellhead. This formula is used when natural gas is processed at a plant and the producer (a percentage plant owner) receives a percentage of the plant proceeds. Similar to 1941 Pipeline Consent Decree, this formula allows a "reasonable return on the investment in the plant, usually ten percent per year." (From C. Smith and G. Anderson, Jr., Federal Taxation of Oil and Gas Transactions 8-9 to 8-10). The Decree allows a seven percent return on investment. SWEPI concludes, from this example, that because income tax is an allowable deduction in this situation (for tax purposes), income tax is also an allowable deduction for royalty purposes.

RVSD feels that deductions used for tax purposes are not pertinent to deductions used for royalty purposes.

Conclusions

For the reasons stated above, RVSD recommends that income tax be excluded as a component of the actual transportation costs to be deducted from Federal royalty by lessees transporting production through lessee-owned pipelines or pipelines owned by affiliates of the lessee.

William H. Feldmiller

William H. Feldmiller

Attachments (9)

Mobil Producing Texas & New Mexico Inc.

NINE GREENWAY PLAZA-SUITE 2700
HOUSTON, TEXAS 77046

X-4

Shell Western E&P Inc.
P.O. Box 576
Houston, Texas 77001
Attn: Mr. C.P. St. Laurent

1
X-4
1

TEMPORARY DELIVERY OF SHELL IN-KIND CO_2 TO THE SEMINOLE-SAN ANDRES UNIT, GAINES COUNTY, TEXAS

Gentlemen:

Mobil Producing Texas & New Mexico Inc. ("MPTM") and Shell Western E&P Inc. ("SWEPI") are working interest owners in the Seminole San-Andres Unit (Unit). Each has elected to furnish CO_2 required by the Unit for an enhanced oil recovery project through an in-kind delivery contract. MPTM has installed meters, pipeline, and facilities to receive and transport its CO_2 from the Allred Station at the Cortez Pipeline to a delivery point at the Sheep Mountain Pipeline.

MPTM has entered into a Carbon Dioxide Transportation Agreement (Transportation Agreement) dated X-4 with X-4 X-4, copy of which is attached hereto as Exhibit "A". X-4 agreed therein to accept delivery of CO_2 at the point of delivery at the Sheep Mountain Pipeline in the NE/4 SE/4 NE/4, Section 764, John H. Gibson Survey, Block D, Yoakum County, Texas for transportation and redelivery for MPTM's account to the Unit located in Tract 35, Section 218, Block G, W.R. RR Company Survey, Gaines County, Texas. MPTM's delivery of CO_2 to the Sheep Mountain Pipeline commenced on or about X-4.

SWEPI intends to deliver its CO_2 in-kind to the Unit through facilities and arrangements expected to be operational by X-4 X-4. Until such arrangements are operational, SWEPI desires MPTM to receive and transport SWEPI's CO_2 through the MPTM owned system from the Allred Station on the Cortez Pipeline to the delivery point on the Sheep Mountain Pipeline. SWEPI desires for X-4 to transport SWEPI's CO_2 through the Sheep Mountain Pipeline for delivery to the Unit upon the same terms and conditions as the Transportation Agreement between MPTM and X-4, except as modified below.

X-4

I.

TRANSPORTATION OF SWEPI CO_2 IN MPTM's PIPELINE SYSTEM

MPTM agrees to receive and transport through the MPTM owned system volumes of SWEPI's CO_2 to be furnished pursuant to the Carbon Dioxide In-Kind Delivery Contract dated February 28, 1984, by and between X-4 and SWEPI; provided that, transportation of SWEPI's CO_2 shall not in any manner diminish or restrict MPTM's ability or right to transport its CO_2 required for delivery to the Unit or other delivery commitments. As consideration for such transportation, SWEPI shall pay MPTM a tariff of X-4¢ per mcf for volumes of SWEPI's CO_2 actually transported. MPTM shall bill SWEPI each month for the volumes of CO_2 transported for SWEPI in the MPTM owned system, and SWEPI agrees to pay MPTM within thirty (30) days of receipt of such bill. The volumes of SWEPI's CO_2 transported by MPTM will be measured at the point MPTM delivers CO_2 to the Sheep Mountain Pipeline.

II.

TRANSPORTATION OF SWEPI CO_2 IN SHEEP MOUNTAIN PIPELINE

X-4 or its agent agrees to receive and transport in the Sheep Mountain Pipeline volumes of SWEPI's CO_2 pursuant to its Carbon Dioxide In-Kind Delivery Contract dated February 28, 1984, by and between X-4 and SWEPI. Further, X-4 agrees to transport SWEPI's CO_2 on an interim basis pursuant to the terms and conditions of the Transportation Agreement, except the volumes of CO_2 transported for SWEPI shall not in any manner affect the requirements and limitations on quantity of CO_2 attributable to MPTM pursuant to Article III nor shall the term as set out in Article XIII be applicable to the transportation of SWEPI CO_2. SWEPI shall reimburse MPTM monthly, within thirty (30) days after MPTM bills SWEPI, for the X-4 per MCF tariff charged MPTM by X-4 for transportation of SWEPI's CO_2. However, X-4 shall measure CO_2 delivered by the Sheep Mountain Pipeline to the Unit and SWEPI shall bear its pro rata share of any shrinkage or line loss of CO_2 while being transported through the Sheep Mountain Pipeline. SWEPI agrees to pay its share of any other assessments or losses imposed upon MPTM by X-4 under the terms of the Transportation Agreement in proportion to its share of the transported volumes of CO_2.

X-4

III.

TERM

This Agreement shall be effective as of —— X-4 —— and shall remain in full force and effect until terminated by either MPTM or SWEPI upon thirty (30) days advance written notice to the other parties hereto.

If the foregoing correctly sets forth our mutual understanding concerning the delivery of SWEPI's Co_2 to the Unit, please so indicate by signing and returning to us one copy of this agreement.

Yours very truly,

D. O. Atkinson

EMGott/ERM/flf

ACCEPTED & AGREED TO THIS

—— X-4 ——

SHELL WESTERN E&P INC.

BY:

In the Absence of:
W. D. Saulmon

ACCEPTED & AGREED TO THIS

X-4

C#3

MPTM - WEST
X-4

CO_2 TRANSPORTATION AGREEMENT

CONTRACT NO.: X-4 /

PIPELINE: Cortez Pipeline

DATE: ——— X-4 ———

TRANSPORTER: Mobil Producing Texas & New Mexico Inc.

OWNER: Shell Western E&P Inc. (SWEPI)

TERM: Cancellable by either party with 30 days PWN

DISTRIBUTION:

Mobil Oil Corporation:
Houston - USGas (orig.)
Dallas - HFVierk, DARichardson*

MPTM:
AJWilson, REDrouhard*, HCPatton*, KADuerst*, HCasas, EHLumpkins*, EMGott*

* Cover Sheet Only

NOTE: Temporary transportation and delivery of SWEPI's in-kind CO_2 to the Seminole-San Andres Unit. MPTM shall transport SWEPI's CO_2 from the Allred Station on the Cortez Pipeline to the Sheep Mountain Pipeline for a fee of X-4 /Mcf.

