620 Denver Club Building ◆ 518 17th Street ◆ Denver, Colorado 80202-4167 ◆ 303/623-0987 ◆ FAX: 303/893-0709 ◆ www.ipams.org

IPAMS
Independent Petroleum Association of Mountain States

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March 20, 2000

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: Establishing oil for Royalty Due on Indian Leases
Supplementary Proposed Rule
65 F.R. 403, January 5, 2000

Dear Mr. Guzy,

The Independent Petroleum Association of Mountain States (IPAMS) appreciates this opportunity to provide comments on the above-referenced Supplementary Proposed Rule. We also appreciate your granting of our request for an extension of the comment period.

While IPAMS acknowledges that several positive improvements to the February 12, 1998, Notice of Proposed Rulemaking have been made, we still have serious concerns with the rulemaking.

To the extent that MMS determines it must require value based on some price other than that paid in the field, the decision to move from NYMEX to spot market prices is generally viewed as a positive move. Clearly, spot market prices more nearly approximate the prices paid at the wellhead than do NYMEX prices. In addition, using the average of the daily high prices for the month – rather than the five highest NYMEX futures settle prices – is more fair.

However, IPAMS is concerned that MMS proposes to use spot market prices for the Rocky Mountain Region established at Cushing, Oklahoma, rather than Guernsey, Wyoming. It may be true that the spot market at Guernsey is thinly traded. Nevertheless, it does come much closer to the value of Rockies crude oil than that generally traded at Cushing. Besides, having to apply location and quality differentials to arrive at a Rocky

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Mountain value adds unneeded complexity and uncertainty to the valuation process.

The modification to the transportation allowance that would permit deductions for transporting oil across reservations is also a welcome move.

However, first and foremost among IPAMS concerns is the fact that MMS still requires royalty to be paid on the highest value: either the lessee's gross proceeds; the average of daily high spot market prices; or the MMS-calculated major portion price.

Although the terms of the Indian lease grant discretion to the Secretary to determine value based on the highest price paid or offered for the major portion of the oil, the lease also states that the price must be for oil produced and sold from the same field where the leased lands are situated. Requiring lessees to value their oil on index prices – which they are not even be receiving – violates the terms of the lease. MMS has not demonstrated that an index price, particularly that proposed for the Rocky Mountain Region, represents the value paid or offered for oil produced and sold from the same field.

Some in industry have commented that if MMS would eliminate the tracing of gross proceeds under this rule, they would be more willing to pay on the higher of an index price or major portion price because of the simplicity. However, IPAMS members favor retaining gross proceeds as the value for determining royalty. Where a lessee sells outright at the lease, and particularly in cases where the oil goes directly to a refinery, there is no exchange on which to base differentials. For the majority of Indian leases, the oil does not physically flow to a market center; therefore, MMS is creating an accounting burden for lessees to net back the price to the wellhead using arbitrary location and quality differentials.

The major portion price that is calculated by MMS should be based on what lessees are receiving for their oil in the field, not the price at some distant market center where the majority of the oil bought and sold is produced elsewhere and physically flows to or is exchanged for like quality oil at the market. Furthermore, the price paid at market centers is almost always higher than that paid in the field because of transportation costs and/or the ability to aggregate volumes in order to obtain a higher price. It is unfair to expect a lessee to pay royalty on a higher price than what he receives in the field for his oil – the limited exception being in the case of a higher major portion price.

Another of IPAMS' concerns is the fear that purchasers who have in the past reported and paid royalties on behalf of small independent lessees will no longer be willing to provide that service in the future because of the accounting burden, the inherent uncertainty in the rule, and the potential liability exposure that purchasers are unwilling to bear. When a lease is traded, transferred or sold, there is a delay in the exchange of information that could prove problematic because the lessee or operator on whose

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behalf the purchaser was paying is no longer there. Thus, there is no one for the purchaser to turn to if MMS subsequently determines that more royalty is due.

In other instances, purchasers may begin to apply even greater discounts to the prices paid to lessees for their oil in order to compensate the purchasers for the increased administrative burden and exposure, thereby further widening the gap between the prices in the field and the prices at a market center. At *best*, this situation would require many more individual lessees to begin reporting and paying their own royalties, which would, in turn, increase MMS's own administrative burden.

IPAMS is also concerned about the 30-day time frame for adjusting royalty reports and payments based on MMS's published major portion price. We do not believe this is enough time, particularly for lessees that have a fair number of leases. IPAMS recommends that amended reports be submitted no sooner than the end of the month following the month MMS publishes the major portion price.

IPAMS still strongly objects to the requirement to submit the Form MMS-4416. We refer you to our earlier comments on the February 12, 1988, proposed rule, as well as comments submitted on the Federal Oil Valuation Rule regarding the proposed Form MMS-4415, which MMS chose to eliminate in the final federal oil rule. We recommend that Form MMS-4416 be eliminated from the Indian oil valuation rule as well.

IPAMS also requests that binding valuation guidance, as provided for in the final Federal Crude Oil Valuation Regulations, be similarly provided for in these regulations.

IPAMS remains concerned about MMS's unwillingness to move on the issue of a lessee's "duty to market at no cost to the lessee". I would again refer you to our earlier comments on both the Federal and Indian Oil Valuation proposals.

The proposed rule is neither fair, nor will it simplify or streamline the valuation process. We do believe it will increase the administrative burden on both lessees and MMS. It will require most lessees to pay royalty on "phantom income", far and above what they expected to pay when they signed their leases.

Again, IPAMS appreciates the opportunity to comment on the Supplementary Proposed Rule. Please contact me if you have any questions, or if you would like to discuss our comments further.

Sincerely,

Carla J. Wilson
Director of Tax and Royalty