AMOCO

Amoco Corporation
Amoco Building
1670 Broadway
Post Office Box 800
Denver, Colorado 80201-0800
Phone: 303-830-4386
E-Mail: rgleo@amoco.com
Fax. 303-830-4160

Robert G. Leo, Jr.
Attorney

MAY 1998
RECEIVED

May 12, 1998

David S. Guzy, Chief
Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
U.S. Department of the Interior
P.O. Box 25165
M/S 3101
Denver, Colorado 80225-0165

Re: **Amoco Production Company Comments on Mineral Management Service Proposal on Valuation of Crude Oil Produced on Indian Leases 30 CFR 206, 63 FR 7089 (February 12, 1998)**

Dear Mr. Guzy:

Amoco Production Company ("APC") Amoco is a Lessee to many Indian Oil and Gas Leases in the United States. It therefore has an interest in the above-noted Crude Oil Valuation Proposed Rule.

Amoco has been involved in the preparation of American Petroleum Institute ("API") Comments (attached) which have been filed pursuant to the Federal Register Notice. Amoco would concur with and support the API Comments relative to this Rulemaking.

Very truly yours,

Robert G. Leo, Jr.

RGL/mmm

cc: M. E. Poehl, Vice President WBU

American Petroleum Institute

1220 L Street, Northwest
Washington, D.C. 20005-4070
202-682-8240

G. William Frick
Vice President
General Counsel and Secretary

May 11, 1998

David S. Guzy, Chief
Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
U. S. Department of the Interior
P.O. Box 25165
MS 3101
Denver, CO 80225 - 0165

American Petroleum Institute Comments on
Minerals Management Service Proposal on Valuation of
Crude Oil Produced on Indian Leases
30 CFR 206, 63 FR 7089 (February 12, 1998)

Dear Mr. Guzy:

The American Petroleum Institute ("API") is a national trade association representing about 400 member companies. Our members are engaged in all aspects of the petroleum industry: exploration, production, transportation, refining and marketing. Many of our members are actively engaged in activities involving crude oil produced on Indian lands and together they account for the vast majority of crude oil royalties paid every year. We therefore have a substantial interest in the Minerals Management Service's ("MMS") Indian lands crude oil valuation rulemaking.

In many respects, the MMS' February 12, 1998, Indian lands crude oil valuation proposal ("Indian Oil Proposal") parallels the MMS' February 6, 1998, Federal lands crude oil valuation proposal ("Federal Oil Proposal"). In the interests of brevity, these comments incorporate by reference the April 3, 1998, comments on the Federal Oil Proposal and focus on important differences between the two proposals. For the record in this rulemaking, attached is a full set of the API April 3, 1998, comments ("API April 1998 Comments"). [1]

---

[1] *See, also,* API May 27, 1997 comments on the MMS' initial proposal at 62 FR 3742 (January 24, 1997); API August 1, 1997 comments on the MMS' supplementary proposal at 62 FR 16116 (April 4, 1997); API November 4, 1997 comments on the alternatives for rulemaking and related workshops at 62 FR 49460

1. Reliance on NYMEX Prices

First, the preamble to the Indian Oil Proposal states that: "MMS is proposing NYMEX prices primarily because they are perceived to best reflect current domestic crude oil market value on any given day and the minimal likelihood that any party could influence them." Indian Oil Proposal at 63 FR 7089, 7092. For reasons set forth at length in API's April 1998 and earlier rulemaking comments on the Federal Oil Proposal, API disagrees that NYMEX prices are an appropriate measure of the value of production at the lease. Indeed, except for the special case of the Rocky Mountain Region, the MMS in its Federal Oil Proposal has abandoned NYMEX prices as the measure of value. *See* API April 1998 Comments at 2-4. Moreover, in the preamble to the Indian Oil Proposal, the MMS acknowledges that "the location/quality adjustments needed to derive lease value using NYMEX would involve considerable administrative effort for all involved." 63 FR 7093.

Second, proposed §206.52 would require that royalties be paid on the highest of (a) the average of the five highest daily NYMEX future settle prices for the prompt month, (b) the gross proceeds received from the sale of oil under an arm's length contract, or (c) the major portion value calculated by MMS. While API certainly opposes use of NYMEX (or any index) in combination with the simplistic differentials proposed, using only the five highest NYMEX prices in a month to calculate the value of oil produced every day of the month is hardly justified by the MMS' "administrative simplicity" rationale at 63 FR 7092.

