Chevron
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Chevron U.S.A. Production Company
1301 McKinney Street
Houston, Texas 77010-3029
Mail Address: P. O. Box 3725
Houston, Texas 77253-3725

George W. Butler III
Senior Counsel
Law Department
(713) 754-7809
Fax (713) 754-3366

<u>**VIA FACSIMILE - (303) 231-3385**</u>

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

Further Supplementary Proposed Rule--Establishing Oil Value for Royalty Due on Federal Leases; 64 FR 73820 (December 30, 1999)

Dear Sir:

Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc. ("Chevron"), appreciates the opportunity to comment on the subject proposed rule. As one of the largest lessee/payors of royalties on oil produced from federal leases, Chevron is significantly affected by the proposal.

Chevron endorses and incorporates by reference the comments of Chevron Pipe Line Company and Barents Group LLC, as well as the oral comments of George Butler submitted at the MMS public workshops in Denver (January 18, 2000), Houston (January 19, 2000), and Washington, DC (January 20, 2000). Chevron also endorses and incorporates by reference the joint comments of API, IPAA, DPC, and USOGA. Finally, Chevron incorporates by reference and reiterates herein all its prior comments.

I. Preferred Alternative to the Proposed Rule

Again, Chevron encourages MMS to take all federal oil royalty in kind. In so doing, the value of production would be established at the time of severance by an agreed upon sale price, rather than many years later, as in the case of royalty paid in value. Payment of royalty in value has become the equivalent of writing a <u>blank</u> check, with the amount not determined until years later, after costly audits, administrative appeals, and litigation. This is because the Department's interpretation of its valuation regulations and verification of royalty payments does not occur until many years after the royalties have been paid. Lessees, on the other hand, must interpret the valuation rules and calculate and pay royalty by the end of the month following production. It is no wonder that disputes arise. By way of example, what lessee could have foreseen when making royalty payments on natural gas liquids ("NGL") how the Department would eventually interpret its NGL valuation regulations in the infamous "NGL Procedure Paper" overturned by the courts many years after the fact? And who could have known that the Department would adopt the tenuous position that ANS spot prices should have been used to calculate royalty value on oil produced from federal leases in California rather than posted prices? MMS' latest proposal fails to fix the inherent problems that have arisen from requiring royalty payments in value, because it perpetuates complicated and ambiguous valuation rules and fails to break the recurring cycle of uncertainty.

A comprehensive royalty-in-kind program would allow the government to eliminate cadres of federal employees required to verify and ascertain royalty value. It would allow the government to participate in downstream markets, with the expectation of achieving higher revenues, without imposing on federal lessees an obligation to market production downstream rather than at the lease. Finally, a comprehensive royalty-in-kind program would achieve what all Americans have the right to know, namely, the fair value of production from federal lands <u>at the time of severance</u>.

II. Duty to Market

Chevron is concerned that MMS' analysis of the Duty to Market presented at pp.73822, et seq., is flawed. MMS denies that it is forcing lessees to market downstream. The essence of MMS' logic is that if a lessee chooses to market downstream, the choice to do so is for the mutual benefit of lessee and lessor, but such a choice should not permit the lessee to disregard part of the sales price obtained at a downstream market. However, this analysis fails to offer a reasoned basis for imposing downstream values on refined production. Requiring index prices on refined production without adjustments for all differences in value between the market center and the lease effectively requires such production to be sold at a market center. MMS does not provide a reasoned explanation for limiting allowable adjustments to actual transportation costs to the alternate disposal point. In order to derive a lease value, *all* differences in value between the market center and the lease must be recognized. By valuing refined production at market center prices without adjusting for all differences in value between the lease and the market center, the rule imposes a duty to market downstream.

III. How to Fix MMS' Proposed Rule

For the reasons set forth in prior comments, Chevron continues to believe that the proposed rule is seriously flawed and cannot succeed in its present form. If the Department of Interior is intent on being paid in value, then Chevron urges that the final rule reflect the Industry Proposal set forth in prior workshops and in the prior joint comments of API, IPAA, DPC and USOGA. Again, Chevron would like to emphasize some areas of concern.

<u>Non-Arm's-Length Option for Arm's-Length Sales</u>

Proposed §206.102 requires that oil sold by a lessee or its affiliate under an arm's-length contract be valued at the gross proceeds accruing to the seller. The proposal would allow a lessee selling oil to an affiliate the option to use the applicable non-arm's-length methodology at §206.103 instead of tracing gross proceeds pursuant to §206.102. This option is also available for arm's-length dispositions that occur following arm's-length exchange agreements. However, many lessees do not have oil marketing affiliates but nevertheless engage in numerous, varied dispositions (e.g., outright sales to third parties, buy/sell or exchange agreements, refinery transfers) that would be extremely difficult, if not impossible, to trace pursuant to §206.102.

