Hurst, Hyla (Strickland)

From: Erik Milito [militoe@api.org]
Sent: Thursday, April 13, 2006 2:03 PM
To: MRM Comments
Cc: Erik Milito
Subject: ATTN: RIN 1010-AD00 - Royalty Strategy Task Force Comments on India Oil Valuation Proposed Rule
Attachments: Royalty Strategy Task Force Comments on Indian Oil Valuation Proposal 2-13-2006.pdf

Attached please find the comments of the Royalty Strategy Task Force on the MMS Indian Oil Valuation proposed rule, proposed on February 13, 2006, RIN 1010-AD00.

The Royalty Strategy Task Force ("RSTF") is a coalition of diverse producers and their trade associations, the American Petroleum Institute, the Independent Petroleum Association of America, the Domestic Petroleum Council and the U.S. Oil and Gas Association. The RSTF welcomes the opportunity to file these comments on the Indian oil valuation proposal. Together, the RSTF members account for virtually all of the royalties paid for oil production from Indian lands.

Our comments augment the discussions at public meetings held in March 2005. We support a revised Indian oil valuation rule that promotes clarity and reasonable certainty, eliminates unnecessary administrative costs for all stakeholders and decreases appeals and litigation with minimal impacts on royalty revenues. Our comments today address all of these matters.

Thanks.

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American Petroleum Institute | Domestic Petroleum Council | ipaa America's Oil & Gas Producers | US Oil & Gas Association

April 13, 2006

ATTN. RIN 1010-AD00
Sharron L. Gebhardt
Minerals Management Service
Minerals Revenue Management
Building 85
Room A-614
Denver Federal Center
Denver Colorado 80225

Minerals Management Service Indian Oil Valuation Proposal,
30 CFR Part 206, 71 Fed. Reg. 7,453 (February 13, 2006)

Dear Ms. Gebhardt:

On behalf of the Royalty Strategy Task Force ("RSTF"), a coalition of diverse producers and their trade associations, the American Petroleum Institute, the Independent Petroleum Association of America, the Domestic Petroleum Council and the U.S. Oil and Gas Association, we welcome the opportunity to file these comments on the Minerals Management Service (MMS) February 13, 2006, Indian oil valuation proposal ("Oil Proposal"). Together, our members account for virtually all of the royalties paid for oil production from Indian lands.

Our comments augment the discussions at public meetings held in March 2005. We support a revised Indian oil valuation rule that promotes clarity and reasonable certainty, eliminates unnecessary administrative costs for all stakeholders and decreases appeals and litigation with minimal impacts on royalty revenues. Our comments today address all of these matters.

Matters Addressed in the Oil Proposal

I. Background

The MMS published a notice in the Federal Register on February 22, 2005 (70 Fed. Reg. 8,556) withdrawing the February 1998 and January 2000 proposals. MMS explained that it was beginning a new process of developing a proposed rule to value oil produced from Indian leases for royalty purposes. In the same notice, MMS scheduled public meetings in three different locations to consult with Indian tribes and individual Indian mineral owners and to obtain information from interested parties. The public meetings were held on March 8, 2005, in Oklahoma City, Oklahoma; on March 9, 2005, in Albuquerque, New Mexico; and on March 16, 2005, in Billings, Montana.

Comments: RSTF actively participated in each of the workshops and provided comments on the areas of interest that were referenced in the meeting notice.

MMS states in the Summary that the intent of this proposed rulemaking is to add more certainty to the valuation of oil produced from Indian lands, eliminate reliance on oil posted prices, and address the unique terms of Indian (tribal and allotted) leases—specifically, the major portion provision. MMS further states that most Indian leases include a major portion provision, stating that value for royalty purposes may, in the discretion of the Secretary, be calculated on the basis of the highest price paid or offered at the time of production for the major portion of oil produced from the same field. There are a few older Indian leases that are still in production that do not contain a major portion provision and do not reserve to the Secretary the authority to determine the reasonable value of production. The major portion provisions of the proposed § 206.54 would not apply to those leases. However, the burden would be on the lessee to demonstrate that its lease has neither of these provisions. The MMS would presume that the lease has at least one of these provisions, unless the lessee demonstrates otherwise.