(Refer to X-4 for MPTM's CO_2 In-Kind Supply Agreement w— X-4 —— .)

EHLumpkins/cm

PROPRIETARY INFORMATION

MMS-RVS-OG-83-374
M.S. 653

SEP 10 1984

Memorandum

To: Chief, Division of Appeals, Office of Program Review

From: Chief, Royalty Valuation and Standards Division

Subject: Income Tax as a Cost of Transportation

By letter dated May 1, 1984, Shell Western E&P, Inc. (SWEPI), filed an appeal to an MMS decision dated March 29, 1984 (Division of Appeals docket number MMS-84-0013-MISC). The case at issue regards transportation of carbon dioxide (CO_2) by pipeline from the McElmo Dome Unit in southwestern Colorado, to a delivery point at the Denver Unit in western Texas. The pipeline is owned by the Cortez Pipeline Company, of which Shell, Mobil, and Conoco, are parent owners.

The MMS decision of March 29, 1984, allowed SWEPI to deduct, from Federal royalty, certain transportation charges assessed by Cortez Pipeline Company in accordance with a 1941 Pipeline Consent Decree. All components of the tariff were allowed to be deducted from Federal royalty with the exception of state and Federal income tax. SWEPI has appealed the exception of income tax as a cost of transportation.

The RVSD upholds its previous position with regard to income taxes. In William and Meyers Oil and Gas Law, Vol. 3, §604.6(b) clearly defines which costs may be considered as a cost of operation; "the current cost of operation has been held to include taxes (other than income taxes) payable by the owner of the working interests." In addition, in Matzen v. Hugoton Production Co., (321 P.2d 576), the Supreme Court of Kansas upheld evidence which established that "from an accounting standpoint, income tax is a sharing of profits, not a cost; that in cost accounting, income tax is never used as a factor in determining cost of operation, cost of sales, nor of any other item."

For the reasons stated above, the Royalty Valuation and Standards Division recommends that income tax should not be allowed as part of the cost of transportation as claimed by SWEPI.

[redacted] T. C. BLAIR

for William H. Feldmiller

Shell Oil Company

P O. Box 576
Houston, Texas 77001

May 1, 1984

Minerals Management Service
Attn: Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
P. O. Box 25165, MS-653
Denver, Colorado 80225

Subject: Notice of Appeal of Transportation Allowance Deduction, McElmo Dome (Leadville) Unit, Montezuma and Dolores Counties, Colorado

Dear Mr. Feldmiller:

Shell Western E&P Inc. (SWEPI), successor in interest to Shell Oil Company as Operator of the McElmo Dome (Leadville) Unit, [1]/ pursuant to 30 CFR Part 290 hereby files its Notice of Appeal of the Minerals Management Service (MMS) transportation allowance deduction for royalty purposes for carbon dioxide (CO_2) gas produced at the McElmo Dome (Leadville) Unit and transported by pipeline to the market for such CO_2 at the Denver Unit, Gaines and Yoakum Counties, Texas.

BACKGROUND

On October 25, 1983, representatives of SWEPI met with representatives of the MMS Royalty Valuation and Standards Division to provide an overview of the McElmo Dome/Denver Unit CO_2 Project. At such meeting SWEPI was requested to provide the MMS with information concerning the Cortez Pipeline Company (Cortez) tariff.

By letter dated December 9, 1983, SWEPI advised the MMS of certain facts which Cortez had provided to SWEPI concerning the tariff to be established by Cortez for the transportation of CO_2 from the McElmo Dome (Leadville) Unit to the Denver Unit. In said letter SWEPI proposed that the

---

[1]/ On January 1, 1984, Shell Western E&P Inc. succeeded to the interest of Shell Oil Company in all facets of the McElmo Dome/Denver Unit CO_2 Project. Reference to SWEPI in this Notice of Appeal shall be deemed as a reference to Shell Oil Company for periods prior to January 1, 1984.

MINERALS MANAGEMENT SERVICE
ROYALTY VAL & STDS DIV
MAY 3 1984

Cortez tariff be allowed as a transportation deduction from the proceeds received by SWEPI for the sale of CO_2 and that SWEPI not be required to pay royalty to the MMS on the Cortez tariff.

The MMS, by letter dated March 29, 1984, advised SWEPI that the tariff calculation procedure utilized by Cortez was acceptable, provided, however, that Federal and State income taxes are not to be considered in computing transportation costs. The MMS then determined that if Federal and State income taxes are retained in the tariff computation, royalty must be paid to the MMS on that portion of the pipeline tariff represented by Federal and State income taxes. It is this determination by the MMS that SWEPI is appealing by this letter.

FACTS

Cortez is a general partnership owned by Shell Cortez Pipeline Company, Mobil Cortez Pipeline Company, and Continental Resources Cortez Pipeline Company. Cortez owns a 500 mile, 30-inch pipeline ultimately capable of transporting approximately 1,000,000 MCF/day of CO_2. The Cortez pipeline is operated as a common carrier and is subject to regulation under the common law of the United States. Since CO_2 is neither oil nor natural gas, the transportation of such CO_2 is not subject to regulation by any federal agency.

Even though not subject to regulation, we have been advised that in order to establish a fair and reasonable tariff, the Cortez partners elected to use the methodology which had been historically used by pipeline companies which were parties to the 1941 Consent Decree in the case of United States v. The Atlantic Refining Company, et al., C.A. 14060, D.D.C. (Dec. 23, 1941).

The Cortez Pipeline Company has posted an initial tariff of $0.39/MCF for CO_2 transported through the pipeline. Cortez has stated that the tariff of $0.39/MCF was agreed upon by the Cortez partners and, because of competitive and economic factors, the tariff does not represent the actual costs of transporting CO_2. Such tariff is based on the assumption that the Cortez pipeline throughput is 1,000,000 MCF/day. In fact, the throughput of the Cortez pipeline is anticipated to reach only 330,000 MCF/day in the third or fourth quarter of 1984 and is not projected to reach an actual throughput of 1,000,000 MCF/day for several years. Achievement of such throughput is, of course, contingent on

sales of CO_2 by producers of CO_2. We have been further advised by Cortez that in the early years of operations the actual transportation cost per MCF, excluding income taxes, is expected to be greater than the posted tariff of $0.39/MCF.

ARGUMENT

The March 29, 1984 letter from the MMS sets forth the policy and procedures by which the unit value of the CO_2 is established for royalty purposes: (1) Establishing the fair market value of the CO_2 at the Denver Unit; (2) deducting therefrom the cost of transporting the CO_2 from the McElmo Dome source field to the Denver Unit; and (3) adding thereto any other reimbursements that may be received as "gross proceeds" by SWEPI as a Federal lessee.

Basically, the above procedures are in accord with 30 CFR Section 221.47 - Value basis for computing royalties. SWEPI's disagreement with the MMS is based on the interpretation of the MMS set forth in the March 29, 1984 letter that Federal and State income taxes are not to be considered in computing transportation costs.

