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**Comments of the American Petroleum Institute, the Independent Petroleum Association of America and the Domestic Petroleum Council on Minerals Management Service Proposal on Valuation of Crude Oil Produced on Indian Leases
30 CFR 206, 64 FR 403 (January 5, 2000)**

Dear Mr. Guzy:

The American Petroleum Institute, the Independent Petroleum Association of America and the Domestic Petroleum Council welcome this opportunity to file comments on the MMS' January 5, 2000 proposal. Our members are engaged in all aspects of the petroleum industry: exploration, production, transportation, refining and marketing. Many of our members are actively engaged in activities involving crude oil produced on Indian lands and together they account for the vast majority of crude oil royalties paid every year. We therefore have a substantial interest in the Minerals Management Service's ("MMS") Indian lands crude oil valuation rulemaking.

In many respects, the MMS' January 5, 2000 Indian leases crude oil valuation proposal ("Indian Oil Proposal") parallels the MMS' December 30, 1999 Federal leases crude oil valuation proposal ("Federal Oil Proposal"). In the interests of brevity, these comments incorporate by reference the January 30, 2000 joint association comments on the Federal Oil Proposal ("Joint Association Comments")(copy enclosed) and API's May 11, 1998 comments on the MMS' prior Indian leases oil valuation proposal.¹



1. Duty to Market

In earlier comments, API objected to the MMS legal assumption that there exists a duty to market free of charge. API May 1998 Comments at 3. The latest Indian Oil Proposal reflects

¹ See e.g., API May 27, 1997 comments on the MMS' initial proposal at 62 FR 3742 (January 24, 1997); API August 1, 1997 comments on the MMS' supplementary proposal at 62 FR 16116 (April 4, 1997); API November 4, 1997 comments on the MMS' alternatives for rulemaking and related workshops at 62 FR 49460 (September 22, 1997); Joint Association December 5, 1997 comments on the rulemaking issues in general; Joint Association April 3, 1998 comments on the MMS' supplementary proposed rule at 63 FR 6113 (February 6, 1998); API July 31, 1998 comments on the MMS' further supplementary proposed rule at 63 FR 38355 (July 16, 1998); Joint Association April 27, 1999 comments to augment March-April 1999 MMS workshops; API November 4, 1999 comments on City of Long Beach decision.

no change on this central issue and we would reiterate the arguments laid out at length in the Federal oil valuation rulemaking. See e.g., Joint Industry Comments at 11-20.

2. Reliance on Spot Prices

In earlier comments, API urged that the MMS not rely on NYMEX prices for valuation of production. API May 1998 Comments at 2. Commendably, the latest Indian Oil Proposal at least tracks the most recent Federal Oil Proposal through elimination of NYMEX futures prices in favor of crude oil spot prices.

However, what remains is a problem common to both proposals, namely, the presumptive use of a downstream index when other better measures of value (e.g., comparable sales, tendering) exist and are better suited to arriving at the "value of production." This indexing orientation rests on flawed assumptions and poses many unnecessary operational problems detailed by industry throughout the Federal oil valuation rulemaking. See e.g., Joint Industry Comments at 8-20 (flawed assumptions), 25-28 (utility of comparable sales) and 30-31 (difficulties in calculating adjustments).

The use of a flawed spot price methodology is especially significant for Indian leases. In its most recent Indian valuation proposal, the MMS acknowledges that most lessees cannot always sell at the top of the market: "In most cases the spot price was the highest of the three values used in calculating the Indian royalty payment." 65 FR 409. Contracts are in fact not typically based on the reported seller's high asking price or at the buyer's low offer price, but are usually concluded somewhere in between.

Location compounds the problem. Most Indian reservations are located in the proposed Rocky Mountain Region, a part of the country where the MMS has agreed that there is a "lack of a reliable spot price." 64 FR 73824. Using the spot price at Cushing, a location hundreds of miles from most Indian reservations and fundamentally dissimilar to the Indian lease market, is guaranteed to yield a royalty value considerably different from the true lease value.

In sum, the MMS' rationale for abandoning NYMEX prices properly acknowledges that "NYMEX prices are not attainable by everyone, that use of NYMEX prices effectively moves valuation away from the lease, and that using these prices would add administrative complexity." 65 FR 404. That same rationale seems equally applicable to the use of remote spot prices and the MMS should abandon this aspect of the proposal altogether.

3. Major Portion Analysis

In earlier comments, API opposed the proposed use of the 75th percentile as the gauge of major portion, observing that the top 25 percent on its face cannot be viewed as reflective of major portion. API May 1998 comments at 3. As amended, the present proposal has not changed this central feature and this will plainly lead to unlawfully inflated royalty obligations. See proposed §206.52(c)(3)(ii). Indeed, the proposed three-tiered approach to valuation, using as it does the highest of gross proceeds, the average of daily high spot prices, or the MMS-calculated major portion leads ineluctably to inflated royalty obligations. Just as use of the 75th percentile would lead to an inflated major portion, the use of spot prices without full deductibility of all post-production additions to value would lead to an inflated value. The MMS cannot lawfully adopt such a triple accounting approach.

In addition, the major portion analysis provisions of Indian leases refer to prices actually received in the field or area not prices requested by sellers hundreds of miles from Indian leases. For this reason alone, namely, strict adherence to the express terms of Indian leases,

the major portion regulations should continue to be calculated solely on prices actually paid or received for production sold in the field or area.

4. Transportation Allowances

Earlier in the rulemaking, API criticized the original proposal's categorical disallowance of transportation allowances for any movement of production within the boundaries of an Indian reservation. API May 1998 Comments at 4. As revised, the new proposal would eliminate this particular problem. Indian Oil Proposal at 65 FR 405.

5. Data Reporting

Earlier in the rulemaking, API urged the MMS to narrow and clarify data reporting requirements to expressly exclude data for state and fee leases. API May 1998 Comments at 4. As revised, the Indian Oil Proposal would amend the proposed Form MMS 4416 to properly limit the leases covered to Indian leases. Indian Oil Proposal at 65 FR 405. However, even as amended, Form MMS-4416 would still require all purchasers (not just lessees) to report the require data even though they may never have any direct contact with the tribe. See proposed §206.61(d)(5). In its latest Federal oil valuation proposal, the MMS eliminated Form MMS-4415 altogether; in this rulemaking the MMS should also eliminate MMS-Form 4416.

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If we can provide you with additional information on this important rulemaking, please contact us.

Sincerely,

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