Comments: RSTF does not agree that the burden should be on the lessee to demonstrate that its lease has neither of these provisions. MMS should not presume that the lease has at least one of these provisions.

II. General Valuation Approach of the Proposed Rule (Proposed 30 CFR §§ 206.52 and 206.53)

First, MMS is not proposing to use either NYMEX or spot market index pricing as primary measures of value for oil produced from Indian leases. Because of the environment in which Indian oil is produced and marketed, MMS proposes to value oil at the gross proceeds that the lessee or its affiliate receives in an arm's-length sale. In the event the sale occurs away from the lease, the proposed rule would provide for appropriate transportation allowances.

Comments: In keeping with the normalization procedure described under the major portion calculation, RSTF believes that MMS intends for the proposed rule to provide for appropriate quality adjustments in addition to appropriate location adjustments, and we therefore encourage MMS to include a provision for appropriate quality adjustments in the Final Rule.

Second, MMS proposes to specify in § 206.52(b) that, if a lessee sells oil produced from a lease under multiple arm's-length contracts instead of just one contract, the value of the oil is the volume-weighted average of the total consideration established under § 206.52 for all contracts for the sale of oil produced from that lease.

Comments: This is consistent with the Federal Oil Rule and RSTF supports this clarifying provision.

Third, if the lessee or its affiliate ultimately sells the oil received in exchange, the value would be the gross proceeds for the oil received in exchange, adjusted for location and quality differentials derived from the exchange agreement(s). If the lessee exchanges oil produced from Indian leases to Cushing, Oklahoma, value would be the NYMEX price, adjusted for location and quality differentials derived from the exchange agreements. If the lessee does not ultimately sell the oil received in exchange, and does not exchange oil to Cushing, the lessee must ask MMS to establish a value based on relevant matters.

Comments: If the lease contains a major portion provision, then it may be appropriate to ask MMS to establish a value based on relevant matters. However, if the lease does not contain a major portion provision, then the Secretary does not have sole discretion to determine the reasonable value of production. For this reason, we feel it would be more appropriate for the lessee to propose a valuation method similar to the Federal Oil Rule.

Fourth, the only situation that is not covered under the proposed § 206.52 is where the lessee transports the oil produced from the lease to its own refinery. As mentioned above, there appears to be only one such case at the present time. In this circumstance, proposed § 206.53 would require the lessee to value the oil at the volume-weighted average of the gross proceeds paid or received by the lessee or its affiliate, including the refining affiliate, for purchases and sales under arm's-length contracts of other like-quality oil produced from the same field (or the same area if the lessee does not have sufficient arm's-length purchases and sales from the field) during the production month, adjusted for transportation costs. If the lessee purchases oil away from the field(s) and if it cannot calculate a price in the field(s) because it cannot determine the seller's cost of transportation, it would not include those purchases in the weighted-average price calculation.

Comments: RSTF supports the use of comparable purchases and sales from the same field or area in this situation, and the exclusion of off-lease purchases that cannot be normalized.

III. Calculation of the Major Portion Value

There are a few older Indian leases that are still in production that do not contain a major portion provision and do not reserve to the Secretary the authority to determine the reasonable value of production. The major portion provisions of the proposed § 206.54 would not apply to those leases. However, the burden would be on the lessee to demonstrate that its lease has neither of these provisions. The MMS would presume that the lease has at least one of these provisions, unless the lessee demonstrates otherwise.

Comments: As stated previously, RSTF does not agree that the burden should be on the lessee to demonstrate that its lease has neither of these provisions. MMS should not presume that the lease has at least one of these provisions.

