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March 20, 2000

Via Facsimile: (303) 231-3385
& Overnight Mail

Mr. David S. Guzy, Chief
Rules & Procedures Staff
Royalty Management Program
Minerals Management Service
Building 85, Room A613
Denver Federal Center
Denver, Colorado 80225

Re: Establishing Oil Value for Royalty Due on Indian Leases
Supplementary Proposed Rule
(65 FR 403, January 5, 2000)

Dear Mr. Guzy:

Marathon appreciates the opportunity to submit the enclosed comments on MMS' recently published supplementary proposed rule for establishing oil value for royalty due on Indian leases.

If you have any questions, please contact me.

Sincerely,

Dow L Campbell

Dow L. Campbell

Enclosure

(117927)

cc: The Office of Information and Regulatory Affairs
Office of Management and Budget
Attention: Desk Officer for the Department of the Interior
725 17th Street, NW
Washington, D.C. 20503

Marathon Oil Company
Comments on MMS' Supplementary Proposed Rule
Establishing Oil Value for Royalty Due on Indian Leases

65 FR 403, January 5, 2000

INTRODUCTION

Marathon Oil Company ("Marathon") welcomes the opportunity to comment on the latest proposed regulations.

Marathon reaffirms and incorporates by reference its comments filed on May 13, 1998, submitted in response to the MMS proposal in the Federal Register on February 12, 1998 (63 FR 7089). Marathon also supports and incorporates by reference the comments filed jointly by the Domestic Petroleum Council, the American Petroleum Institute, and the Independent Petroleum Association of America on March 6, 2000, in response to the MMS' most recent proposal. In addition, Marathon offers the following comments:

USE OF AVERAGE OF HIGH DAILY SPOT PRICES

Since the MMS has a stated goal that its index pricing should better reflect values generally obtainable, its abandonment of NYMEX prices is appropriate. (65 FR 404). However, changing from the average of the five highest NYMEX settle prices to the average of the daily high spot prices still leads to unreasonable and generally unattainable values. Spot prices are reported as a bid/ask range (or bid/offer range) where the seller is asking for the high price and the buyer is willing to bid (or offer) the low price. Contracts are not typically concluded at the seller's high asking price or at the buyer's low offer price, but rather, most actual agreements involve prices that are somewhere in between. The average of the low prices is more indicative of market value because it represents the price that buyers are willing to pay.

DUTY TO MARKET AT NO COST TO THE INDIAN LESSOR

The Supplementary Proposed Rule fails to address the comments related to the issue of duty to market at no cost to the Indian lessor which were filed in response to the Notice of Proposed Rulemaking. (63 FR 7089, February 12, 1998). Marathon reasserts that any duty to market ends at the lease line, and we incorporate by reference our earlier comments on this issue and those filed in response to the Federal oil valuation rulemaking. There is simply no basis for the claim that a lessee has an obligation to bear all the costs and risks of marketing the Indian lessor's royalty share of production downstream of the lease. If the tribe or allottee wants to share in the benefits of the downstream market, it must also share the costs and risks of marketing downstream of the lease.

THE PROPOSED 'MAJOR PORTION' ANALYSIS IS FLAWED

The 'major portion' analysis methodology of the supplementary proposal continues to be contrary to the plain terms of the Indian leases. The following provision is from a typical Indian lease:

> Value may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered (whether calculated on the basis of short or actual volume) at the time of production for the major portion of the oil of the same quality and gravity, and gas, and/or natural gasoline, and/or all other hydrocarbon substances produced, sold and saved from the area where the Leased Premises are

produced, and the actual volume of the marketable product less the content of foreign substances as determined by the Authorized Officer. (*emphasis added*).

By including index pricing in the array of prices, the proposed 'major portion' valuation methodology would improperly value oil based on prices paid, if at all, for oil from other areas, not just the area where the leased premises are located.

The proposed major portion methodology fails to abide by the clear requirements of the lease agreement. The lease language requires that different major portion prices be calculated for each different quality of oil. The MMS' proposal, however, requires that quality adjustments be made to all of the oil, and then one major portion price will be applied to all the various qualities of oil. These two methodologies do not yield the same results. The proposal will unfairly result in a substantially higher royalty burden on oil of a lesser quality. In essence, if a lower quality crude oil volumetrically represents less that 75% of the production from an area, under the proposal its royalty will be based on the value of the higher quality crude produced from the area. The paraffin example discussed in the preamble on page 409 is evidence that the MMS recognizes this condition.

This 'major portion' calculation would now be calculated based on the 75th percentile price. This is also contrary to the plain meaning of the lease terms and the MMS' own interpretation of those lease terms. The term majority is defined as follows:

> **ma·jor·i·ty**
> ...
> **3 a** : a number greater than half of a total
> **b** : the excess of a majority over the remainder of the total : MARGIN
> **c** : the preponderant quantity or share
> ...
> Webster's New Collegiate Dictionary, *emphasis added.*

The MMS' proposed 75th percentile represents the price at or above which the bottom of the top 25 percent of the oil is sold, and below which the other 75 percent is sold. This 75 percent figure is not the plain meaning of 'major portion', nor does it represent the MMS' own long-standing interpretation of this term. For decades, the MMS has applied the 50th percentile plus 1 methodology in its Indian audits, orders and in IBLA decisions. (*See:* Ladd Petroleum Corp., 127 IBLA 163, 173 (1993)). It is so defined in the current regulations. 30 C.F.R. §206.52(a)(2)(ii). At page 3-34 (a copy of which is attached hereto as Exhibit "A") of the current *Oil and Gas Payor Handbook-Volume III* (revised 01/16/98), the MMS has again defined the majority price as "that price at which 50 percent (by volume) plus 1 barrel (bbl) of oil (starting from the bottom) is sold". To change this methodology now, especially in connection with the additional change to implement index pricing, clearly amounts to an unlawful attempt to effectively increase the royalty rate by administratively changing the lease terms.

