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May 5, 2015

Subject: Comments on Proposed Rule on the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Report (Federal Register Vol 80, No 3, 608), Published January 6, 2015

Dear Mr. Southall:

Shell Offshore Inc., along with its affiliates supporting offshore exploration and production (Shell), is pleased to provide comments on the subject rulemaking.

Shell is one of the largest leaseholders in the Outer Continental Shelf (OCS), including the Gulf of Mexico and Alaska, and one of the largest producers of oil and natural gas from federal leases in the United States. While Shell appreciates the stated intent of Interior Department's Office of Natural Resources Revenue (ONRR) to ensure greater clarity, efficiency, certainty, and consistency for product valuation, we have concerns that many provisions of the proposed rule will have significant negative impacts on energy producers and stakeholders that are directly contrary to these objectives. Even more troubling is the absence of justification for the most significant proposed changes.

As a major producer and payor of substantial royalties for lease contracts on U.S. federal lands, Shell is committed to working closely with your agency in providing comments and suggestions on how to improve the regulatory structure governing royalty collections. We appreciate your interest in meeting your responsibilities to the public and recognize the complexity of the issues involved. However, we were disappointed to discover likely detrimental economic impacts, troublesome ambiguities, burdensome requirements, legal deficiencies, and a major policy shift away from "fair" market valuation policies embedded in the proposed rule.

Shell fully endorses the comments of the American Petroleum Institute (API) and the Council of Petroleum Accountants Societies (COPAS). In consideration of the seriousness and consequential nature of these concerns, we suggest ONRR schedule a workshop to discuss the many issues noted before you proceed with the promulgation of a final rule. Moreover, we strongly recommend you consider re-proposing an amended rule as a means to ensure an effective and transparent process for the transition to a new regulatory framework.

While Shell commends ONRR for a number of changes which could simplify the compliance process and provide more certainty for payment requirements, the following areas of concern are provided to highlight some of the major legal and policy issues with the proposed changes.

Proposed "Default Provision"

The new "default" option (Sec 1206.144) introduces foreboding uncertainty into the royalty collection process by allowing ONRR to "second guess" arm's-length agreements without any requirement for the agency to provide a justification for invoking such intervention. Serious questions of legal sufficiency arise as to when or why such discretion will be exercised to override the well accepted standard that "gross proceeds" from market contracts are the best indicator of fair value to the public.

The proposed provision does not afford lessees the opportunity to correct or challenge whatever concerns ONRR may assume in opting to apply the default provision. The prospect that ONRR may exercise such unbounded authority to dictate an alternative valuation "for any reason" creates needless unpredictability and anxiety for lessees. In effect, the introduction of the default provision represents an apparent policy shift from "fair market" valuation to "fair government" valuation.

Policy Reversal – Offshore Subsea Completion Transportation Allowance

The proposed reversal of the treatment of subsea transportation lines (Sec 1206.20) poses a significant threat to the viability of deep water offshore fields. Deep water lessees have invested millions and in some cases even billions of dollars for high-potential prospects relying upon the terms of current regulations, which provide allowances for the associated costs of transporting oil and gas to distant host platforms. The proposed change would unquestionably increase the costs for subsea systems with tiebacks to existing facilities. A subsea manifold is a "central accumulation point" and production downstream from that point should be eligible for a transportation allowance. To do otherwise penalizes the development of innovative technologies that minimize surface facilities, reduce environmental risks, and increase ultimate recovery. Moreover, ONRR has made little effort to explain why subsea activities that have long been considered part of transportation should now be labelled "gathering".

This arbitrary rule change discourages production from potentially numerous isolated discoveries which, when added together, may provide substantial energy, environmental, and economic benefits to the nation. Since the ONRR cost-benefit analysis fails to evaluate the potential economic impacts of such a change, Shell strongly recommends that ONRR correct this deficiency and evaluate such impacts prior to moving forward with this proposal.

Lack of Justification for New Criteria

As documented in the API and COPAS comments, the proposed rule contains numerous new criteria without any explanation or rationale to justify the changes. Examples include: (1) adoption of a "10 percent below the lowest reasonable measure" for invoking the "default provision", (2) changing the "multiplier" of the S&P BBB bond rate from 1.3 to 1.0 for purposes of providing for an appropriate rate of return, (3) use of the "highest reported bid week price" for the gas pricing index, (4) the proposed "floor" and "ceiling" for transportation deductions, (5) the proposed standard processing deduction for NGLs, and (6) the proposed standard T&F charges.

The criteria adopted for ONRR's current regulations were the result of careful multi-year studies jointly conducted by MMS, states, tribes, industry and other stakeholders. For ONRR to unilaterally change such long-standing measures without any attempt to provide an analytical rationale poses a serious risk that resultant royalty payments will not reflect fair valuation for the public or fair charges for lease contracts.

Definition of "Misconduct"

Shell objects to the definition of "misconduct", as provided in Sec 1206.20, to include behavior which: "would not need to be willful, knowing, voluntary, or intentional." As a company that stresses the highest ethical standards for all our employees, attaching such a label to inadvertent paperwork errors or unintentional mistakes is a serious departure from existing legal definitions, and poses the potential for unjustified and wrongful damage to our business reputation.

Contractual Obligations for Both Lessees and the Lessor

Shell has invested billions of dollars in U.S. energy properties obtained through competitive bidding processes with terms and conditions which became binding to both Shell and the lessor upon lease award. We are committed to full payment of our royalty obligations according to the terms of our lease contracts. Retroactive amendments to well-established royalty terms, no matter whether the impact is great or small, represents a serious threat to certainty and viability of investment projects as well as to the sanctity of lease contracts as noted in the API comment letter.

Pattern of Higher Royalty Obligations and Increased Cost Burdens

A comprehensive review of the numerous amendments included in the proposed regulations reveals a clear pattern in favor of higher royalty obligations and increased reporting burdens associated with most of the proposed changes. The ONRR cost-benefit analysis published along with the Proposed Rule exposes how each significant change results in higher royalty payments and increased costs for private sector energy providers. Such a troubling pattern is made even more questionable by the lack of justification for the expected results.

Conclusion

While some provisions of the proposed rule may represent improvements to the current regulatory regime, Shell has serious concerns that the expected consequences for the most significant new provisions may be harmful to the intended objectives as set forth in the Preamble. We anticipate detrimental and inequitable economic and legal impacts to stakeholders for provisions offered without explanatory rationale. We look forward to participating with all other stakeholders in a workshop or meeting to discuss how to remedy these deficiencies going forward.

Shell is grateful for the opportunity to comment on this important public policy matter. Please contact Mr. Kent Satterlee at 504 425 4143 if you have questions concerning these comments.

With regards,



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