For MMS to be able to calculate major portion values based on oil type, and to be able to adjust reported arm's-length gross proceeds values for API gravity, MMS must require the royalty payors to report this information on Form MMS–2014. The API gravity is currently reported to MMS on production reports, but not in a manner that will allow the data to be used in conjunction with the royalty data reported. If a final rule adopts the major portion methodology proposed here, MMS would revise the reporting requirements for Indian leases for Form MMS–2014 to require lessees to report oil type and API gravity for Indian leases.

Comments: The proposed regulation change will require industry to incur significant software development costs and system modification changes. Following is a brief synopsis of the related reporting changes that we believe will have the most impact on system costs:

1) Reporting of API Gravity on 2014 - This will require a system change to include this on the 2014 transaction as well as changes to the logic for prior period corrections, etc. Also, MMS is looking for the API gravity associated with the contract rather than the actual weighted average gravity. Crude pricing sometimes utilizes a "deemed" gravity. This "deemed" gravity is never associated with the accounting record and, if required, would require substantial programming to capture this as a new element.

2) Crude Type - This element is not currently in the revenue accounting stream at all. In order to capture the information for reporting purposes, there would be substantial changes at multiple levels within PRA software to capture and store this additional element.

3) This regulation would require different reporting requirements for Indian oil leases than those required for federal oil leases. Incorporating this additional logic into the MMS Reporting system would require additional programming. In 2004, there were 401 oil & gas payors for production from Indian leases and 240 of those payors also remitted revenues for oil & gas production from Federal leases. Requiring API Gravity and Crude Type on the 2014 form for Indian leases will cause these 240 payors to establish reporting practices for Indian leases that differ from reporting practices for Federal Oil leases.

In summation, the adoption of the proposed rule as it exists today would require rather extensive system changes.

The MMS also seeks comments on:

- Whether we should include arm's-length sales of oil produced from Federal leases within a designated area, as reported to MMS, in the calculation of the major portion value; and
- Whether we should expand the boundaries of the designated area beyond the reservation boundaries and include arm's-length sales of oil produced from Federal leases in the vicinity of a reservation, as reported to MMS, in the calculation of the major portion value

Comments: In the interests of certainty, predictability, and ease of administration, RSTF does not support the inclusion of arm's-length sales from Federal leases within a "designated area" in the major portion and believes that the "designated area" should be limited to the reservation boundaries, for the following reasons. In the proposed rule, the term "designated area" is defined as "an area specified by MMS for valuation purposes." 71 Fed. Reg. at 7,470. The current definition provides no clarification of what the boundaries of the "designated area" will be. Defining the "designated area" to be the Indian reservation where the oil is produced would be clear and would provide the MMS, the tribes and allottees, and the Indian lessees with certainty regarding what constitutes a "designated area" and thus avoid disputes over the issue. Further, MMS acknowledges that it cannot calculate major portion values without API gravity and crude type information being reported on the Form MMS-2014, but this information is not required to be reported on the Form MMS-2014 for Federal leases. RSTF is concerned that extending the designated area beyond the boundaries of a reservation to include federal leases in the vicinity of the reservation may also necessitate the MMS's mandating the reporting of crude oil type and quality information for oil from the nearby Federal leases. As indicated elsewhere in these comments, the reporting of this information on the Form MMS-2014 is burdensome and costly for RSTF members. Additionally, RSTF has concerns that including federal leases in a "designated area" could cause oil from federal leases to be subject to the Indian oil rule record production and retention requirements. In fact, the current proposed § 206.64(a) requires lessees to retain and make available purchase, sales, and transportation information regarding all oil produced from a "designated area." 71 Fed. Reg. at 7,475. Yet at the same time, because the proposed definition of "designated area" provides no guidance as to what constitute the boundaries of a designated area, lessees will not even know the limits of the geographic area to which their record retention requirements under the rule apply. Accordingly, RSTF opposes MMS's expanding the boundaries of the "designated area" beyond reservation boundaries

MMS also states that one of the tribal lessors takes a substantial portion of its royalty in kind rather than in value. The producers nevertheless do report a value for that oil on Form MMS–2014. The MMS understands that the value reported for the royalty-in-kind volumes is the price at which the lessee sold its working interest share. Under the proposed rule, MMS would include these values in the major portion calculation. Not doing so would result in loss of substantial volumes from the major portion calculation. The only reported values that would not be included in the major portion calculation are values reported for oil that is refined without being sold at arm's length.