FORM MMS-4416

The proposed Form MMS-4416 (as amended) continues to require all purchasers, not just lessees, of Indian oil to report the required data. This will create two major problems. First, not all purchasers will necessarily know if they purchased oil from Indian leases. Second, those purchasers who are aware that they are purchasing Indian oil would then be subjected to additional record-keeping and administrative burdens. Anything which adds to transaction costs can have only one result: the buyer will offer a lower price to the seller in order to compensate for the additional burdens imposed upon the buyer. Does MMS really want to make Indian production disfavored in the marketplace?

Other questions remain unanswered such as to how calculate and report sulfur content, paraffin content and API gravity on an annual basis when these quality indicators can vary from month to month.

IMPROPER TRANSPORTATION ALLOWANCE FOR RIK BARRELS

As proposed, the MMS would improperly disallow a transportation allowance for transporting oil taken as royalty in kind and delivered to the lessor in the designated area. (*See:* §206.60(a)(2)(i)). In the preamble at page 405, the MMS recognized, for royalties paid in value, that there is no requirement that lessees transport oil within a designated area at no cost to the lessor, and that transportation costs should be calculated from the point where oil is measured for sale. Oil taken as royalty in kind should be treated similarly and a lessee should be permitted a transportation allowance from the measurement point to the delivery point even if it is within the designated area.

MAJOR PORTION VALUE SHOULD EXCLUDE ROYALTY TAKEN IN KIND

The proposed rule indicates that the major portion analysis will include volumes taken in kind. (*See:* §206.52(c)(3)(ii)). How will the oil royalty taken in kind be valued? An arbitrary valuation of these volumes by the MMS could dramatically affect the major portion price calculation. The major portion value should simply exclude royalty taken in kind and eliminate this concern.

IMPROPER INCLUSION OF ALASKA NATIVE CORPORATION

The MMS has estimated that the proposed oil valuation regulations would result in increased annual Indian oil royalties of approximately $4.7 million. (65 FR 408) To arrive at this estimate the MMS analyzed the 1997 data for the top 12 Indian fund codes. Included in the top 12 Indian oil and condensate fund code recipients is Cook Inlet Region, Inc. (CIRI). The MMS' analysis estimates that CIRI's royalties are projected to increase by about 10.6% or $44,142.74 (65 FR 409).

CIRI is an Alaska native corporation which received interests in certain federal leases pursuant to the Alaskan Native Claims Settlement Act (ANCSA). Through this proposed regulation, the MMS is effectively elevating CIRI to the status of an Indian tribe for royalty purposes, notwithstanding the fact that CIRI's lessees contractually agreed to bear only the burdens of federal lessees, not the more demanding requirements imposed on Indian lessees. An Alaska native corporation is not an Indian tribe and the federal government does not have the same relationship with native corporations as it has with Indian tribes.

> Two basic requirements "must be met to give rise to federal fiduciary responsibilities: 1) A federal statutory or regulatory scheme imposes certain broad management responsibilities of Indian resources upon the Government, and 2) these management responsibilities require the Government to generate revenue from the Indian resources under management. No express provision in the ANCSA creates a trust or fiduciary relationship between the Government and Village Corporations or Regional Corporations. To the contrary, the first section of the Act establishes that Congress intended to avoid establishing any 'wardship or trusteeship' under the ANCSA. 43 U.S.C. §1601(b). The legislative history shows that the Senate considered and rejected language that would have created such obligations."
>
> Seldovia Native Ass'n, Inc. v. U.S., 35 Fed. Cl. 761, 776, *modified,* 36 Fed. Cl. 593 (1996), *aff'd,* 144 F.3d 769 (Fed. Cir. 1998).

CIRI simply is not entitled to the benefits of Indian tribal status and its lessees should not be burdened by transforming federal leases into Indian leases by administrative fiat.

CONCLUSION

Although several of our concerns have been addressed in MMS' current proposal, the MMS continues to base its proposed methodologies on the false assumptions that a significant market at the lease does not exist, but that a duty to market downstream of the lease at no cost to the lessor does exist. Marathon and industry have offered substantial evidence to rebut these assumptions, but the MMS has failed to rebut that evidence. Therefore, Marathon supports an expansion of the current federal royalty-in-kind initiative to Indian leases as the most viable alternative for resolving the issue of Indian royalty oil valuation. Royalty-in-kind offers the best long-term solution to satisfying the Indian lessee's royalty obligation while assuring that the tribe or allottee receives fair market value for its royalty oil.

[1*7927]

EXHIBIT "A"

3. OIL VALUATION

Compute the majority price as follows:

Step	Procedure
1	Array all arm's-length sales prices and corresponding volumes from the highest price at the top to the lowest price at the bottom.
2	Starting from the bottom, sum the cumulative percentages that each volume represents of the total volume.

The majority price is that price at which 50 percent (by volume) plus 1 barrel (bbl) of oil (starting from the bottom) is sold.

Figure 3-19 illustrates calculation of a majority price for Indian oil.