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

**Minerals Management Service Proposed Regulation concerning Valuation of Oil produced from Indian lands, 30 CFR Part 206, 71 Fed. Reg. 7,453 (February 13, 2006)**

Dear Ms. Gebhardt:

Thank you for the opportunity to file our comments on the proposed regulation concerning the valuation of oil produced from Indian lands administered by the Department of Interior, other than lands held for the benefit of the Osage Nation (Indian Oil Valuation). On behalf of the U.S. Oil & Gas Association (USOGA), we would first like to note that as co-signers of the comments concerning this proposed rulemaking made by the Royalty Strategy Task Force (RSTF) that these comments are intended to be supplementary to those comments and should be read as being consistent with those comments in every way. USOGA is a voluntary association whose members pay significant royalties to the Minerals Management Service (MMS) for oil produced from Indian lands whose royalty interests are managed by MMS.

USOGA agrees that the MMS proposal is a timely attempt to update the regulations concerning Indian Oil Valuation. Changes in the marketing of oil since 1988 are significant, and this is an appropriate opportunity for MMS to continue its practice of clarifying and simplifying the valuation regulations while maintaining its obligations as trustee for the tribal and individual Indian beneficiaries.

## Scope of these Comments

There are two significant issues that we would like to deal with more extensively than did RSTF: the reasoning behind the definition of "major portion" and the proposed change in the definition of "marketable condition."

## Major Portion

USOGA is aware that many Indian leases contain a clause that allows the Secretary to base the valuation of oil on the "highest price paid or offered at the time of production for the major portion of oil production from the same field." The currently applicable rule, in effect since 1988, defined major portion as the value that represents the median value of like-quality oil produced from the field and sold at arm's-length. USOGA understands that the current rule, which requires MMS to know all prices received from the relevant fields, the quality of each barrel of oil sold and whether the sales were at arm's-length has been difficult for MMS to implement and does not object, in general, to MMS's efforts to simplify the process for calculating this major portion value. USOGA also understands from the history of the proposals that MMS has made concerning Indian Oil Valuation and the comments that were made in the public meetings preceding the publication of this proposal, that some Indian beneficiaries believe that it would be reasonable for MMS to implement a rule that used the price of a barrel of oil that was priced higher than the median value as the "major portion" value.

In this proposal, MMS continues its historical practice of measuring major portion as the median value. It has proposed expanding and clarifying the oil to be included in the array of prices to a "designated area", rather than limiting the array to oil from the field in which the oil was produced. It also proposes to change the information required to be provided on Forms MMS-2014 to include information needed to describe the quality of the oil. MMS proposes to use the information collected on the Forms MMS-2014 to calculate the appropriate major portion values by type of oil, adjusted to a common API gravity and to publish those values on the MMS internet site. Lessees would then be required to regularly check the MMS *internet site* or the FEDERAL REGISTER and to revise any values that, when adjusted for API gravity, are less than the MMS published price for the type of oil and month of production and to pay the applicable additional royalty.

USOGA would like to express its agreement that the use of the median value is the appropriate value when calculating "major portion." While we understand that in previous rulemaking proceedings Indian tribes have argued forcefully for the adoption of a standard where the 75$^{th}$ percentile of oil should be used to define major portion, we believe that the use of such a price would be, by its very nature, arbitrary. MMS has conducted no studies of the distribution of arm's-length or other oil prices by field, corrected for gravity and thus has no reasoned basis for changing the long-standing practice of the department to use the median value of the array of arm's-length prices, the use of which has never been found to be a violation of MMS's trust responsibility.

Even if MMS had conducted a study, it is difficult to understand how the use of the 75th percentile (or any specific percentile greater than the median price) could be reasonable. According to Webster's New World College Dictionary (4th ed.) the relevant definitions of adjective "major" are: "1a) greater in size, amount, number or extent; b) greater in importance or rank; 3 constituting a majority." Similarly that dictionary defines the noun portion as "a part or limited quantity of anything, esp. that allotted to a person." The most straightforward definition of the phrase is thus the majority part or the price of oil that makes the majority of the prices in the array – the median price or price of the fiftieth percentile plus one barrel. Having used this rule with no significant problems for over thirty years, it is difficult to understand why the arguments of some tribes that it is not high enough should be seen as anything other than an arbitrary and capricious attempt to unreasonably increase royalties.