The issue of not considering Federal or State income taxes in the computation of transportation costs is moot with respect to the transportation of CO_2 from the McElmo Dome (Leadville) Unit to the Denver Unit at this time since the actual cost of transportation per MCF, excluding income taxes, will be greater than the initial tariff. However, the position of the MMS will become an issue in the future.

There currently is no market for CO_2 produced from the McElmo Dome (Leadville) Unit except for CO_2 purchased by the Denver Unit. The actual cost of transporting CO_2 through the Cortez pipeline from Southwestern Colorado to West Texas is a marketing cost which must be assumed by the royalty owner as well as the working interest owners. These actual costs of transportation, which will in the future include payment of both Federal and State income taxes, constitute the Cortez tariff and are incurred by the Federal lessee who transports CO_2 to the Denver Unit for sale. SWEPI, as a Federal lessee transporting CO_2 to the Denver Unit for sale, is entitled to be reimbursed by the purchaser of CO_2 for the tariff charged for transporting such CO_2, subject to certain limitations as set forth in the Denver Unit CO_2 Sale and Purchase Contract. Since the Sale of CO_2 to the Denver Unit was the first such sale of CO_2 from the McElmo Dome (Leadville) Unit - and is still the only such sale - it was

necessary to agree with the Denver Unit working interest owners that they would not bear the full cost of the Cortez pipeline tariff.

Thus, any actual costs of transportation borne by SWEPI which are not reimbursed by the Denver Unit were agreed to through negotiation with the Denver Unit working interest owners. The MMS, however, by its determination not to permit deduction of all the actual transportation charges (the tariff) incurred by SWEPI has arbitrarily and without justification imposed a penalty on SWEPI which was neither negotiated nor anticipated. The full tariff paid by SWEPI should be permitted to be deducted from the price received for CO_2 sales by SWEPI for royalty payment purposes to the MMS.

The methodology utilized by Cortez in establishing its tariff for the transportation of CO_2 is not novel. Every regulatory agency assigned the task of regulating pipeline rates has always, and without exception, allowed both Federal and State income taxes as a cost of service and thereby an element of the tariff. If Cortez was a regulated pipeline, MMS would undoubtedly allow SWEPI to deduct transportation charges equal to the entire tariff paid to Cortez. It is also presumed that the MMS would permit full deduction of a tariff charged to SWEPI if a third party (other than an affiliate) owned the pipeline. Thus, the action taken by the MMS in not permitting SWEPI to deduct the actual tariff paid to Cortez for transporting CO_2 simply because Cortez is not subject to any regulatory agency jurisdiction and because SWEPI and Cortez are affiliates is discriminatory and should not be permitted.

The MMS has not provided SWEPI with any rationale for its departure in this case from its historic acceptance of pipeline tariffs which are based on payment of both Federal and State income taxes. The only distinction in the case of this CO_2 pipeline from the many crude oil and petroleum product pipelines where the full tariff is permitted to be deducted as a transportation allowance is that such pipeline is not subject to regulation by a Federal regulatory agency. SWEPI considers this a distinction without a difference, since Cortez has elected to adopt a pipeline tariff methodology that would be acceptable to a regulatory agency having jurisdiction over the CO_2 pipeline. Further, the Cortez pipeline tariff is subject to the large body of common law concerning common carriers. Cortez must not discriminate in its service or charges between its customers

and must establish just and reasonable rates for its service.

For the foregoing reasons, SWEPI respectfully submits that the disallowance of the Federal and State income tax components of the Cortez Pipeline Company tariff in computing the transportation deduction for royalty payment purposes is arbitrary and capricious and constitutes a departure from previous MMS determinations. The MMS has provided no justification for such departure and has thus discriminated against SWEPI.

Respectfully submitted,

William G. Riddoch

William G. Riddoch
Senior Counsel
On behalf of Shell Western E&P Inc. (713) 870-3625

cc: Mr. Norman Hess
Appeals Division
Minerals Management Service, MS-623
12203 Sunrise Valley Drive
Reston, Virginia 22091

United States Department of the Interior
MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

MMS-RVS-OG
MS-653

MAR 29 1984

Certified Mail -
Return Receipt Requested

Shell Oil Co.
Attention: Mr. William G. Riddoch
P.O. Box 576
Houston, TX 77001

Dear Mr. Riddoch:

In your letter dated December 9, 1983, you presented proposals concerning the valuation, for royalty purposes, of carbon dioxide (CO_2) gas to be produced from the McElmo Dome Unit in southwestern Colorado. The gas will be transported from the unit approximately 530 miles to the Denver Unit in western Texas, for use in a tertiary oil recovery project. Shell Oil Co., as a working interest owner and Unit Operator of the McElmo Dome Unit, is selling its gas to Shell Oil Co. as operator of the Denver Unit and representative of the Denver Unit interest owners. The gas is being transported to the Denver Unit by the Cortez Pipeline Co., which is owned by Shell Cortez Pipeline Co., Mobil Cortez Pipeline Co., and Continental Cortez Pipeline Co.

You have proposed to exclude from royalty payments the quantity of CO_2 to be used in filling the Cortez pipeline. You also have proposed that the "Carbon Dioxide Sale and Purchase Contract" between Shell as Seller, and Shell as Buyer and Operator of the Denver Unit, be recognized as an arm's-length contract. As such, you propose that the price of CO_2 as determined by Section 4.1 of the contract be the value basis for royalty payments with no royalty being required on the CO_2 pipeline tariff. The partners of Cortez Pipeline Co. have elected to calculate the CO_2 pipeline tariff on the basis of the 1941 Pipeline Consent Decree methodology which provides, in essence, that the pipeline tariff is established to provide a 7 percent return to the owners.

The policy and procedures of the Minerals Management Service require that a computation of the unit value of CO_2, for royalty purposes, at the McElmo Dome Unit be accomplished by (1) establishing the fair market value of the CO_2 at the Denver Unit, (2) deducting therefrom the cost of transporting the gas from the McElmo Dome Unit to the Denver Unit, and (3) adding thereto any other reimbursements that may be received as "gross proceeds" by Shell as a Federal lessee.

The Bureau of Land Management has advised that it will approve the measurement of CO_2 gas, for royalty purposes, at metering facilities located at the McElmo Dome Unit field facility. This is the point at which value will attach for

royalty purposes, and Federal royalty is due on all CO_2 gas that is produced. Royalty will become due on the CO_2 as it is produced at the McElmo Dome Unit, and the initial line fill cannot be excluded from royalty payment.

A decision as to the fair market value of the CO_2, for royalty purposes, at the Denver Unit cannot be made on the basis of information now available. We will soon be requesting more specific details regarding the negotiations that led to the sales agreement as part of the process of making a determination of the value of CO_2. That request, however, will be made under separate cover in order not to violate the confidentiality of contract information previously submitted to us. The use of the price cited in the sales contract by and between "Shell Oil Company, Seller" and "Denver Unit Operator, Buyer" is acceptable in the interim as a basis for payment of Federal royalty until a final determination can be made by MMS regarding the fair market value of the CO_2 for royalty purposes. In the event the final determination were to result in a value greater than the price specified in the contract, MMS will not assess a late payment charge on the additional royalty which would be due.

