Chevron

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Supplementary Proposed Rule
Establishing Oil Value for Royalty Due on Federal Leases
(63 FR 6113, February 6, 1998)

Dear Sir:

Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc. ("Chevron"), one of the largest producers of oil from federal leases, offers the following comments on the subject supplementary proposed rule ("2/6/98 proposal"). Chevron endorses and adopts the comments of the American Petroleum Institute (API), the Council of Petroleum Accountant Societies (COPAS), the Rocky Mountain Oil and Gas Association (RMOGA), and the various reports of the Barents Group LLC.

The 2/6/98 proposal is completely unworkable and should be withdrawn. It would require that royalty on oil refined by a lessee or its affiliate be based on an index methodology which would, in the overwhelming majority of cases, fail to arrive at the market value of production at the lease, in violation of lease provisions and law. 30 CFR 206.103. The proposal's failure to include appropriate transportation, location and quality adjustments to spot prices renders it arbitrary, capricious, an abuse of discretion, and not in accordance with the law.

The 2/6/98 proposal would require that oil sold by a lessee or its affiliate in an arm's-length sale, including oil not actually produced from a federal lease but received in exchange for federal oil, be based on the gross proceeds accruing to the seller. 30 CFR 206.103. Tracing proceeds in such a manner would be extraordinarily impracticable, rendering such a methodology arbitrary, capricious, an abuse of discretion, and not in accordance with the law.

The 2/6/98 proposal would utterly fail to achieve certainty in royalty valuation. Not only would it be impossible to obtain a binding value determination to be used when royalty must be paid (30 CFR 206.107), MMS would reserve the right to pick and choose the index or the proceeds methodology, e.g., 30 CFR 206.102(c)(1), 206.102(c)(3).

The 2/6/98 proposal would be extraordinarily expensive, for lessees and the government. Lessees would need to add employees and implement expensive systems to capture downstream data and calculate weighted average prices. In addition, hundreds, if not thousands, of additional federal employees would be required to verify such payments. Disputes, appeals, and litigation would increase.

In conclusion, Chevron would like to take this opportunity to point out that MMS can do the right thing for the American taxpayer by taking the federal royalty in kind. In so doing, the value of production would be established at the time of production, by means of an agreed upon sale price, rather than many years later, as in the case with royalty paid in value. It is indeed unfortunate that writing a royalty check to the government has become the equivalent of writing America a blank check, with the amount not determined until years later, after costly and unnecessary audits, administrative appeals, and litigation. This is because the current state of the law confers upon the Secretary of the Interior broad discretion in interpreting the Department's valuation rules. However, the Department's interpretation invariably does not occur until many years after its regulations are promulgated. 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 "Procedure Paper"? And who could have known when the 1988 valuation rules were adopted that the Department would, many years later, adopt the 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 proposes to fix the inherent problems which have arisen from requiring royalty payments in value with new and different valuation rules, but this does not address the recurring cycle of publishing valuation rules but then not interpreting them until many years later.

Chevron suggests that a comprehensive royalty-in-kind program would allow the government to eliminate cadres of federal employees required to monitor, verify, and ascertain correct royalty value. It would allow the government to participate in downstream markets, in the hope 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, from federal lessees to the school children of California, should have the right to know, namely, the value of production from federal lands at the time of severance.

Respectfully submitted,

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