Comments: When a Federal or Tribal lessor takes its royalty in kind, the lessee is no longer required to submit a 2014 Form for the in-kind royalty production. The fact that a lessee is submitting a 2014 Form and reporting value for the price at which the lessee sold its working interest share does not accurately reflect the value of the in-kind royalty production. For the sake of accuracy in reporting, the Tribal lessor, or its trustee, should submit the 2014 Form for the in-kind royalty production. This would be consistent with the procedure that MMS follows for Federal oil and gas royalty production that is taken in-kind.

The MMS would not change the percentile at which the major portion value is determined. The MMS historically has used the 50th percentile-plus-one-unit measure for the major portion calculation. Because MMS believes almost all oil produced from Indian leases is sold at arm's length, there appears to be no reason in the oil context to depart from the major portion measure in the current rule.

Comments: The major portion measure in the Indian Gas Rule was revised effective January 1, 2000 after an extensive negotiated rulemaking process that resulted in a gas index formula. The index formula was intended to replace both the gross proceeds requirement and the major portion requirement. There is no such index formula being proposed for Indian Oil, so RSTF agrees that there is no reason to depart from the major portion measure in the current rule.

IV. Transportation Allowances

If the transportation arrangement is at arm's length, the proposed rule would incorporate the provisions of the 2000 Federal Oil Rule that became effective on June 1, 2000 (as amended in 2004), in calculating that allowance. That allowance is based on the actual cost paid to an unaffiliated transportation provider. As has been the case historically, MMS is proposing to continue to treat arm's length transportation arrangements for oil produced from Indian leases identically to arm's-length transportation arrangements for oil produced from Federal leases. For arm's-length transportation allowances, MMS also proposes to eliminate the requirement in the current Indian rule, at 30 CFR 206.55(c)(1), to file Form MMS–4110, Oil Transportation Allowance Report. Instead of Form MMS–4110, the lessee would have to submit copies of its transportation contract(s) and any amendments thereto within 2 months after the lessee reported the transportation allowance on Form MMS–2014. This change mirrors the elimination of the requirement to file the analogous Form MMS–4295 for arm's-length transportation allowances under the Indian Gas Valuation Rule, published on August 10, 1999 (64 FR 43506) (1999 Indian Gas Rule), and effective January 2000.

Comments: RSTF supports the elimination of Form 4110 for arm's-length transportation allowances. However, RSTF opposes the requirement that lessees submit copies of transportation contracts and amendments thereto within 2 months after reporting a transportation allowance because this requirement is unnecessarily burdensome on industry, yet can provide at best only an incremental benefit to the MMS. The regulations' record retention and production provisions require lessees to retain transportation contracts and other information used to calculate transportation allowances and to make the information available to auditors on request. Failure to retain and provide such information can subject a lessee to penalties and other sanctions. Thus, because lessees have incentive to retain and provide the information and because MMS has the means by which to assure that the Indian lessors are kept whole in the event information is not retained or provided, RSTF submits that the additional burden on industry of monitoring submission of such information is unjustified.

For non-arm's-length transportation arrangements, the lessee would have to calculate its actual costs. Under the proposed rule, Form MMS–4110 would still be required, but the requirement to submit a Form MMS–4110 in advance with estimated information would be eliminated. Instead, the lessee would submit the actual cost information to support the allowance on Form MMS– 4110 within 3 months after the end of the 12-month period to which the allowance applies. This also mirrors the change made in the 1999 Indian Gas Rule at 30 CFR 206.178(b)(1)(ii). As MMS explained when it proposed these changes in the 1999 Indian Gas Rule, in the case of oil valuation, MMS ''believes this change will ease the burden on industry and still provide MMS with documents useful to verify the allowance claimed.''