The "tariff calculation" procedure to arrive at a value deduction for transportation costs proposed by Shell is acceptable, with the exception that, for royalty purposes, Federal and State income tax are not to be considered in computing transportation costs. Accordingly, Federal and State income tax should be eliminated before transportation costs are computed. Should they be retained in the computation, royalty must be paid on that portion of the pipeline tariff represented by the Federal and State income taxes. Royalty will also be due on any reimbursements made to the seller. Shell should be aware that, in the future, MMS will be publishing a transportation allowance procedure as proposed rule-making. If and when that new procedure becomes effective, you may wish to request that it be applied to this case. You would have to make a revised application and any approval by MMS would not be retroactive.

The "Sales Quantity" as reported on Form 2014, will be the CO_2 volume measured at the BLM approved facilities at McElmo Dome Unit. The "Sales Value" of the CO_2, as reported on Form 2014, will be computed by multiplying the unit value price per Mcf of CO_2 established at McElmo Dome times the "Sales Quantity". As stated previously, during the interim period until we have completed our review, the contract price specified in the agreement will be used in computing the "Sales Value". Under no circumstances will the sales value be less than the gross proceeds accruing to the lessee for the sale of the CO_2. Please note that no lag time between the date the CO_2 is produced and when it is sold will be considered in determining the CO_2 unit value.

Documentation such as billings, invoices, or similar evidence which support claimed costs shall be maintained in your accounting office for future audit by MMS. Records shall be maintained for six years after they are generated, unless you are advised that MMS has initiated an audit or investigation involving such records and that they must be maintained for a longer period.

You have the right to appeal the orders contained in this letter in accordance with the provisions of Title 30, Code of Federal Regulations Part 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with

Minerals Management Service
Attn: Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
P.O. Box 25165, MS-653
Denver, CO 80225
Telephone (303) 231-3184

within 30 days from the date of receipt of this letter.

A copy of your appeal should be forwarded to

Mr. Norman Hess
Appeals Division
Minerals Management Service, MS-623
12203 Sunrise Valley Drive
Reston, VA 22091
Telephone (703) 860-7251

If an appeal is filed, it would not relieve Shell of the responsibility of paying royalties as described herein.

Sincerely,

William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

Shell Oil Company

P O Box 576
Houston, Texas 77001

December 16, 1983

Mr. Larry Cobb
Minerals Management Service
Royalty Valuation and Standards Division
Box 25165, Mail Stop 653
Denver, Colorado 80225

Subject: Shell Oil Company McElmo Dome
CO_2 Field - Royalty Valuation

Dear Mr. Cobb:

Pursuant to your telephone request, enclosed is a copy of the 1941 Pipe Line Consent Decree. As I mentioned to you, this Decree was agreed upon by the Department of Justice and the common carrier pipelines in order to resolve litigation concerning payment of dividends by the pipeline to any shipper-owner. As long as dividends did not exceed 7% of the valuation of the common carrier's property, the common carrier would not be in violation of the Interstate Commerce Act or the Elkins Act.

If you have any further questions, please advise.

Yours very truly,

William G. Riddoch

William G. Riddoch
Attorney for Shell Oil Company

WGR:NC

Attachment

APPENDIX

United States v. Atlantic Refining Company et al

FINAL JUDGMENT

The plaintiff, United States of America, having filed its complaint herein on December 23, 1941; all the defendants having appeared generally and severally filed their answers to such complaint denying the substantive allegations thereof; all parties hereto by their respective attorneys herein having severally consented to the entry of this final judgment herein without trial or adjudication of any issue of fact or law herein and without admission by any party in respect of any such issue and in final settlement of all claims herein in issue;

WHEREFORE IT IS ORDERED, ADJUDGED AND DECREED in compromise and in final settlement of all money claims herein in issue, including claims for penalties, damages and forfeitures, as follows:

I. That the Court has jurisdiction of this cause of action, of the subject matter hereof and of all the parties hereto.

II. For the purposes of this judgment when hereinafter used:

"Defendant common carrier" shall mean and include each and every common carrier engaged in the business of transporting crude oil or gasoline or other petroleum products in interstate commerce by pipeline which is or may be (a) a defendant, or (b) the successor of a defendant, or (c) the subsidiary of a defendant, or (d) a pipeline department of one or more defendants, or (e) a corporation, some or all of whose stock is owned by a defendant, or the successor or subsidiary of a defendant, or (f) owned or operated in such a manner that a defendant, its successor or subsidiary shall be entitled to participate in its net earnings.

"Shipper-owner" shall mean and include each defendant and its affiliates where such defendant or any of its affiliates ships crude oil or gasoline or other petroleum products by pipeline of any defendant common carrier and either the defendant or any one of its affiliates is entitled to participate in the net earnings of the defendant common carrier.

"Affiliates" shall mean and include successors and subsidiaries of any defendant, the parent of any defendant, and the subsidiaries of any such

parent, and such other persons, groups or corporations so related as to in effect control or to be controlled by any defendant.

"Petroleum products" shall not mean or include natural gas.

III. No defendant common carrier shall credit, give, grant, or pay, directly or indirectly, through or by any means or device whatsoever, to any shipper-owner in any calendar year, commencing as of January 1, 1942, any earnings, dividends, sums of money or other valuable considerations derived from transportation or other common carrier services which in the aggregate is in excess of its share of seven percentum (7%) of the valuation of such common carrier's property, if such common carrier shall have transported during said calendar year any crude oil, or gasoline, or other petroleum products for said shipper-owner, but shall be permitted (insofar as the Interstate Commerce and Elkins Acts are concerned) to credit, give, grant, or pay said percentum.

(a) Valuation as hereinabove used shall mean the latest final valuation of each common carrier's property owned and used for common carrier purposes as made by the Interstate Commerce Commission. To the latest final valuation of the commission shall be added the value of additions and betterments to the common carrier property made after the date of such latest final valuation, and from this sum shall be deducted appropriate amounts for physical depreciation on, and retirements of, common carrier property, computed by the carrier as of the close of the next preceding year, in accordance with the methods used by the Interstate Commerce Commission in bringing valuations down to date, the classifications of property to conform to the uniform system of accounts for pipelines prescribed by the Interstate Commerce Commission. Such valuation shall not include the value of the common carrier facilities acquired through the investment of excess earnings transferred to and withdrawn from the surplus account as provided in paragraph V hereof.

(b) In event the Interstate Commerce Commission has not determined the final valuation of the property owned and used for common carrier purposes by any common carrier, and until such time as the Interstate Commerce Commission has determined the final valuation of such common carrier's property, the valuation shall be determined by the common carrier and shall be based upon the records and accounts of the carrier kept in accordance with the accounting methods set forth in the Uniform System of Accounts for Pipe Lines prescribed by the Interstate Commerce Commission. To this determination of valuation by the common carrier shall be added the value of additions and betterments to the common carrier property made after the date of such determination, and from this sum shall be deducted appropriate amounts for physical depreciation on, and

retirements of, common carrier property, computed as of the close of the next preceding year, in accordance with the Uniform System of Accounts for Pipe Lines prescribed by the Interstate Commerce Commission. Such determination of valuation shall not include the value of the common carrier facilities acquired through the investment of excess earnings transferred to and withdrawn from the surplus account, as provided in paragraph V hereof.

