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Exxon Mobil Corporation Comments on Minerals Management Service Supplementary Proposed Rule on Establishing Oil Value for Royalty Due on Indian Leases, 65 FR 403 (January 5, 2000)

Dear Mr. Guzy:

Exxon Mobil Corporation (ExxonMobil) appreciates the opportunity to comment of the Minerals Management Service (MMS) Supplementary Proposed Rule on Establishing Oil Value for Royalty Due on Indian Leases, published at 65 FR 403 (January 5, 2000). As a significant producer of federal and Indian oil, ExxonMobil has a substantial interest in the outcome of this rulemaking.

ExxonMobil adopts and incorporates by reference the earlier comments of Mobil Business Resources Corporation in this rulemaking, as well as the comments of the American Petroleum Institute on the original proposal and this supplementary proposed rule. Additionally, since the Indian oil rulemaking parallels many of MMS' original proposals in the federal oil valuation rulemaking, ExxonMobil also adopts and incorporates by reference its predecessors' comments in federal oil valuation rulemaking and the comments of the American Petroleum Institute in that rulemaking. ExxonMobil will comment at this time only to emphasize, clarify and supplement these other comments.

The MMS has made important changes during the course of the rulemaking, which should be retained in the final rule. These include:

- The use of spot prices instead of NYMEX futures prices;

- The use of the average of high daily spot prices rather than the average of the five highest NYMEX settle prices in a given month;
- Allowing the deduction of transportation costs from the lease instead of from the reservation boundary; and
- Limiting the information required to be submitted on the proposed Form MMS-4416 to information regarding Indian oil.

The proposal still suffers from fundamental flaws, some of which were identified and corrected in the final Federal Oil Valuation Rule (March 15, 2000). While ExxonMobil believes that the MMS did not go far enough in making these corrections, at the very least, the MMS should make the same corrections in the Indian oil valuation rulemaking that was made in the federal oil valuation rulemaking.

Downstream Spot Market Prices and Duty to Market Downstream Free of Charge

In addition to the comments incorporated by reference on this issue from the federal oil valuation rulemaking, ExxonMobil points out that imposing royalties on downstream values instead of the value of the production at the lease effectively increases the royalty rate, something that many Indian leases prohibit in the absence of the lessee's consent. See, e.g., Section 3(g) of Lease Form 5-157 (Jan. 1962).

Value of Production at the Lease

MMS should confirm through specific language in the rule that it is complying with the statutory and contractual requirement that royalties be assessed only on the value of production at the lease, not on the value of downstream post-production activities such as downstream marketing and transportation. In order to arrive at the value of production at the lease, MMS must allow deductions and/or adjustments based on fair and reasonable transportation rates.

Binding Valuation Determinations

The Indian oil rule should be changed to be consistent with the federal oil rule with respect to value determinations. Indian lessees are no less entitled to expeditious determinations by the agency regarding their royalty obligations than are federal lessees.

Reasonable Transportation Allowances

The Indian oil rule should be changed to be consistent with the federal oil rule with respect to the calculation of non-arm's length transportation allowances. Indian and federal lessees are both entitled to deduct actual, reasonable transportation costs. While the MMS did not provide for an adequate return on investment in the final federal oil rule, it did provide for a minimum value based on 10 percent of investment. It also provided that if a pipeline facility is sold, a new depreciation schedule could be used based on the resale price.

Form MMS-4416 Reporting Burden

The burdensome proposed Form MMS-4415 was eliminated from the final federal oil rule. The similar proposed Form MMS-4416 should be eliminated from the Indian oil proposal.

Time Limit for Major Portion Prices

The deletion of the 120-day time limit for the MMS to determine major portion prices should be reconsidered.

The original proposed rule stated that the MMS would calculate and publish the major portion price within 120 days of the end of each production month. Proposed 206.52(c)(1), 63 FR 7101 (February 12, 1998). The supplemental proposed rule removes the 120 day limitation 65 FR 413 (January 5, 2000). The MMS explained in the preamble that meeting the 120-day deadline should be possible in most cases, but that the "MMS can foresee occasional problems in acquiring the needed data and performing the major portion calculations within 120 days." 65 FR at 404. Additionally, the MMS asserted that the change "should have no adverse impact on royalty payors, because late payment interest would not begin to accrue on any underpayment based on any additional amount owed as a result of the higher major portion value until the due date of the amended Form MMS-2014." Id.