Comments: RSTF supports the elimination of the advanced submission of Form 4110 for non-arm's-length transportation allowances.

The MMS is proposing that the non-arm's-length allowance calculation, and the costs that would be allowable and non-allowable under the non-arm's-length transportation allowance provisions, be revised to incorporate the provisions of the 2004 Federal Oil Rule. See proposed § 206.59(b). The MMS proposes treatment of costs identical to the treatment of costs in the 2004 Federal Oil Rule because it does not perceive any reason to treat oil pipeline transportation costs differently depending on lessor ownership. The MMS seeks comments on the question of whether allowable and non-allowable costs under this Indian oil valuation proposed rule should be different than the allowable and non-allowable costs under the 2004 Federal Oil Rule. Based on the comments, MMS may adopt all, part, or none of the changes that are different from the current Indian oil valuation regulations or the 1999 Indian Gas Rule.

Comments: RSTF does not know of any reason to treat oil pipeline transportation costs differently depending on lessor ownership.

Finally, the 2004 Federal Oil Rule, which amended 30 CFR 206.111(i)(2), changed the allowed rate of return used in the non-arm's-length actual cost calculations from the Standard & Poor's BBB bond rate to 1.3 times the BBB bond rate. In March 2005, MMS promulgated an identical change to the allowed rate of return used in the calculation of actual costs under non-arm's-length transportation arrangements in the Federal Gas Valuation Rule, published March 10, 2005 (70 FR 11869) (2005 Federal Gas Rule), which amended 30 CFR 206.157(b)(2)(v). The proposed change to this rule would incorporate this same change, for the same reasons the rate of return was changed in the 2004 Federal Oil and 2005 Federal Gas Rules (*i.e.*, the 1.3 times BBB rate more accurately reflects the lessees' cost of capital).

Comments: RSTF agrees with the proposed change to this rule for the same reasons the rate of return was changed in the 2004 Federal Oil and the 2005 Federal Gas Rules.

V. Other Issues Raised in the Preamble

The MMS also proposes to add a definition of the term ''affiliate'' and revise the definition of ''arm's-length contract'' in § 206.51 to be identical to the 2000 Federal Oil Rule and to conform the rule to the court's decision in *National Mining Association* v. *Department of the Interior*, 177 F.3d 1 (D.C. Cir. 1999). The MMS recently made the same change to the 2005 Federal Gas Rule at 30 CFR 206.151.

Comments: The definition of the term "affiliate" includes specific factors that MMS will consider in determining whether there is control in a particular case. The definition of "arm's-length" contract means a contract or agreement between independent persons who are not affiliates and who have opposing economic interests regarding that contract. Opposing economic interest is not a defined term, and MMS does not state any factors that will be considered in determining whether parties to a contract have opposing economic interest. The Interior Board of Land Appeals decision in *Vastar Resources, Inc.*, 167 IBLA 17 (Sept. 26, 2005) (the "*Vastar* decision"), provides clarity regarding factors to be considered to determine whether the parties to a contract have "opposing economic interests." In addition to defining "affiliate," MMS should define the term "opposing economic interests" and incorporate determining factors from the Vastar decision in the definition.

The MMS also proposes to modify the format of the definition of ''Exchange agreement'' in § 206.51 from the way that it is formatted in the 2000 Federal Oil Rule. The MMS is proposing to make this change only for the purpose of readability. The MMS does not intend to change the meaning of the term ''Exchange agreement'' in any respect.

Comments: RSTF concurs with this format change that is solely for the sake of readability.

The MMS is also considering whether to change the definition of the term ''marketable condition'' in § 206.51 to mean lease products ''that are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract or transportation contract typical for disposition of production from the field or area.'' This change is incorporated in the proposed rule. The current definition refers to lease products ''that are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area.'' We request your comments regarding this change.