(c) Any amounts permitted to be credited, granted, paid or given during any calendar year as hereinbefore provided, if earned and withheld, may be credited, granted, paid or given at any time thereafter in addition to credits and payments permitted during such subsequent years, unless (i) such earned and withheld sums shall have been invested in common carrier facilities and (ii) included in valuation as above defined.

(d) Any amounts permitted to be credited, granted, paid or given during any calendar year as hereinbefore provided, if not earned, may be credited, granted, paid or given within any one or more of the next succeeding three years, in addition to credits and payments permitted during each such subsequent year.

IV. No shipper-owner shall solicit, accept or receive, directly or indirectly, through or by any means or device whatsoever, from any defendant common carrier any sums of money or other valuable considerations which said defendant common carrier is prohibited from granting, crediting, paying, or giving by the provisions of paragraph III hereof.

V. Commencing January 1, 1942 each defendant common carrier shall retain (except as hereinafter provided) net earnings derived from transportation or other common carrier services in excess of the amounts permitted to be credited, granted, paid or given by paragraph III hereof and transfer such excess earnings to the surplus account within 90 days after the end of each calendar year. The said excess earnings shall be transferred to the surplus account as a separate item therein and in such a form as to be readily identifiable. The excess earnings thus transferred to the surplus account may be used by the defendant common carrier for extending existing or constructing or acquiring new common carrier facilities, for maintaining normal and reasonable working capital requirements during the current calendar year, and for retiring of any debt outstanding at the time of the entry of this judgment and decree, provided, however, that such debt or refunded debt was originally incurred for the purpose of, and the proceeds thereof expended in, constructing or acquiring common carrier property. In case of the dissolution, sale, transfer or divorcement of any defendant common carrier, any retained portion of the surplus ac-

count may be disbursed to stockholders of the corporation which owns and controls the defendant common carrier at that time.

VI. In the event a shipper-owner or defendant common carrier should knowingly violate the provisions of paragraphs III or IV hereof, then and in such event, upon proof of such violation on hearing after notice, and in lieu of any and all other remedies or proceedings for the enforcement hereof, the United States may have judgment entered in this cause against the recipient of any sums the payment of which is prohibited by this judgment for three times the amount by which the sum received exceeds the amount permitted by this judgment to be granted, credited, given or paid to such recipient.

VII. This judgment shall not in any manner (1) limit or qualify in any way the right of any party to introduce in the case of *United States of America v. American Petroleum Institute, et al.*, now pending in the District Court for the District of Columbia, or in any other proceeding, civil or criminal, brought under the antitrust laws, competent evidence otherwise admissible relating to the construction, operation, maintenance, use or distribution of pipelines or other means of transportation owned, operated, or controlled by the defendants herein, or with respect to the investment in, valuation of, benefits derived from ownership of or interest in, or rate of return upon, said pipelines or other methods of transportation, or (2) limit, restrict, enlarge or control in any way the right of the United States in the case of *United States of America v. American Petroleum Institute, et al.*, or in any other proceeding brought under the antitrust laws to obtain from the Court such relief, including sale, divorcement, or any other kind of rearrangement with respect to pipelines or any other means of transportation now or hereafter owned, operated or controlled by the defendants herein, as the Court deems proper.

VIII. Each defendant common carrier shall render a report to the Attorney General of the United States not later than the 15th day of April of each year, showing for the preceding calendar year: the valuation used as earnings basis; total earnings available for distribution to owners or stockholders; earnings, dividends, payments or benefits credited, paid, granted or given to all stockholders or owners; and amounts of money transferred to or withdrawn from the surplus retained pursuant to paragraph V hereof.

IX. This judgment shall not be construed to restrict, limit, or enlarge any right, privilege or exemption granted to any pipeline corporation or its stockholders (a) by the provisions of the Act of Congress approved July 30, 1941, entitled "An Act to Facilitate the Construction, Extension, or Completion of Interstate Petroleum Pipe Lines related to National De-

fense", or (b) by the terms of any proclamation of the President of the United States issued pursuant to the Act of July 30, 1941.

X. The jurisdiction of the case is retained for the purpose of enabling any of the parties to this judgment to apply to the Court at any time for such further orders and directions as may be necessary or appropriate in relation to the construction of or carrying out this judgment, for the modification hereof upon any ground, and for the enforcement of compliance herewith in the manner set forth above. No further modification hereof [illegible] any liability [illegible] for any act or conduct performed prior to the date of such modification, in excess of the liability imposed by paragraph VI hereof.

NOTE 3 - PROPERTY, PLANT AND EQUIPMENT:

Property, plant and equipment consisted of the following (thousands of dollars):

	DECEMBER 31, 1985	1984
Land	$	$
Rights of way		
Buildings		
Office, communication and data handling equipment		
Vehicles		
Line pipe, equipment and other pipeline construction		
Construction work-in-progress		
Less: accumulated depreciation and amortization		

X-4 X-4

Construction of the pipeline system began in the second quarter of 1982 and was completed in 1983. Operation of the pipeline system began in May 1984. Property, plant and equipment at December 31, 1985 and 1984 includes capitalized interest cost of— X-4 —

NOTE 4 - INVESTMENT IN SUBSIDIARY:

Cortez Capital was incorporated in Delaware in April 1982. All of its outstanding capital stock is owned by the Company. Cortez Capital was formed solely to assist the Company in the financing of the Company's construction and working capital requirements by issuing debt securities and lending the proceeds to the Company. Cortez Capital may also enter into other types of financial arrangements related to the financing of the pipeline. All costs incurred, including interest, administrative charges and debt issue costs are reimbursed by the Company.

1985 Dep: —— X-4 ——

1985 ROI: —— X-4 ——

Shell Oil Company

P.O. Box 576
Houston, Texas 77001

December 9, 1983

Mr. William Feldmiller
Minerals Management Service
Royalty Valuation and Standards Division
Box 25165, Mail Stop 653
Denver, Colorado 80225

Dear Mr. Feldmiller:

Subject: Shell Oil Company McElmo Dome CO_2 Field - Royalty Valuation

On October 25, 1983, Mr. L. L. Wilkerson and the undersigned met with you and members of your staff to provide you with an overview of the McElmo Dome/Denver Unit CO_2 Project and to present to you some of Shell's proposals with respect to royalty valuation of the CO_2 to be produced from the McElmo Dome Field.

Briefly, Shell's proposals that were discussed at our meeting were to exclude from royalty payments CO_2 which will be used as line fill in the 500-mile CO_2 pipeline from the McElmo Dome Field to the Denver Unit, and to recognize the CO_2 Sale and Purchase Agreement between Shell, as seller, and Shell, as Operator of the Denver Unit, as buyer, as an arms-length transaction for royalty valuation purposes. During our meeting you requested that we also provide information concerning the CO_2 pipeline tariff calculation. Set forth below is supporting data and information with respect to Shell's proposals and the information requested by you.