Each month, Chevron Products Company, a separate division of Chevron U.S.A. Inc., engages in hundreds of separate dispositions, often out of large pools that cannot be sourced back to specific leases. The proposed rule would require Chevron to calculate a weighted average price to be allocated back to hundreds of leases in the Gulf of Mexico. Assuming Chevron were able to calculate such a price in a timely manner, each arm's-length contract would still be audited. If, on audit, any arm's-length contract were disqualified due to a finding of lack of opposing economic interests, misconduct between the contracting parties, or breach of the duty to market, then that disposition would not only have to be revalued under §206.103, the weighted average price of the remaining arm's-length contracts would also have to be recalculated, thereby affecting the weighted average price for all leases. To make matters even more complicated, part of Chevron's Gulf of Mexico production is not ultimately sold, but transferred to a refinery. Therefore, production from each lease would have an arm's-length component and a non-arm's-length component, with each component valued under a different methodology. This would impose an almost insuperable administrative burden on Chevron. See attached affidavits of K. Dawkins and C. Perryman. Chevron's prior comments, as well as the Industry Proposal, maintain that it makes better sense to offer the option to value all arm's-length dispositions using the non-arm's-length methodology in §206.103, irrespective of whether there has been an intervening transfer to an affiliate or an arm's-length exchange. This option should be exercisable in each area, i.e., California, the Rockies, and all other parts of the US.

At the same time, lessees who have the ability to trace their proceeds should be allowed to do so, and should not be forced to use index to value arm's-length dispositions.

Non-Arm's-Length Dispositions

Proposed §206.103 proposes various methods for valuing production not sold at arm's-length.

With respect to §206.103(a), Chevron continues to maintain that ANS spot prices are an inappropriate measure of value for oil produced from federal leases in and offshore California.

With respect to §206.103(b)(3) Chevron notes that crudes produced in the Salt Lake regional area are primarily priced on calendar month basis. The crudes are priced in the same month that they are delivered. Chevron estimates that 73% of the crude that moves to Salt Lake City refineries is based on calendar month pricing, while only 19% of this crude is based on trade month pricing, and the balance is long-haul Canadian crude that is priced in the month it is produced (i.e. calendar) but delivers into Salt Lake in the following month. Chevron therefore recommends that royalty be paid on a calendar month basis when the index methodology is used.

With respect to §206.103(c)(2), Chevron notes that the phrase "for deliveries during the production month" is unclear. Crudes in this area are traded on a trade month basis, and Chevron recommends that royalty be paid on a trade month basis when the index methodology is used.

In all cases where an index methodology is provided for in rule, Chevron recommends that all language regarding timing (trade month vs. calendar month) be clarified with specific examples.

<u>MMS-approved Publications</u>

Proposed §206.104 should clarify that any approved publication may be used, and that any approved publication may be selected for any grade.

<u>Value Determinations</u>

Proposed §206.107 should clarify that a lessee may rely on a proposed value method pending a response and utilize that method. It should also expressly provide that reliance on a proposed method will not be considered willful non-compliance or constitute a false claim.

It should also provide that, at the discretion of MMS or the Secretary, a value determination may employ any valuation methodology provided for in the rule.

III. Implementation of the Final Rule

The effective date of the rule should be extended in order to allow lessees a reasonable time necessary to implement appropriate work processes and computer system changes, i.e., 180 days.

IV. Paperwork Reduction Act

Chevron maintains that the administrative burden of complying with the proposed rule have been underestimated by MMS in its regulatory analysis of the proposed rule. We are particularly concerned with the time required to calculate royalty value under §206.102. Please see the comments of Barents Group LLC.

V. Conclusion

Chevron urges MMS not to publish the proposed rule as a final rule, but rather to take all its royalty in kind. Alternatively, Chevron urges MMS to adopt the Industry Proposal, as explained in industry comments and prior MMS public workshops.

Respectfully submitted,

George W. Butler, III

Enclosures

cc: Tammy Croote, Desk Officer, OMB via FAX 202.395.3258

UNITED STATES OF AMERICA
MINERALS MANAGEMENT SERVICE

DECLARATION OF KATHRYN L. DAWKINS

COUNTY OF CONTRA COSTA)
)S.
STATE OF CALIFORNIA)

I, Kathryn L. Dawkins, being first duly sworn, depose and state as follows:

1. This Affidavit is made in support of the comments of Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc. ("CPDN") on the Further Supplementary Proposed Rule, Establishing Oil Value for Royalty Due on Federal Leases; 64 FR 73820 (December 30, 1999).

