

average of the returns to equity and debt (without considering income tax treatment). That led MMS to determine that two times the BBB rate was appropriate for that calculation.

MMS has examined some rates of return in the oil industry and believes that some weighted average rate of return considering both equity and debt is appropriate as an actual market-based cost of capital. MMS believes that establishing a uniform rate of return on which all parties can rely is preferable to the costs, delays, and uncertainty inherent in attempting to analyze appropriate project-specific or company-specific rates of return on investment.

MMS believes that the subset of companies that have invested, or are likely to invest, in oil pipelines is a very limited subset of the oil industry. MMS also believes that no standard industrial classification corresponds to those who are willing to invest in pipelines. MMS has received a new study from the American Petroleum Institute ("API"), titled "BBB Bond Rate Not an Adequate Measure of Capital Cost," that concluded that the cost of capital (after taxes) of the Department of Energy's Financial Reporting Service Companies was closer to 1.6 to 1.8 times the Standard and Poor's BBB bond rate. The API study explained that this group of producers included the companies that would be most likely to own pipelines. MMS, through its Offshore Minerals Management, Economics Division, has also studied several years' worth of data for both non-integrated oil transportation companies and larger oil producers, both integrated and independent, that MMS believes are more likely to invest in oil pipelines. This study concluded that that range of rates of return that would be appropriate for oil pipelines would be in the range of 1.1 to 1.5 times the Standard and Poor's BBB bond rate. While the relationship between the rates of return that MMS has examined and the BBB rate has not been constant, MMS is proposing for comment a rate of return of 1.5 times the Standard and Poor's BBB rate as this rate is within the range recommended by its own experts and close to the rate recommended by the industry experts.

## 2. Specification of Certain Allowable and Non-Allowable Costs—§§ 206.110 and 206.111

### (i) Arm's-Length Transportation

In Section 206.110, MMS is proposing to add a new paragraph (b) that would specify many of the costs incurred for transporting oil under an arm's-length

contract that are allowable deductions. MMS believes these costs are costs that are directly related to the movement of crude oil to markets away from the lease. Those costs include:

(1) The amount that you pay under your arm's-length transportation contract or tariff.

(2) Fees paid (either in volume or in value) for actual or theoretical line losses.

(3) Fees paid to a pipeline owner for administration of a quality bank.

(4) The cost of carrying on your books as inventory a volume of oil that the pipeline operator requires you to maintain, and that you do maintain, in the line as line fill. You must calculate this cost as follows:

(i) Multiply the volume that the pipeline requires the shipper to maintain in the pipeline by the value of that volume for the current month calculated under section 206.102 or section 206.103, as applicable; and (ii) multiply the value calculated under paragraph (i) by the monthly rate of return, calculated by dividing the rate of return specified in section 206.111(i)(2) by 12.

MMS proposes to allow this deduction because this cost appears to be an actual cost directly associated with transporting oil. In each month for which line fill is required, a shipper incurs the loss of available capital associated with the value of the line fill volume. The proposal therefore would allow a return on that value, calculated as described above. MMS seeks comments on whether this cost should be allowed as part of the transportation deduction.

(5) Fees paid to a terminal operator for loading and unloading of crude oil into or from a vessel, vehicle, pipeline, or other conveyance.

(6) Fees paid for short-term storage (30 days or less) incidental to transportation as required by a transporter.

(7) Fees paid to pump oil to another carrier's system or vehicles as required under a tariff.

(8) Transfer fees paid to a hub operator associated with physical movement of crude oil through the hub when you do not sell the oil at the hub. These fees do not include title transfer fees.

MMS proposes to allow lessees to deduct transfer fees paid to a hub operator associated with physical movement of crude oil through the hub when the shipper does not sell the oil at the hub. MMS believes that this also is a cost directly incurred for movement of the oil. MMS believes that title

transfer fees are a cost of selling oil, not moving it, and are not deductible.

(9) Payments for a volumetric deduction to cover shrinkage when high-gravity petroleum (generally in excess of 51 degrees API) is mixed with lower-gravity crude oil for transportation. While this situation does not arise frequently, MMS believes that in such cases, this volumetric deduction is an actual cost incurred in moving oil.

(10) Costs of securing a letter of credit or other surety that the pipeline requires a shipper to maintain. These costs should only include the currently allocable costs applicable to the Federal lease. MMS believes that shippers can generally use two different means of assuring creditworthiness. The first involves a deposit or advanced payment in which the shipper incurs only the costs associated with the time value of money because they receive their deposit back. The other involves actual out-of-pocket costs to obtain a letter of credit, guarantee, or surety bond. MMS believes that these two means should be accounted for differently in calculating your transportation allowance.

In the first case, if you make a cash deposit of two months of the expected transportation charges (say \$50,000), and transport 100,000 barrels per month, of which 75,000 barrels are from a Federal lease, you must calculate the cost as follows:

(i) Multiply the deposit by the monthly rate of return, calculated by dividing the rate of return specified in section 206.111(i)(2) by 12, and (ii) multiply that result by the proportion of total production from each Federal lease. In this example, if the Standard and Poor's BBB bond rate was 8%, the allowable monthly rate would be

$$\left( \frac{.08 \times 1.5}{12} = .01 \right),$$

and that would be multiplied by the amount of the deposit to get the monthly cost, which would be \$500. Then you could include the share of that applicable to the Federal lease ( $75,000/100,000 = 3/4$ ). So you could include \$375 as an allowable transportation cost for as long as the \$50,000 is on deposit (and the other factors remain unchanged).

In the second case involving the expense of a letter of credit or other surety, if you pay your bank \$5000 as a non-refundable fee for a letter of credit, you can include the proportion allocable to Federal production in the month that fee is paid, and then never again.

MMS believes that this is a cost that the lessee must incur to obtain the