Shell's proposal to exclude from royalty payments to the MMS the quantity of CO_2 to be used in line-fill of the Cortez Pipeline is based on the fact that such CO_2 will ultimately be unavoidably lost pursuant to 30 C.F.R. Section 221.44. Information supporting Shell's proposal, as well as extensive information and data concerning Shell's metering plan for the McElmo Dome CO_2 production, is contained in Attachment 1.

On January 1, 1982, Shell, as seller, entered into a CO_2 Sale and Purchase Contract (Contract) with Shell, as Operator of the Denver Unit, authorized by and acting on behalf of the Working Interest Owners of the Denver Unit pursuant to the terms of the Unit Operating Agreement, as buyer. (Attachment 2). To date, this Contract constitutes Shell's only sale of CO_2 from the McElmo Dome Field. Shell proposes that this Contract be recognized for what it is . . . an arm's-length transaction . . . for purposes of determining royalty valuation.

DEC 12 1983

Sections 4.2 and 4.3 of the Denver Unit Agreement clearly authorize the Working Interest Owners to approve the CO_2 Project as an enhanced oil recovery program and to approve all contracts necessary for the implementation of such program. (Attachment 3). A Denver Unit CO_2 Procurement Committee (Committee), comprised of the six largest Working Interest Owners in the Unit (Shell, Conoco, Exxon, Texaco, ARCO, and Getty), was formed and approved by vote of the requisite percentage of Unit Working Interest Owners on October 7, 1980. (Attachment 4).

In January 1981, Shell removed itself from this Committee to avoid any inference of conflict because of Shell's role as a potential seller of CO_2 to the Unit. (Attachment 5). Conoco, as owner of the next largest interest in the Denver Unit, served as Chairman of the Committee after Shell's resignation.

After receiving Shell's summary proposal in November 1980 to sell CO_2 to the Unit, the Committee sought firm offers to supply CO_2 to the Denver Unit from Amoco, ARCO, Amerada-Hess, CO_2-in-Action, Mobil, and Sun-Texas. In April 1981, after it appeared that no other offers would be forthcoming, Shell submitted a full CO_2 Sale and Purchase Contract to the Committee based on its summary offer five months previously. Between April 1981 and December 1981, Shell and the Committee conducted extensive negotiations on the terms of the Contract. Finally, in December 1981, after concluding negotiations with Shell and consideration of an offer submitted by Mobil, Conoco recommended that Shell submit the negotiated contract to the Unit Working Interest Owners for approval. (Attachment 6). The ballot dated December 7, 1981, which Shell sent to the Unit Working Interest Owners seeking approval of the Contract and authorization to execute said Contract on behalf of the Working Interest Owners was approved. (Attachment 7).

We submit that the foregoing documentation clearly demonstrates that the CO_2 Sale and Purchase Contract was an arm's-length transaction between Shell and the Denver Unit Working Interest Owners. Thus, the commodity value of the CO_2 as determined by Section 4.1 of the Contract should be the basis for valuation of royalty payments to the MMS. Currently, the commodity value of the CO_2 is 76.34 cents per MCF.

At our meeting, you inquired about the ownership of the Cortez Pipeline Company - the owners of the 500-mile CO_2 pipeline - and whether such pipeline tariff was subject to regulation. The Cortez CO_2 pipeline, a common carrier, although not subject to regulation by any federal agency, since CO_2 is neither crude oil nor natural gas, is nevertheless subject to regulation under the common law of the United States by virtue of it being a common carrier pipeline. The partners of Cortez Pipeline Company (Shell Cortez Pipeline Co., Mobil Cortez Pipeline Co., and Continental Cortez Pipeline Co.) have elected to calculate the CO_2 pipeline tariff on the basis of the 1941 Pipeline Consent Decree methodology which provided that dividend payments of up to 7% of I.C.C. valuation would not be challenged by the Department of Justice. This Consent Decree meant, for all practical

purposes, that the tariff of the pipeline was established so as to provide a 7% return to the shipper owners. The Pipeline Consent Decree, until recently, was the standard method utilized by regulatory agencies for determining tariffs for petroleum pipelines and was the method utilized during the planning stages of the Cortez CO_2 pipeline.

Shell has obligated itself by the CO_2 Sale and Purchase Contract to base such pipeline tariff for the first six contract years on the assumption that the Cortez CO_2 pipeline throughput is 1,000,000 MCF per day. Although a tariff has not yet been published by Cortez Pipeline Company, Shell's current estimate of the pipeline tariff for the first full contract year based on the Pipeline Consent Decree method is 37.9 cents per MCF.

Shell submits that it should not be required to pay royalty to the MMS based on the CO_2 pipeline tariff. There is no market for CO_2 at the McElmo Dome Field and the CO_2 must be transported 500 miles by pipeline - to the Denver Unit in West Texas - before it achieves the value placed on it by Shell and the Denver Unit Working Interest Owners.

We hope the foregoing will enable you to conclude that the value of the CO_2 sold to the Denver Unit for royalty purposes is the commodity value of the CO_2 as determined by the Contract. We also hope that from the foregoing you will conclude, as Shell has, that royalty is not due the MMS on the CO_2 utilized as line fill for the Cortez CO_2 pipeline. If you have any questions in connection with the foregoing or require further information or data on any aspect of Shell's proposals, please advise the undersigned.

Yours very truly,

William G. Riddoch

William G. Riddoch
Attorney for Shell Oil Company
(713) 870-3625

WGR:NC

Attachments

cc: Mr. L. L. Wilkerson (w/o attach.)

CARBON DIOXIDE SALE & PURCHASE CONTRACT

MOBIL PRODUCING TEXAS & NEW MEXICO INC. - dated March 31, 1983

SHELL OIL COMPANY

EXHIBIT "B"

7% TARIFF CALCULATION

	$000
Valuation	1,000
7% of Valuation	70
Income Tax	64
Interest	100
Operating Expense (Salaries, power, maintenance, district level supervision, dispatching, etc.)	200
General Expense (Employee benefits, overhead, etc.)	40
Ad Valorem Tax	25
Financial Depreciation	29
Gross Revenue (Total of all above items other than Valuation)	528
Volume (4,000 units per day)	1,460
7% Tariff	36¢

Verification of Calculation

Revenue	528
Total Costs	394
Operating Income	134
Tax	64
Net Income	70

All numbers are included for illustrative purposes only and are not projections of anticipated numbers.

STATE OF TEXAS

COUNTY OF HARRIS

ON THIS 15th day of April, 19 83, before me, appeared R. L. Howard, to me personally known, who, being duly sworn, did say that he is the Attorney-In-Fact ✓ of SHELL OIL COMPANY and that said instrument was signed in behalf of said corporation by authority of its Board of Directos and said Appearer acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my official hand and seal on the date hereinabove written.