Third, in response to the MMS request for suggestions on market value indicators other than NYMEX, API's April 1998 comments on the Federal Oil Proposal address the use of tendering and royalty-in-kind. *See* API April 1998 Comments at 2-5. These alternatives, as well as the modified benchmarks described by API and other industry commenters in the Federal oil valuation rulemaking should be considered in this rulemaking as well.

2. Definition of "Lessee"

Proposed §206.51 would define "lessee" expansively to mean:

> . . . any person to whom an Indian Tribe or allottee issues a lease, and any persons assigned an obligation to make royalty or other payments required by the lease. This includes any person holding a lease interest (including operating rights owners) as well as an operator, purchaser, or other person who makes royalty payments to MMS or the lessor on the lessee's behalf. Lessee includes all affiliates, including but not limited to a company's production, marketing, and refining arms.

(September 22, 1997); and, Joint Association December 5, 1997 comments on the rulemaking issues in general.

As unduly expansive as the §206.51 definition of "lessee" is, many of the succeeding operative provisions use the vaguer term "you" which blurs the lessee's obligations under these proposed regulations. For example, under §206.52(b), if a non-affiliated purchaser remits royalties on the production which it purchases, is it required to pay royalties on the "sale of your oil under an arm's length contract"? In other words, does the purchaser pay royalties on the price it receives for the resale of the oil or the price it pays to the producer? Likewise, does §206.52(b) require that a producer pay royalty on the basis of prices received by its refinery for the sale of refined oil products?

3. <u>Major Portion Analysis</u>

First, proposed §206.52(c)(3) would replace the well-established 50% plus 1 rule with a 75th percentile rule because of Indian representative assertions that the existing rule uses a *median* which is not synonymous with *major*. However, the top 25% is plainly not "major portion" in the common use of the term nor as the Interior Board of Land Appeals has employed the term. *See Ladd Petroleum Corp.*, 127 IBLA 163,173 (1993)(more than 50% is major). The term "major portion" is an integral part of Indian lease agreements and the MMS cannot unilaterally redefine a term central to the original bargain.

Second, proposed §206.52(c)(2) suggests that the MMS is reserving the right to consider prices on the entire Indian reservation or, potentially, in a "designated area" which is larger than the Indian reservation and larger than the field. However, existing lease provisions require payment of "the highest price paid or offered at the time of production for the major portion of oil production from the same field."

Third, it appears that, in calculating the major portion analysis, the MMS would not look just to prices actually received but also to the adjusted NYMEX prices reported by lessees. However, the purpose of the major portion analysis is to assure that the Indian lessor receives a royalty based on a price comparable to (most) other prices actually received in the field or area, not to guarantee that the royalty will be based on a hypothetical price unlinked to actual sales.

4. <u>Duty to Market Free of Charge</u>

Proposed §206.53(d) includes the requirement that lessees market oil at no cost to the Indian lessor. API's comments on the Federal oil valuation rulemaking address this squarely, showing that such a requirement is unlawful. *See* API April 1998 Comments at 5. Moreover, this duty to market free of charge is already the subject of

litigation instituted on the MMS gas transportation allowance rule, 62 FR 65753 (December 16,1997). *See Independent Petroleum Association of America v. Armstrong et al., 98 CV 531 (filed March 2, 1998) and American Petroleum Institute v. Babbitt et al.,98 CV 631 (filed March 13, 1998).*

5. Transportation Costs

First, §206.60 would disallow transportation allowances for transportation within the boundaries of an Indian reservation because Indian lessors assert that leases are typically silent on transportation costs. Yet in the preamble the MMS states that Indian lessors "acknowledge that costs to move production away from the reservation. . . may be legitimate deductions." 63 FR 7094(middle column). The MMS has long permitted the deduction of transportation allowances, and there is no basis for disallowing some transportation costs while permitting the deduction of others. *See, e.g.*, 53 FR 1207 (January 15, 1998) explaining the MMS long-standing policy of granting transportation allowances and citing *Kerr-McGee Corp.*, 22 IBLA 124 (1975). With respect to the movement of production, only true gathering costs are non-deductible.

Second, for myriad reasons, the MMS should not categorically disallow transportation allowances based on FERC tariffs. *See* API April 1998 comments at 7-9.

6. Reporting

Proposed §206.53 would require lessees and their purchasers to provide sales data for production sold, purchased or obtained from an Indian reservation and from "nearby fields and areas." Since the MMS offers no authority for requiring submission of data respecting fee and state leases, API urges the MMS to clarify and narrow this provision to exclude data for fee and state leases.

#####

If you have questions, please call David Deal of my staff at (202) 682 - 8261.

Sincerely,

G. William Frick

G. William Frick
Vice President, General
Counsel and Secretary

Enclosure