2. I am Supervisor, Federal Royalty and Reporting. I have served in this capacity since August, 1998. I am responsible for, among other things, payment and reporting by CPDN of royalties on production from federal lands leased to Chevron U.S.A. Inc.

3. I am over 18 years of age and am competent to testify to the matters set forth herein, and I have personal knowledge of those matters.

4. CPDN pays royalties to the MMS, an agency of the United States Department of the Interior ("DOI"), under various oil and gas leases covering federal lands onshore and offshore. CPDN has certain obligations to pay royalties to the federal government on production from these lands, pursuant to the provisions of the leases themselves, and applicable law and regulations.

5. Royalty on oil is due by the end of the month following production. Federal oil royalty is calculated by CPDN's revenue and royalty payment computer system, which requires that crude oil value be input by the 1st through 5th workday of the month following production in order to record revenue and calculate royalty payments due by the end of the month following production. Adjustments to royalty prices can be made through the 15th workday, but require retroactive system adjustments that

would show the reversal and rebooking for royalty payment and reporting purposes, greatly increasing Chevron's computer processing costs as well as increasing the number of reported lines

6. Information about actual oil dispositions, including arm's-length sales and exchanges, is not recorded in CPDN's revenue and royalty payment system. Actual oil dispositions are recorded in a separate accounting system maintained by Chevron Services Company for a separate division of Chevron U.S.A. Inc., Chevron Products Company ("CPDS"). In order to record revenue and calculate royalty based on actual dispositions, CPDN's accounting system would have to use oil pricing information obtained from CPDS's accounting system. There is currently no process in place for CPDN to obtain such information from CPDS.

Further, affiant saith not.

Kathryn Dawkins

Kathryn Dawkins, Supervisor
Federal Royalty and Reporting
Chevron U.S.A. Production Company.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Laura Mize

Notary Public

My Commission Expires:
12-26-2002

LAURA MIZE
Commission # 1206216
Notary Public - California
Contra Costa County
My Comm. Expires Dec 26, 2002

UNITED STATES OF AMERICA
MINERALS MANAGEMENT SERVICE

DECLARATION OF CAROL C. PERRYMAN

COUNTY OF HARRIS	)	
	)S.	
STATE OF TEXAS	)	

I, Carol C. Perryman, being first duly sworn, depose and state as follows:

1. This Affidavit is made in support of the comments of Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc. ("CPDN") on the Further Supplementary Proposed Rule, Establishing Oil Value for Royalty Due on Federal Leases; 64 FR 73820 (December 30, 1999).

2. I am Manager, Domestic Crude Marketing Accounting/East, of Chevron Services Company, which provides accounting services for Chevron Products Company, a Division of Chevron U.S.A. Inc.(" CPDS"). I have served in this capacity since December, 1998. I am responsible for, among other things, accounting for all domestic crude oil acquisitions and dispositions by CPDS in the United States, except Alaska and California.

3. I am over 18 years of age and am competent to testify to the matters set forth herein, and I have personal knowledge of those matters.

4. CPDS markets all of CPDN's controlled share of oil production. CPDN's oil production is aggregated, commingled with third-party purchased crude, and moved to market centers and/or refineries.

5. CPDS enters into numerous separate contractual arrangements, including spot sales, term sales, spot purchases, term purchases, spot buy/sells, term buy/sells, and refinery transfers. Each month, there are hundreds of individual transactions, none of which are sourced

back to any specific lease. Rather, all dispositions are accounted for on a contract basis.

6. In connection with the subject rulemaking, Domestic Crude Marketing Accounting/East extensively investigated our systems' capabilities to differentiate actual dispositions by contract between outright sales, exchanges, and refinery transfers and calculate weighted average sales prices for each grade at each market center. We simply do not possess such capability. Leases are not mapped to contracts within our existing systems. In addition , in most cases, estimated volumes are initially booked and are then adjusted to actual deliveries after accounting systems are closed on the seventh work day, as necessitated for corporate financial reporting. This volume reconciliation is largely dependent on information from third party run tickets and pipeline statements that are not always available for accounting close. CPDS's dispositions are finalized by means of retroactive reversal and rebooking, which is not complete until after value for royalty purposes must be input into CPDN's revenue and royalty payment system. In short, calculation of weighted averaged prices based on actual dispositions is beyond our capability and would require major revision, if not complete replacement, of existing accounting systems and work processes.

Carol Perryman

Carol Perryman, Manager
Domestic Crude Marketing Accounting/East
Chevron Services Company

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Carol L. Hicks

Notary Public

My Commission Expires:
June 5, 2000

CAROL L. HICKS
NOTARY PUBLIC
State of Texas
Comm. Exp. 06-05-2000

NOTARY PUBLIC STATE OF TEXAS