While the MMS is correct that it should be able to meet the 120-day deadline originally proposed, it is incorrect in asserting that payors will not be adversely affected if this time constraint is removed. Late payment interest is not the only consideration. Today, major portion analysis is sometimes performed years after the production occurred and the royalties were due. This delay makes it exceedingly difficult for affected lessees to obtain the information and documents needed to critically evaluate MMS' analysis to determine if it was done correctly. If 120 days is considered by MMS to be sufficient in most cases, a regulatory time limit of 180 days should be more than sufficient to accommodate the exceptional circumstances in which MMS may need more time. ExxonMobil urges MMS to reinstate the 120-day limit or, at the very least, that it include a 180-day limit in the final rule.

Major Portion Determinations

ExxonMobil has previously commented on the proposal's objectionable use of a 75th percentile value to determine "major portion". The MMS has a longstanding established definition of "major portion" being 50% + 1 barrel as shown in Payor Handbook Volume III, the Royalty Valuation Training Manual, in current regulations at 30 CFR § 206.52(a)(2)(ii) and as used in the major portion invoices and demands issued by the MMS. The MMS should not change their longstanding definition, nor promulgate rules that conflict with the plain meaning of the lease terms.

Additionally, the proposal currently states "If this value exceeds the value you initially reported for the production month, you must submit an amended Form MMS-2014 with the higher value within 30 days after MMS publishes the major portion value in the **Federal Register**". This is an insufficient time period for analyzing the determination and making the payment. At a minimum, lessees should be allowed at least 60 days to submit amended forms and any additional royalties. Additionally, many lessees' systems and processes are designed to submit all royalty reports (Form MMS-2014) together at the end of each month. It would be extremely difficult for such lessees to report mid-month to comply with a 30-day deadline. Therefore, we suggest the proposed rule be changed to read, "If this value exceeds the value you initially reported for the production month, amended Form(s) MMS-2014 and additional royalty payment(s) will be due by the end of the second month following publication of the major portion value in the **Federal Register**".

"Lessee" Definition

MMS has no statutory or contractual authority to define a "lessee" as including "all affiliates, including but not limited to a company's production, marketing, and refining arms." 63 FR at 7100. As the agency previously has recognized, the separate existence of corporate affiliates cannot simply be ignored absent facts that justify piercing the corporate veil. Getty Oil Co. 51 IBLA 47 1980.

The use of the terms "lessee" and "you" in the proposal creates confusion and ambiguity regarding the obligations imposed by the proposal. For example, proposed section 206.61(d)(5) is entitled "What information must lessees provide to support index pricing adjustments, and how is it used?" It then requires "you", presumably the lessee, to submit the information required on the Form MMS-4416. 65 FR at 415. The proposed instructions for the form, however, state that "you" should fill out the form "if you produce, sell, purchase, exchange, or refine oil produced from Indian lands." 65 FR at 418. This seems to envision that others, besides lessees, will have to submit the form, but this is not at all clear from the language of the proposed rule.

Burdensome and Unauthorized "Triple Accounting"

MMS has no statutory or contractual authority to require Indian lessees to calculate and pay royalties on the highest of three different values. Even if authorized, the "triple accounting" required by the proposed rule is unreasonably and unnecessarily burdensome.

If the MMS insists upon retaining spot market prices as a valuation methodology (in spite of its non-conformity with the lease terms), the MMS should eliminate the requirement for lessees to continue to track their gross proceeds. At the February 8, 2000 public workshop on the rulemaking, MMS representatives identified only one historical instance in which the gross proceeds basis for Indian oil royalties would have been higher than the downstream spot market price. It is unreasonable to place this onerous administrative burden on every Indian lessee, when the MMS itself has determined it might prevent a situation that occurred only once in thousands of reports and payments.

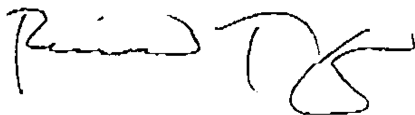
A more reasonable and less burdensome method would be to replace the requirement with an "opt out" provision similar to the provision contained in the Indian gas valuation regulations. That provision allows Indian lessors who have concerns about the gas index-based "major portion" formula to "opt out" of using it, relying instead on negotiated agreements between the lessees and lessors, or gross proceeds if they so choose. Similarly, the oil valuation rule could provide that lessees who pay royalties to Indian lessors who have "opted out" of the spot price formula would continue to pay on gross proceeds, subject to MMS' subsequent major portion calculation.

Conclusion

Finally, ExxonMobil continues to believe that a workable Royalty in Kind (RIK) program is a preferable alternative to the disputes that will result from the rule if promulgated as currently proposed. The Navajo Nation has taken royalty in kind successfully and circumvented many of the issues that this proposal will create.

ExxonMobil appreciates your consideration of these comments.

Sincerely,



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