## Marketable Condition

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.'' MMS has added the phrase "or transportation contract" to the current definition in this proposal.

Regardless of any possible merits of making this change in the abstract, and RSTF explains in detail in their comments some of the problems with the reasoning behind this change, this rulemaking is not the proper time to make it. As MMS explained in the preamble to this rulemaking, the vast majority of Indian oil is sold at arm's-length at the lease. MMS has identified only one situation where a producer of oil sells oil at arm's-length after it has transported it away from the lease. MMS has not given one example of what it might mean for an oil transportation contract to require oil to be in a certain condition. USOGA is unaware of oil sale's contracts that affect Indian oil that require the oil to be in a certain condition. We are aware of some pipelines in the Gulf of Mexico that will only transport sweet oil. Is MMS stating that if such contracts are "typical" for the area that sour oil is therefore not in marketable condition and that if a lessee transports its oil by barge to avoid that pipeline that it still must increase the value of its oil to correspond with the value of sweet oil from that area?

As MMS has not explained why it is making this proposal at this time it is not possible for anyone to meaningfully comment on this change. The only possible reason that USOGA can imagine for MMS to make this proposal at this time is to use this rulemaking by analogy in its currently pending litigation concerning the valuation of coal-seam natural gas produced from federal lands. It is not appropriate for MMS to use this rulemaking that affects neither federal lands nor natural gas for that purpose. It has been barely one year since MMS published a final regulation that amended the rule for valuing natural gas. 70 FED. REG . 11869 (March 10, 2005). It devoted considerable resources to studying the transportation of natural gas and to defining the line between transportation and non-transportation related services, such as gathering and compression. It did not choose to disturb the long-standing definition of marketable condition at that time with respect to a product (natural gas) for which the disputes were clear. It is not appropriate to do so in this rulemaking where there is no factual basis for disturbing the status quo in ways that no one can predict.

More importantly, the current definition is the appropriate one. We will continue to have some disagreements with MMS over their interpretation of the rule, and we would prefer any service that benefits transportation to be clearly defined as transportation. See 70 FED. REG . 11869 (March 10, 2005). We do accept that MMS has the authority to require the lessee to put the oil in the condition that contracts for the sale and purchase of oil typical in a field or area require, or to pay MMS on the value that oil in such condition would realize.

However transportation contracts are not the same as sales contracts. Oil for sale must be free of basic, sediment and water and otherwise able to be refined in the refinery to which the oil is sold. Oil that is transported by "typical" means can have other requirements. We believe it is clear that it would not be reasonable for a producer of sour oil on the outercontinental shelf to be required to sweeten oil simply because the pipeline in the area happens to be unwilling to transport any sour oil. Similarly, if oil is of a viscosity that allows it to be transported by truck, but which is too viscous to be transported by the local pipeline without blending. blending is not needed to put the oil in marketable condition. The oil is marketable in exactly the form it is in. It is acceptable to the party who will ultimately use it. Even if a lessee were to blend the oil in order to be able to transport it by pipeline, the costs of blending should be deductible as it is necessary for transportation, but not for marketing.

Again, looking to Webster's, it defines "marketable" as "1a) that can be sold: fit for sale b) readily salable." Marketable does not mean "that which can be transported or readily transportable." As the comments of the RSTF make clear, costs of transportation are deductible, as a matter of the nature of the lease, which requires a percentage of the product or the value of production from the lease.

Looking to royalty-in-kind as an analogy, it would not be reasonable for the lessor who has a lease with sour oil to require its lessee to give it sweet oil. It would not be reasonable for the lessor who has oil of 9° API gravity to blend it to 22° simply because transportation contracts "typical" for the field or area require blended oil. If a transporters refused to transport oil unless there was sufficient oil to fill the tank truck; it would not be reasonable for the lessor to require the lessee to tender a tank truck full when its royalty share amounted to only half a tank truck, even if that requirement was "typical" of transportation contracts.

## Summary

USOGA appreciates the opportunity to comment on these rules and believes that MMS was correct in proposing to define major portion as the median value of the array of oil of like-quality from the designated area. However, we strongly disagree with the proposal to require a lessee to meet the requirements of transportation contracts at no cost to the lessor. MMS has given no reasons for this proposed change and we believe that it is clear that the requirements of transportation contracts are different in kind from the requirements of sales contracts and that such costs are costs associated with transportation and should be deductible.

Sincerely,

Albert Modiano