markets which may suggest the need for differences in the design of a royalty-in-kind program.

2. Selection of Areas for Future Royalty-In-Kind Pilot(s)

Since the current pilot program is limited to offshore leases in the Gulf of Mexico, MMS is interested in exploring the possibility of conducting a future pilot program in an area with onshore Federal leases. Any implementation of an on-shore pilot will require close cooperation with the Bureau of Land Management and the affected states. The MMS is seeking views on what areas should be considered in future royalty-in-kind projects. Relevant considerations would include the availability of price indices, the volumes of oil or gas available, the level of market competition, special valuation issues, transportation market structure, and the views of the respective states in which the leases are located.

3. Non-Jurisdictional Pipelines in Taking Royalty Gas

Gas marketing companies taking Federal royalty gas will, in some cases, be charged for the services of non-jurisdictional pipelines. Non-jurisdictional pipelines are not regulated by the Federal Energy Regulatory Commission (FERC), which means that the owner is able to charge what the market will bear. The services of these pipelines are critical in transporting the gas from the lease or gathering point to a main pipeline inlet. The problem which arises for MMS is that, in many cases, there appears to be no effective competition in the provision of these services. In the absence of any realistic prospect that competing pipelines would be built, there is no competitive pressure imposed on the owners in pricing the services of these pipelines. This lack of competition can be reflected in a lower bid price for the in-kind royalty gas.

This issue will be examined by MMS in planning future pilots. Alternative courses of action are open to MMS in dealing with the issue of non-jurisdictional pipelines. These could include the following:

a. Eliminate from future pilots any leases in which non-jurisdictional pipeline fees will be imposed on gas marketers;

b. Employ bid evaluation criteria to determine whether the transportation adjustment to the bid reflects unusually high pipeline costs and reject bids if the costs are ‘‘too high;’’ and

c. Require lessees to deliver gas to the inlet of the jurisdictional pipeline and provide an allowance for the reasonable costs of transportation.

These alternatives are not ideal solutions. First, eliminating leases from future pilots because of non-jurisdictional pipelines essentially avoids an issue which must be addressed if in-kind royalty collection is to be applied more broadly in the future. Also, such a procedure may unnecessarily exclude leases prior to any evidence that a ‘‘pricing problem’’ exists for pipeline services. Second, bid evaluation criteria are effective in imputing value for pipeline services when competition exists or when transportation tariffs are regulated and clearly promulgated. However, the task of establishing reasonable cost for the services of non-jurisdictional pipelines could involve considerable conjecture on the part of the MMS. Third, a requirement that the lessee deliver gas to the inlet of the major pipeline would raise administrative costs since MMS would need to grant an allowance to cover the expenses of additional transportation.

4. Aggregation of Leases and the Use of Alternate Bid Procedures

In the current gas marketing pilot, leases were aggregated into groups of various sizes. These groupings were based on location and pipeline proximity. However, a view has been expressed that MMS should have used larger aggregations of leases which would mean a smaller total number of groups. One possible rationale for larger aggregations is that the sale price of gas received by marketers is sensitive to volumes; that is, larger volumes can be sold at a higher price per MMBtu.

The current pilot included a bidding feature designed to accommodate marketers desiring to market larger volumes of gas. The alternate bid procedure allowed bids on an aggregation of groups. Such bids would win the gas in the aggregation if the alternate bid were to exceed the total value of the next highest bids for the groups in the aggregation. The MMS was surprised by the apparent lack of interest in the alternate bid procedure. One possible explanation is that the preparation of alternate bids is more complex and time-consuming. Prospective bidders were given a relatively brief period in which to prepare bids after the issuance of the Invitation for Bids (IFB).

5. Lessee Responsibilities in Providing Federal In-Kind Gas Royalties

A long-standing and sometimes controversial element of the Federal royalty collection process has been the requirement that the lessee place the product in ‘‘marketable condition’’ at no cost to the lessor. The current pilot largely conforms to these traditional procedures by specifying that the lessee is required to place the royalty gas in marketable condition (pipeline condition, i.e., after any necessary dehydration, sweetening, and compression) before it is taken by the purchaser of MMS royalty gas. Lessees have often argued that the marketable condition rule imposes a royalty on value added by the lessee, rather than simply on the value of the produced mineral. It has also been argued that this policy can negatively affect the efficient management and ultimate recovery of the resource.

In the current pilot, MMS indirectly shares in the costs of marketing, to the extent that marketers pass those costs on through the bid price. In evaluating the pilot, MMS will be looking at the effect that different procedures may have on Federal revenues. The MMS would welcome views at the workshop on how responsibilities can best be shared between the lessor and the lessee in order to ensure efficient management of the resource, a market-based royalty collection system that is less costly to administer, and receipt of fair market value by the Government for its royalty share of production.

6. Appropriate Index Prices in Gas Royalty In-Kind

In the current pilot, a single price index (Inside FERC) was used as the basis for the bidding and subsequent royalty payment. The use of the Inside FERC indices was a convenient and familiar alternative during a period in which the MMS was trying to quickly design and implement the pilot for the 1994–95 winter season. However, the view has been expressed that MMS should employ several published indices in future pilots or expansions of in-kind royalty collection. Possible approaches could involve the use of a composite index based on all of the published prices for gas in a particular area or allowing the bidder to choose which index to use.

The MMS also is open to alternative bidding procedures which are not necessarily tied to published index prices. Conceivably some other price could serve as the basis upon which bids could be formulated. Also, in exploring alternative bidding procedures, MMS is examining the feasibility of including transportation rates in the bids.