Comments: The RSTF opposes the proposed change to the definition of the term "marketable condition" because, without explanation, it arbitrarily classifies certain deductible transportation costs as nondeductible costs of placing production in marketable condition. The proposed change is a major change in the legal framework used to determine the royalties due for production produced from federal and Indian lands. If adopted, the change would constitute a significant departure from longstanding principles of oil and gas law applicable to federal and Indian leases. Dating back to the origins of the marketable condition rule in *California Co. v. Udall*, 296 F.2d 384 (D.C. Cir. 1961), the determination of what constitutes marketable condition has always been based on the requirements of sales contracts in the field or area. The reason for this rule is obvious in that sales contracts in the field or area determine what requirements are necessary to market oil or gas production. Transportation contracts, by contrast, determine what is necessary to move production and, again going back to and preceding *California Co. v. Udall*, deductions for transportation costs have always been required to derive value at a lease when production is sold away from the lease. *See, e.g., California Co. v. Udall*, 296 F.2d at 386; 30 C.F.R. § 206.54 (2005). Further, the determination of what constitutes transportation is made by considering the purpose for which a particular cost is incurred. *See, e.g., Snyder Oil Corp.*, MMS-92-0500-O&G, at 11 (1996) ("Whether a function should be considered a transportation-related cost or a non-deductible marketing cost is dependent on its purpose").

RSTF opposes the proposed rule change because of its facially arbitrary and irrational categorization of certain costs incurred for the purpose of transportation as nondeductible costs of placing production in marketable condition. Like other federal agencies, MMS is not permitted to make rules that are arbitrary and capricious or lacking in a rational basis. *See, e.g., Motor Vehicle Manufacturers Ass'n, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). However, it is arbitrary and irrational for the MMS to deny lessees deductions for transportation costs simply by defining particular transportation costs as marketing costs. If MMS was empowered to define words with established meanings in whatever fashion suited its regulatory whims, then the agency's rulemaking power would be liberated from the requirement that it follow even minimum standards of rationality. Fortunately, federal agencies are not granted such unfettered rulemaking power, and their rules must have a more rational basis than "because I say so." *See, e.g., Indep. Petroleum Ass'n of Am. v. DeWitt*, 279 F.3d 1036, 1042 (D.C. Cir. 2002) ("But Interior has offered no 'distinction' at all, only an unusually raw ipse dixit. On its face, it is hard to see how money paid for assurance of secure transportation is not 'for transportation'; the cost of freight insurance looks like a shipping expense, for example, even if the goods arrive without difficulty and the premium therefore goes unused.... While some reason may lurk behind the government's position, it has offered none, and we have no basis for sustaining its conclusion") (citation omitted). Thus, RSTF submits that if adopted the MMS's proposed rule change will be unlawful because it inexplicably and arbitrarily forces costs of transportation into the "marketable condition" box.

A further problem with the MMS's proposed rule change is that it will introduce significant new uncertainty into the determination of whether certain costs constitute transportation or marketable condition costs because the proposed language is ill-considered and confusing. The proposed language refers to lease products "in a condition that they will be accepted by a *purchaser* under a . . .

transportation contract typical for disposition of production from the field or area." (italics added). However, transporters, not purchasers, are the parties that accept production pursuant to transportation contracts; purchasers accept delivery pursuant to the terms of sales contracts, not transportation contracts. Likewise, transporters accept production in whatever state is necessary to facilitate its movement, not, like purchasers, in the condition that is necessary "for disposition." RSTF suggests that the contortions of the proposed language result from the attempt to include by regulatory fiat in the definition of marketable condition costs that have nothing to do with marketing and everything to do with transportation.

For the reasons given above, RSTF respectfully requests that the proposed change to the definition of "marketable condition" to include conditioning to meet requirements of transportation contracts be withdrawn. However, if MMS is unwilling to withdraw its proposed change at this time, RSTF additionally submits that industry's ability to meaningfully comment on the proposal is currently limited by the absence of any explanation for the proposed change. MMS's failure to provide any explanation for its proposal makes it difficult to meaningfully comment on it because RSTF and others are left speculating about the intended meaning of the proposed language and what perceived shortcoming of the current rule MMS wishes to rectify with the change. Thus, if MMS is unwilling to abandon the proposed rule change, RSTF requests that, at the least, MMS supplement its proposed rulemaking with an explanation for the change and allow time for additional comments.

