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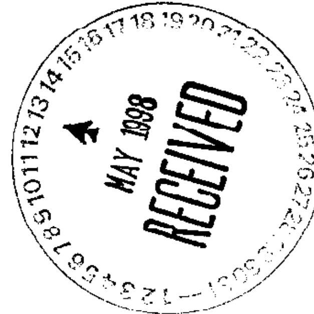

May 12, 1998

Mr. David S. Guzy
Chief, Rules and Publications Staff
Minerals Management Service
Royalty Management Service
P. O. Box 25165 MS 3021
Denver, Colorado 80225-0165

Dear Mr. Guzy:

RE: Establishing Oil Value for Royalty Due on Indian Leases – 63 Fed. Reg. 7089 (February 12, 1998)

The Council of Petroleum Accountant's Societies (COPAS) appreciates the opportunity to comment on the MMS' proposed rulemaking governing oil valuation on Indian leases. COPAS members have extensive experience with Royalty Management Program (RMP) rules and handle royalty valuation, allowances, adjustments, bills, audits, and other royalty matters on a regular basis. Therefore, we believe our comments will be beneficial in improving RMP processes for both the MMS and industry.

General Comments

COPAS is disappointed with the publication of this proposed rulemaking. Many of the concepts in this rulemaking are the same as MMS published in their proposed rule "Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil" issued January 24, 1997. These concepts have been shown to be totally unworkable, but we must comment on them again even though they were modified by MMS in later proposed rules.

This proposed rule also contains many new concepts that we believe to be very detrimental to the lessee and make Indian leases non-competitive when compared to non-Indian leases. This proposed rule places an unjustified new reporting requirement on both the lessee and the purchaser, even though the purchaser may not know it is purchasing Indian oil. It abandons MMS' historic practice of determining market value at the lease based upon arms-length contracts in favor of a totally unworkable netback method based upon a speculative value.

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COPAS recommends that this proposed rule be withdrawn by MMS because of its detrimental effects to both the lessor and lessee.

Specific Comments

Sec. 206.51

Arm's-length contract - COPAS recommends that MMS use the definition of control used by BLM as the basis for its determination of affiliation. Under such definition, ownership of less than 20 percent creates a presumption of non-control, ownership of 20 percent to 50 percent creates a presumption of control, and ownership in excess of 50 percent constitutes control.

Sec. 206.52

Under this section, MMS proposes to value Indian oil on the highest of three methods; 1) gross proceeds, 2) the average of the five highest daily NYMEX futures quotes for the prompt month, or 3) a value determined by MMS performing a major portion analysis.

COPAS is adamantly opposed to MMS' valuation methodology for a number of reasons:

1) It does not determine market value at the lease.
2) In the majority of situations, it does not allow gross proceeds in arms-length transactions as the royalty value.
3) It uses a speculative financial market as value instead of actual transactions.
4) The netback method proposed is fatally flawed due to the fact that accurate location adjustments cannot be determined and therefore one cannot determine market value at the lease.
5) In the preamble, MMS justifies the use of the five highest trading days on NYMEX as if it was a major portion price calculation, but they also intend to do a major portion analysis calculation. MMS cannot do two major portion analysis calculations under the terms of the lease.
6) Lessees who move the oil downstream of the lease must trace the oil which is not possible in the majority of situations.
7) The prompt month as defined by MMS is not the production month being valued.

COPAS recommends that royalty value be based upon gross proceeds under arm's-length contracts and non-arm's-length value be determined using arm's-length purchases or sales, a competitive bid or tendering program, and only as a last resort should a netback method be used.

Sec. 206.53

Part (a) states, in part, "On request, you must make available sales and volume data for production you sold, purchased, or obtained from the designated area or from nearby fields or areas. This includes sales or volume data from fee and state leases..."

COPAS objects to the concept of furnishing data pertaining to fee and state leases and recommends that this reference be deleted.

Part (d) states, in part "... market the oil for the mutual benefit of yourself and the lessor at no cost to the Indian lessor..."

COPAS does not agree that oil marketed away from the lease must be done at no cost to the Indian lessor. COPAS also believes that by placing the "market for the mutual benefit" language in the regulations, auditors will make judgements without recognition of the facts or situations that existed at the time of the sale. Therefore, COPAS recommends that this language be deleted.

Sec. 206.60

(a)(2)(i) – If the Indian lessor takes royalty in-kind, it should do so at the lease and not within the designated area. COPAS recommends that this provision be deleted.

(a)(2)(ii) - COPAS does not believe that lessees are required to transport oil within a designated area at no cost to the lessor. COPAS recommends that this provision be deleted.

(d) - COPAS objects to MMS defining areas within Oklahoma where no transportation allowance may be deducted. We do not believe that lessees are required to move oil across state or fee leases at no cost to the Indian lessor. Also, COPAS does not agree that because the lease terms are silent, no transportation is allowed to the reservation boundary. It is inconsistent with the lease provisions to value production away from the lease and not allow a deduction to move oil to the valuation point. COPAS recommends that these concepts be deleted.

Sec. 206.61

(c)(i) - COPAS does not believe it is possible to determine a location differential in a substantial number of situations. There are no published prices for Condensate or Wyoming Sour, for example. This is one of the fatal flaws in the MMS netback philosophy.

(c)(iii) - COPAS does not believe that using differentials is a proper method to determine costs. Differentials are trading differences that may or may not be reflective of costs of transportation. Also, we believe it to be highly probable that no differential will be based on the costs from the boundary of the designated area to a market center or other location. This is yet another flaw in the netback philosophy.

Form MMS-4416

COPAS objects to this data collection requirement in its entirety. MMS is requesting data that is not known by either the lessee or purchaser. As examples, if a lessee sells oil at the lease, he may not know what refinery the oil went to, the Sulphur content or the Paraffin content. These data are not available in the accounting records and would have to be gathered manually, if these could be gathered at all. A purchaser may not know the MMS lease number or that it is purchasing Indian oil. Also, a purchaser may have the same problems as cited for the lessee related to Paraffin and Sulphur content.

Some lessees have expressed concerns that by MMS placing a new reporting burden on purchasers, it will, at best, cause the value they receive to be lowered or, at worst, drive purchasers away from Indian leases.

COPAS does not believe that this new reporting burden is justified; therefore, we recommend that it not be implemented.

Conclusion

COPAS believes the proposed valuation methodology is fatally flawed. We also believe the proposed methodology does not result in a fair or reasonable royalty value at the lease, which is where royalty value should be determined. COPAS recommends this proposal be withdrawn.

Sincerely,

John E. Clark
Chairman, COPAS Federal Affairs Subcommittee

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cc:
Scott Cailteux
Bill Stone
Mary Stonecipher
COPAS Federal Affairs Subcommittee