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April 6, 1998

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Mr. David S. Guzy
Chief, Rules and Publications Staff
Royalty Management Program
Minerals Management Service
P.O. Box 25165, MS 3021
Denver, CO 80225-0165

Re: Proposed Rules
Department of the Interior, Minerals Management Service, 30 CFR Parts 206 and 208
"Establishing Oil Value For Royalty Due on Federal Leases and on Sale on Federal Royalty
Oil," NOPR, 63 Fed. Reg. 6113 (February 6, 1998); NOPR, 62 Fed. Reg. 49460 (September
22, 1997); NOPR, 62 Fed. Reg. 3742 (January 24, 1997)
(Our File L1030)

Dear Mr. Guzy:

I appreciate the opportunity to provide the following comments regarding the proposed rule for establishing oil value for royalty due on federal leases and on sale of federal royalty oil. This letter will supplement the comments of Scurlock Permian Corporation ("SPC") dated April 17, 1997 and November 3, 1997. Scurlock Permian LLC ("SPLLC") is the successor by merger to SPC.

SPLLC has its headquarters in Houston, Texas. SPLLC is a gatherer and marketer of crude oil in the United States. SPLLC employs over 900 people with operations in 15 states. SPLLC operates more than 2,400 miles of active crude oil gathering lines and pipelines. SPLLC also operates a fleet of more than 300 tractor-trailers to gather crude oil. SPLLC also has crude oil tankage at 154 onshore terminal locations plus 12 marine terminals.

SPLLC holds no federal lease interests and no operating interest in any crude oil producing field. SPLLC is a third-party purchaser and marketer of crude oil.



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In response to the supplementary Notice of Proposed Rulemaking ("NOPR") published February 6, 1998 in the Federal Register, SPLLC reiterates the comments of SPC pertaining to the subject NOPR. Further, we believe that the proposed rules are unworkable, unnecessary and unfair to crude oil purchasers and marketers. SPLLC respectfully submits the six specific objections to the proposed rules summarized below.

1. **Federal Preemption**

The MMS has no jurisdiction to the extent that the crude oil purchases and transportation are accomplished through the use of trucks. The Federal Aviation Administration Act of 1994 exempts from regulation, in part, the intrastate prices, routes and services of "motor carriers of property." 49U.S.C. §14501(c).

2. **FERC**

The MMS has no jurisdiction to the extent that the crude oil purchases and transportation are accomplished through the use of common carrier pipelines. The Federal Energy Regulatory Commission, and/or state agencies, have exclusive jurisdiction over common carrier pipeline rates.

3. **MMS' Enabling Statutory Authority**

The Federal Oil and Gas Royalty Management Act requires the Secretary to establish a comprehensive inspection, collection, and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed, and to collect and account for such amounts in a timely manner. The proposed rule does not measure value of the production at the lease or first point of sale, but rather measures the value of a similar type of crude oil at the market center. At the lease, the purchaser bears the cost of gathering, transportation and marketing services, as well as the risk of spills, line loss, price volatility between dates of purchase and delivery, exposure to environmental risks and credit risks in reselling the crude oil. Accordingly, because the proposed rule does not measure the value of the production removed or sold from the lease, it exceeds the statutory authority of the Secretary.

4. **Constitution**

If the primary purpose of the new rule is to raise revenue, then promulgation of the rule is controlled by the taxing provisions of the Constitution. *Rodgers v United States*, 138 F.2d 992, 994 (6th Cir. 1943). "The test to be applied is to view the objects and purposes of the statute as a whole and if from such examination it is concluded that revenue is the primary purpose and regulation merely incidental, the imposition is a tax and is controlled by the taxing provisions of the Constitution." *Id.* Article I, Section 8, Clause 1 grants exclusively to Congress the "power to lay and collect taxes," and limits the forms of taxes which may

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be imposed. If the new rule is a "tax", it was promulgated in contravention of those limitations because it is non-uniform and was enacted by an executive agency rather than Congress.

5. Consultant's Testimony

MMS states in the February 6, 1998, NOPR that the agency relied upon presentations by crude oil brokers and refiners, commercial oil price reporting services, companies that market oil directly and private consultants knowledgeable in crude oil marketing to conclude that posted prices do not accurately reflect the value of production removed or sold at the lease. The rulemaking further acknowledges that it was the culmination of the work of the Interagency Task Force set forth in the "Final Interagency Report on the Valuation of Oil Produced from Federal Leases in California," (May 16, 1996) which commissioned expert studies only from those individuals who testified for the State of California in the Long Beach Litigation that challenged posted prices. MMS' deliberate reliance on experts predisposed to reject posted prices is arbitrary, capricious and an abuse of discretion. By failing to identify the experts and consultants upon whom MMS has relied and describe the presentations that these individuals and others have made, MMS has failed to provide interested parties the notice and opportunity to comment as required by the Administrative Procedures Act.

6. Royalty-in-Kind

The proposed rule, if implemented, would seriously harm the midstream business, including the business of SPLLC, and the efficiencies midstream companies bring to the overall domestic crude oil markets. On the other hand, if the MMS sold the federal royalty in kind, the MMS could be assured of obtaining market value and could decide whether to engage in additional transactions itself, including volume aggregation and exchange contracts to market centers, as the agency may desire, subject to the attendant risks and costs.

While the MMS may see these regulations as necessary restraints on the major oil producers and refiners, these regulations are in fact price controls which will be detrimental to independent purchasers and merchants who provide market efficiencies. Royalty-in-kind sales will provide the fair assignment of value to federal royalty oil without imposing the proposed restraints and inefficiencies.

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Your consideration of these concerns is appreciated.

Very truly yours,

SCURLOCK PERMIAN LLC

A handwritten signature in cursive script, appearing to read "Lawrence J. Dreyfuss", written in black ink.

Lawrence J. Dreyfuss

cc: Ben Dillon (IPAA)

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