In proposed § 206.57, MMS is also seeking comments on whether presenting certain information in a table versus text format would be preferable to the reader. In the proposed table format, MMS would also change the grouping of the information by presenting the main ideas in a table and then listing the considerations applicable to that information below the table in text format. The MMS wishes to use the format that makes the regulations the clearest and most easily accessible.

Comments: RSTF concurs that MMS should use the format that makes the regulations the clearest and most easily accessible.

Finally, proposed § 206.64 regarding records retention is adapted from 30 CFR 206.105. The time for which records must be maintained is governed by § 103(b) of the Federal Oil and Gas Royalty Management Act, 30 U.S.C. 1713(b), and is not affected by the change in 30 U.S.C. 1724(f), which was enacted as part of the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA), because RSFA applies only to Federal leases. The referenced regulations in proposed § 206.64 reflect this difference.

Comments: Providing MMS does not limit the term "designated area" to the boundaries of the relevant reservations, RSTF objects to proposed § 206.64(a). (See discussion above regarding "designated area.") Proposed section 206.64(a) holds that "[o]n request, you must make available sales, volume, and transportation data for production you sold, purchased, or obtained from the designated area." 71 Fed. Reg. at 7,475. If the phrase "designated area" means an area larger than a reservation, then the proposed language could subject production from federal, state, and even fee lands to the record production and retention requirements applicable to Indian lands. Further, the regulation as drafted applies the record retention requirements to a lessee's records regarding <u>purchases</u> of oil from the "designated area." Thus, the record retention requirements for Indian oil could potentially reach oil produced or purchased by a company from fee lands that MMS deemed to be in a "designated area." Even more problematic, because the proposed definition of "designated area" merely indicates that a "designated area" is "an area specified by MMS for valuation purposes[,]" lessees will not even know until long after the fact the geographic scope of the areas from which they are required to retain records. Accordingly, RSTF requests that the record retention requirements be limited to records bearing on the production, sale, and transportation of oil from the reservations covered by the regulations.

Matters Not Specifically Addressed in the Preamble

I. The Definition of the Term "Lessee"

The proposed definitions in the notice amend the definition of a "lessee" to include:

(1) Any person who has an interest in a lease (including operating rights owners);

(2) An operator, purchaser, or other person with no lease interest who makes royalty payments to MMS or the lessor on the lessee's behalf; and

(3) All affiliates, including but not limited to a company's production, marketing, and refining arms.

71 Fed. Reg. at 7,470. The preamble of the rule, however, does not appear to explain why the MMS believes it is necessary to amend the previous definition with the above-quoted language. Further, it is not evident from the body of the rule why MMS needs the definition at all because the term does not appear to be used in the valuation provisions of the rule. Rather, the rule refers in many places to "you" or "your" or to a "seller." However, none of these terms are defined. RSTF submits that the rules would be more clear and less ambiguous if they continued to rely on the term "lessee" as traditionally defined in place of references to the ambiguous and undefined terms "you," "your," and "seller."

II. Actual Transportation Costs

The current requirement to report actual transportation costs in the production month that they occur is extremely burdensome. The Royalty Reporting Subcommittee of the Royalty Policy Committee developed several options for making prior period adjustments in a less burdensome manner, but consensus among Tribal, State and industry representatives could not be achieved. Industry encourages MMS to continue promoting collaborative efforts between stakeholders in an effort to streamline and simplify this process.

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We urge the MMS to carefully consider our comments and welcome any further questions you might have in order to reach a satisfactory resolution of this important rulemaking.

Sincerely,

Erik G. Milito
American Petroleum Institute

William F. Whitsitt
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