Coastal
The Energy People

May 12, 1998

Department of the Interior
Minerals Management Service
Royalty Management Program
Rules and Procedure Staff
Building 85, Denver Federal Center
Denver, Colorado 80225

Attn: David Guzy, Chief
Rules and Procedure Staff

COMMENTS
on the Proposed Rule
for Valuation of Crude Oil Royalty
Produced on Indian Leases

In Response to the Notice of
February 12, 1998
63 *Federal Register* 7089

Dear Mr. Guzy:

In response to the above referenced Notice, Coastal Oil & Gas Corporation, ANR Production Company, CIG Exploration, Inc., and Coastal States Trading, Inc., (collectively Coastal) submit the following comments.

I. Coastal

Coastal has operations in oil and gas exploration and production, natural gas transmission and storage, natural gas marketing, crude oil refining and marketing, and in other areas. Coastal holds oil and gas leases with Indian tribes and tribal corporations. At the time of the submission of these comments, Coastal has interests in approximately one hundred fifty (150) producing oil and gas wells on Indian lands.

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II. Background

On February 12, 1998, the Minerals Management Service (MMS) published a Notice of Proposed rulemaking to amend the current federal regulations concerning valuation of crude oil for royalty calculation purposes on Indian leases. The proposed rule is subsequent to proposed rules for valuation of royalty on oil from federal leases. This proposed rule for Indian oil royalty valuation is significantly more complicated and more difficult to administer than the proposed rules for federal leases. While the federal rules may have had stated goals of simplification and certainty, the proposed rule for Indian oil royalties is overly complicated and would not yield certainty.

III. Position

Coastal adopts and incorporates the comments submitted by the American Petroleum Institute ("API") to this proposed rule. The API comments were previously submitted, and for brevity, will not be attached hereto.

1. Calculations of Proceeds for Lessor's Oil Royalty.

Coastal adopts the API's response and comments objecting to the use of NYMEX prices. NYMEX prices do not reflect prices paid for the lessor's oil. The proposed rule should neither use the NYMEX prices nor use the five highest NYMEX days out of a month. The MMS recognizes the unworkability of the NYMEX and has abandoned NYMEX prices from the federal proposed rule. MMS proposes that if it uses the flawed NYMEX method, then MMS will apply the "major portion of oil production from the same field" into the NYMEX method. NYMEX and "major portion" are completely unrelated methods which should not be confused or applied in combination. NYMEX is not related to "production from the same field." The NYMEX is too far removed from the actual field to have anything to do with major portion. In addition, there is no reasonable basis for selecting only the top five days out of approximately twenty days in a NYMEX price-month. Application of either the NYMEX prices or merely the top five NYMEX prices for one month is arbitrary and capricious.

The several methods proposed by the MMS create onerous administrative burdens for lessees and royalty payors. The proposed rule requires the lessee to make two different determinations of royalty and to pay on the highest amount. The MMS would then do a major portion determination (a third determination). If the major portion reflects an increase to the royalty previously calculated by two methods, MMS would then require lessees to pay additional royalty according to the major portion result determined by MMS. The recently enacted Federal Oil and Gas Royalty Simplification and Fairness Act ("FOGRSFA") provides for the recoupment

of interest on overpayments. Any proposed rule should contain the same or similar provisions as FOGRSFA and allow for recoupment of overpayment of royalty and interest on overpayment of royalty.

The proposed rule would place the penalties of delays on reporting on the lessees. The rule should not place penalties on the lessee when delays may result from the requirements of the rule, from the MMS publication of numerical factors, or on the calculations to be performed by the MMS.

Tribal economic development of oil was inadequately considered. The onerous and time consuming administrative requirements for payments and reporting do not encourage economic development. The lack of certainty and stability created by the process of determining royalty payments does not promote economic development. The scheme proposed by the MMS contradicts the federal government's fiduciary and trust obligations to the tribes. While Coastal desires to continue its amicable business relations with its Indian lessors, the federal government's proposed rule inadequately considers the impact this rule may have on tribal economic development.