My Commission Expires:

JANET N. KIRKPATRICK
Notary Public in and for Harris County, Texas
My Commission Expires May 9, 1984

Janet N Kirkpatrick
Notary Public in and for
Harris County, Texas

Enclosure 2

Mobil Exploration & Producing U.S. Inc.
McElmo Dome Unit (CO_2)
Value, Allowance, and Percentage Calculations

Value/Mcf Calculation

Year	Sales Value 1/	÷	Sales Quantity 2/	=	Value/Mcf
3/1/88-12/31/88	$49,186,525.80		64,135,623		$0.766915
1989	$75,648,714.08		91,602,962		$0.825833
1990	$89,731,590.50		98,238,967		$0.913402
1991	X-4		48,932,944		X-4

1/ Data from Mobil's July 1, 1993, letter, Attachment E.

2/ Data from Mobil's July 1, 1993, letter, Attachment D (Form MMS-4295, Schedule 1).

Allowance/Mcf Calculation

Year	Allowable 1/ Transportation Costs	+	Throughput	=	Rate/Mcf
3/1/88-12/31/88	$24,265,827.34		64,135,623		$0.378352
1989	$36,548,600.19		91,602,962		$0.398990
1990	$38,459,272.27		98,238,967		$0.391487
1991	X-4		48,932,944		X-4

1/ Data from Mobil's July 1 letter, Attachment D (Form MMS-4295 - subject to future review and audit).

Percentage Calculation

Year	Allowance/Mcf	÷	Value/Mcf	=	Percentage
3/1/88-12/31/88	$0.378352		$0.766915		0.493343
1989	$0.398990		$0.825833		0.483137
1990	$0.391487		$0.913402		0.428604
1991	X-4		X-4		X-4

Attachment B

Calculation of overhead percentage:

Non-volume Field Expense
+ Windfall Profits Tax
+ Production & Severance Tax

TOTAL PRODUCING DIRECT

X-4

Non-volume Producing Overhead
+ A&G Exp. - Info. Systems
+ A&G Exp. - other

TOT PRODUCING INDIRECT

Total Producing Indirect / Total Producing Direct = Burden Rate

X-4 / X-4 = X-4

****

From Form MMS-4295 for the Wasson (MPTM) Pipeline:

Total operating costs

Total Maintenance costs

Times overhead % X-4
= Exploration & Producing Overhead

X-4

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X-4

(SCHEMATIC, NOT DRAWN TO SCALE)

Mobil Producing Texas & New Mexico Inc.
Houston, Texas

FROM Mc ELMO DOME (LEADVILLE) UNIT CO_2 DISPOTSITIONS

2/87

DRAWN	CTA	SCALE	N/A	DWG. NO.
CHECKED	CAS	DATE		B-HO-19,661

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

TAKE PRIDE IN AMERICA

IN REPLY
REFER TO:

attach 40

MMS-RVS-OG:90-0752
Mail Stop 3520

Memorandum

To: Chief, Division of Appeals

From: Chief, Royalty Valuation and Standards Division

Subject: Appeal by Shell Oil Company Concerning a Transportation Allowance for Carbon Dioxide Produced From the McElmo Dome Unit, Colorado

By letter dated December 10, 1990 (copy attached), Shell Oil Company (Shell), on behalf of its operating subsidiary Shell Western E&P Inc. (SWEPI), timely appealed a November 5, 1990, decision (MMS-RVS-OG:90-0662; copy attached) by the Royalty Valuation and Standards Division (RVSD) regarding the transportation allowance for carbon dioxide (CO_2) produced from the McElmo Dome Unit. That decision, which was issued to SWEPI in response to the Interior Board of Land Appeals (IBLA) Decision No. 87-47 dated January 23, 1990 (copy attached), accepted the rate of $0.39 per Mcf established in the "Cortez Pipeline Letter Tariff" (copy attached) as a transportation allowance for the period April 15, 1984, through February 29, 1988. The RVSD noted, however, that SWEPI had submitted transportation allowance forms (Form MMS-4295) for the period March 1, 1988, through December 31, 1988, and concluded that SWEPI therefore had elected to come under the new transportation allowance regulations effective March 1, 1988. At issue in the present appeal is whether the filing of Form MMS-4295 by SWEPI prevents the provision of 30 CFR § 206.157(c)(2)(v) (1988) from governing the determination of the transportation allowance on and after March 1, 1988.

BACKGROUND

The McElmo Dome Unit is a CO_2 field located in Dolores and Montezuma Counties, Colorado. The SWEPI is a working-interest owner in and operator of the unit. The produced CO_2 is transported through the Cortez Pipeline to oil fields in west Texas for use in enhanced oil recovery projects. The Cortez Pipeline Company, a general partnership of Shell, Mobil Cortez Pipeline Company, and Cortez Vickers, Inc., owns the Cortez Pipeline. Shell characterizes the pipeline as a common law, common carrier pipeline.

By letter dated December 9, 1983 (copy attached), Shell requested approval to calculate the transportation allowance for the costs of moving the CO_2 production through the Cortez Pipeline based on the 1941 Pipeline Consent Decree methodology. This methodology, which was used by the Department of Justice and common carrier petroleum pipelines to provide a 7-percent return to the pipeline owners, provides that operating expenses, depreciation, interest, and State and Federal income taxes be included as components of a transportation tariff. (Shell referred to the Cortez Pipeline transportation charge as a "tariff," although it has not been approved as such by any State or Federal jurisdictional

authority.) By decision dated March 29, 1984 (copy attached), MMS approved the calculation procedure to determine the transportation allowance with the exception that State and Federal income taxes were to be excluded from the transportation costs. The SWEPI appealed the exclusion of the income taxes by its letter of May 1, 1984 (copy attached).[1]

In its field reports of September 10, 1984, and May 6, 1985 (copies attached), to the Division of Appeals, Office of Program Review, RVSD recommended that State and Federal income taxes be excluded when computing transportation costs on the basis that MMS policy is to deny income taxes as a cost of transportation. By decision dated August 6, 1986 (MMS-84-0013-MISC; copy attached), the Director, MMS, denied SWEPI's appeal and affirmed the order of RVSD. The SWEPI then appealed the Director's decision to the IBLA.

In its Decision No. 87-47, the IBLA set aside and remanded that portion of the MMS decision disallowing State and Federal income taxes as elements of SWEPI's transportation allowance. The IBLA concluded that MMS "unfairly discriminates against a CO_2 lessee in denying a deduction for that component of a pipeline tariff relating to Federal and State income taxes solely on the basis that such lessee is an affiliate of the pipeline operator."

FINDINGS

As a result of IBLA Decision No. 87-47, RVSD notified SWEPI (letter of November 5, 1990) that the rate of $0.39 per Mcf established in the "Cortez Pipeline Letter Tariff," which includes State and Federal income taxes, was acceptable as a transportation allowance for the period April 15, 1984, through February 29, 1988. The RVSD also determined that because SWEPI had submitted Form MMS-4295, "Gas Transportation Allowance Report," for the period March 1, 1988, through December 31, 1988, SWEPI had elected to come under the new regulations effective March 1, 1988.

In the present appeal, Shell (on behalf of SWEPI) states that it interprets RVSD's decision to indicate that the tariff calculation procedure will not be permitted to determine the transportation allowance for the period on and after March 1, 1988. Accordingly, Shell contends that RVSD's decision was in error for two reasons:

1) The regulation at 30 CFR § 206.157(c)(2)(v) permits SWEPI's continued use of the tariff calculation procedure for the transportation allowance on and after March 1, 1988; and

2) the filing of Form MMS-4295 by SWEPI was to comply with the regulations, but such filing was not meant to preclude SWEPI from using the tariff calculation procedure to compute the transportation allowance on and after March 1, 1988.

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[1]The SWEPI succeeded Shell in its interests in the McElmo Dome Unit on January 1, 1984. Reference to Shell throughout this document is made only to address periods prior to this date and to address the present appeal.

Reason No. 1

Shell argues that 30 CFR § 206.157(c)(2)(v) permits the continued use of the Cortez Pipeline tariff as the transportation allowance (with respect to SWEPI's sales of McElmo Dome CO_2) on and after March 1, 1988, because this regulation provides that transportation allowances based on non-arm's-length or no contract conveyances that are in effect (approved by MMS in writing) at the time the regulations became effective (March 1, 1988) will be allowed to continue until such allowances terminate. Accordingly, Shell contends that the approval letter dated March 29, 1984, was in effect on March 1, 1988, and that the CO_2 transportation allowance based on the tariff calculation procedure therefore should remain applicable on and after March 1, 1988.

RVSD's Response

Prior to March 1, 1988, MMS policy was to approve transportation allowances prospectively on a 12-month reporting basis. However, the March 29, 1984, decision was based upon a procedure different from the usual procedure. That approval did not specifically address the effective and termination dates for SWEPI's transportation allowance. However, in the March 29 decision, MMS stated that it would be publishing a new transportation procedure or rule-making and that "if and when that new procedure becomes effective, you [Shell] may wish to request that it be applied to this case."

In Shell's initial proposal of December 9, 1983, Shell stated that "it has obligated itself by the CO_2 Sale and Purchase Contract to base such pipeline tariff for the first six contract years on the assumption that the Cortez Pipeline throughput is 1,000,000 Mcf per day." (Emphasis added.) As defined in the "Carbon Dioxide Sale And Purchase Contract," dated March 31, 1983 (copy attached), between Mobil Producing Texas & New Mexico (Mobil) and Shell, the "first six contract years" that the tariff calculation procedure would be applicable is the period April 15, 1984, through April 30, 1990 (William Riddoch, Shell, telecommunication of November 21, 1991). Therefore, RVSD concludes that the intent of the March 29 decision was to approve the Cortez Pipeline calculation procedure for the "first six contract years."

In light of these findings, RVSD concludes that the decision dated March 29, 1984, is applicable for the first six contract years (that is, for the period April 15, 1984, through April 30, 1990). Therefore, MMS approval to use the tariff calculation procedure for the transportation allowance was indeed in effect on March 1, 1988.

Reason No. 2

Shell argues that under the new regulations at 30 CFR § 206.157(c)(2)(ii) (1988), lessees were required to submit to MMS an initial Form MMS-4295. This regulation states that the initial Form MMS-4295 shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until the transportation allowance under the non-arm's-length contract situation terminates, whichever is earlier.

In its appeal of the November 5 decision, Shell states that perhaps it should not have filed Form MMS-4295 for the Calendar Years 1988 and 1989 but rather should have relied on the regulations at 30 CFR § 206.157(c)(2)(v) to permit the continued use of the tariff calculation procedure for the Cortez Pipeline transportation allowance. The SWEPI filed the allowance forms on June 30, 1988, and May 1, 1989, for the Calendar Years 1988 and 1989, respectively. However, SWEPI stated in its letter (dated June 28, 1988) accompanying the allowance forms for Calendar Year 1988 that "filing of Form MMS-4295 does not constitute a basis for estoppel or waiver of a producer's position as to how royalty is to be calculated."

RVSD's Response

In the November 5 decision, MMS determined that because SWEPI submitted Form MMS-4295 for the period March 1, 1988, through December 31, 1988, SWEPI had elected to come under the new regulations effective March 1, 1988, rather than to continue using the Cortez Pipeline tariff rate of $0.39 per Mcf.

By the "Dear Payor" Letter dated February 4, 1988 (copy attached), MMS notified royalty payors of the new regulations and of certain new instructions required as a result of the issuance of those regulations, including the instructions regarding the election of the lessee to file a new allowance form under the new regulations.

The "Dear Payor" Letter instructs that for allowances that are in effect as of March 1, 1988, and until the existing approval terminates, the lessee needs do nothing to validate the allowance claimed on Form MMS-2014. In that letter, MMS also informed the payors that the lessee may, however, at any time in advance of the termination date of the existing approval and after the effective date of the regulations, make an election to submit the new allowance forms and begin reporting accordingly on Form MMS-2014.

In situations where a lessee performs transportation services for itself, such as SWEPI's case, the regulation at 30 CFR § 206.157 (1988) would have required that a lessee electing to come under the new rules submit a Form MMS-4295. On that form, a lessee would calculate the transportation allowance based upon the lessee's reasonable actual costs as required by 30 CFR § 206.157(b) (1988). The regulation at 30 CFR § 206.157(b)(5) (1988) provides that if a lessee has a non-arm's-length transportation contract or has no contract, including those situations where the lessee performs transportation services for itself, MMS may grant an exception from the requirement that the lessee compute actual costs only if the lessee has a tariff approved by the Federal Energy Regulatory Commission (FERC) or by a State regulatory agency.[2]

[2]By letters to IBLA dated September 9, 1985, and October 9, 1986 (copies attached), SWEPI verified that the transportation fees established in the "Cortez Pipeline Letter Tariff" were not approved by either FERC or a State regulatory agency.

Although Shell submitted Form MMS-4295 for the period on and after March 1, 1988, SWEPI used the rate of $0.39 per Mcf as the transportation allowance rather than computing the allowance as the rules would have required. The SWEPI did not request an exception to the requirement that the allowance be calculated based upon the lessee's actual costs. The SWEPI did, however, include on the forms a disclaimer. Therefore, RVSD concludes that SWEPI's intent of filing Form MMS-4295 was to deduct a transportation allowance rather than electing to terminate the March 29, 1984, approval.

CONCLUSIONS

The RVSD concludes that Shell has succeeded in its burden of proof to demonstrate that the transportation fees established in the "Cortez Pipeline Letter Tariff" and charged to SWEPI are applicable for determining transportation allowances on and after March 1, 1988. Accordingly, RVSD recommends that the appeal be granted and that SWEPI be allowed to use the tariff for the period March 1, 1988, through April 30, 1990.

The RVSD determined that MMS approval to use the tariff calculation procedure for the transportation allowance terminated on April 30, 1990. Accordingly, effective May 1, 1990, RVSD believes that Shell should compute the transportation allowance based upon its reasonable actual costs in accordance with the regulations at 30 CFR § 206.157(b).

Milton K. Dial

14 Attachments