2. Definition of Lessee.

The proposed § 206.51 improperly expands the definition of "lessee" without any authority to do so. The proposed rule adds the following sentence: "Lessee includes all affiliates, including but not limited to a company's production, marketing, and refining arms." The proposed rule unnecessarily includes affiliates of a lessee. If the production, marketing or refining affiliates of a lessee do not lease the Indian minerals or do not have an obligation with the Indian lessor to pay royalty, there is no reasonable basis to include the marketing and refining arms of a lessee. A production affiliate need not be defined as a lessee because in many instances a production affiliate may not be involved in a lessee's operation, leasing or payment of royalties of a given Indian lease. The language appears to be an impermissible attempt to expand the scope of a lessee to intrude upon and obtain information from affiliates of a lessee.

3. Major Portion Analysis.

MMS does not explain how or why "major portion" should equate to the 75th percentile of oil produced or to the top five price days out of approximately 20 days (for a month). Major portion should not be included in determinations of payments where the calculations are based on factors far removed from the lease. Perhaps it is time to abandon "major portion" as vague, ambiguous, and has no definite purpose.

4. Duty to Market Free of Charge.

Coastal adopts the API's comments regarding to duty to market oil at no cost to the lessor. The duty to market at no cost may be contrary to lease terms. The MMS recognizes that Indian lessors and their lessees can agree for the Indian lessor to take its royalty-in-kind. *See proposed § 206.53(c)(4) (major portion value includes royalty taken in kind).* Royalty taken-in-kind would exclude marketing of the oil by the lessee. The regulation should expressly provide for what the MMS already recognizes -- the lawfulness of taking of royalty-in-kind.

5. Lessor-Lessee Agreements

The MMS should allow the Indian lessors and the lessees to continue to reach amicable relationships for the development of tribal and Indian resources without undue and unnecessary intervention by the MMS. In the regulation relating to Indian royalties, the MMS should include provisions allowing for and recognizing the sovereign right and private contract right of the tribes and Indians to privately agree on mutually acceptable terms with lessees on the methodology for computation of royalties -- even if the methodology is different from the regulations.

6. Reporting.

MMS proposes in § 206.53 to require lessees (which under the proposed definition would include affiliate marketing and refining companies) to provide data for oil sold, purchased or obtained from off-reservation fields and areas. The MMS should narrow this rule to exclude fee and state leases. Otherwise, as proposed, the rule is unlawful. Proposed § 206.52 would increase the reporting burdens on lessees.

7. Actual Market Prices.

MMS requested comments on how to determine, 6 months after the rule is effective, whether the values determined by the rule are replicating actual market prices and satisfying Indian lease terms. MMS's request points out the flaws and uncertainties created by the proposed rule. One of the principal flaws of the rule is MMS's attempt to "replicate actual market prices". The term "market price" plays strongly in the MMS's attempt to appeal to public opinion, so as to make it appear that lessee's would want to pay less than a "market price" (as if conjuring the incorrect image of the lessees paying less at a grocery market than anyone else). However, the term "market price" as used in the proposed rule does not relate to computing royalty on oil. The commodity price of oil is not the price of oil for valuation of royalty. The commodity price of oil is too distant from the well head to provide a basis for determining royalty on oil produced from the well. The MMS is confusing and misapplying different markets. MMS's choice of the term "replicate" reflects that the MMS is not attempting to determine royalty based on production of

oil from the lease. Instead, MMS seeks to artificially inflate "values" through complicated and unworkable commodity indices, through taking the "value" from the highest of three methods, and by escalating the "major portion" to seventy-five percent.

It is difficult to substantiate the MMS's position that industry is not paying enough money in royalties under the current regulations when the MMS increased the royalty rate for Indian leases a few years ago. The MMS's desire to increase the amount paid in royalties to itself and others is not an adequate basis for introducing convoluted, administratively onerous, and difficult to apply methods for calculating royalty.

IV. Conclusion

For the foregoing reasons and for the reasons and comments in the previous submitted comments to this proposed rule and to the federal rules, Coastal urges the MMS to 1) withdraw the proposed rule; 2) in lieu of the proposed rule to implement methods suggested in the comments; or 3) conduct an analysis of the effects, impacts and economic consequences of the proposed rule.

Respectfully submitted,

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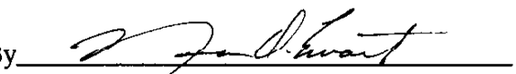
CIG EXPLORATION, INC.
COASTAL STATES TRADING, INC.

By 

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