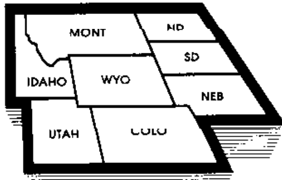


Rocky Mountain
Oil & Gas Association

Cliff Dodge
Executive Vice President
and General Manager

1900 Grant Street, Suite 510 • Denver, Colorado 80203-4305
303/860-0099 • FAX 303/860-0310

May 13, 1998

Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
P.O. Box 25165, Mail Stop 3101
Denver, CO 80225-0165

RE: MMS Proposed Rulemaking modifying the regulations to establish the value for royalty purposes of oil produced from Indian leases (60 FR 65610) 30 CFR Part 206 (dated February 12, 1998)

Dear Mr. Guzy:

The Rocky Mountain Oil and Gas Association (RMOGA) welcomes this opportunity to submit comments on MMS' February 12, 1998 notice regarding the proposed rule for Establishing Oil Value for Royalty Due on Indian Leases (63 Fed. Reg. 7089). RMOGA is a trade association whose members are responsible for approximately 90 percent of the exploration, production, refining, marketing and transportation of oil and gas in the eight-state Rocky Mountain region.

RMOGA and many of its members have participated actively in this process from the very beginning, and because of the strong interest of RMOGA members, we feel compelled to offer the following comments.

Unfortunately, RMOGA must ask that the MMS withdraw the proposed rule because we believe there is no explanation or basis in fact for its promulgation. Our members feel that the promulgation of this rule is simply an extension of the larger MMS effort to dramatically alter the current method of oil valuation on Federal Leases.

RMOGA believes that the proposed rule for establishing oil value on royalties due on Indian leases does not add certainty to the valuation of Indian production, and this implementation, if carried out, would not only hinder but would hurt RMOGA members' attempts at creating business efficiencies as potential integrated Indian lessees.

RMOGA believes the basic assumption of the MMS' proposal is to boost the amount of dollars the government achieves from royalty on Indian Oil. We will elaborate, but suffice it to say that substituting non-related indices and changing the point of valuation away from the lease all result in additional revenues owed to the Indian Lessors in the form of royalties.

As in the February 6, 1998 Supplementary Proposed Rule for Oil Valuation on Federal Leases, this proposal begins by attacking one of the bedrock issues of oil valuation, the "arm's-length" transaction. Despite much dialogue with MMS, RMOGA continues to believe strongly that the best indicators of the open market value of production at the lease are willing buyers and willing sellers with differing economic interests completing a sale, and evaluating an array of similar sales of crude oil in the producing field or area. Nothing has changed except the way MMS looks at things. There is still a dynamic market at the lease, and there are many factors that continue to enter into these agreements that give us a range of prices for a barrel of oil. The MMS "one price fits all" philosophy has no relevance in today's marketplace, and would discount market factors and penalize both buyers and sellers while rewarding the government.

The MMS proposal for valuing oil from Indian Leases is similar to the proposal for valuation on Federal Leases, and in the view of RMOGA is just as flawed. Here we see the NYMEX concept redesigned. For Indian Leases, the MMS proposes using the average of the five highest daily NYMEX futures settle prices for WTI at Cushing, Oklahoma. This process uses the NYMEX to value every type of crude oil in every Indian oil producing field, despite the fact that the NYMEX is a hedging/speculatory tool with virtually no relationship to a wet barrel of oil whatsoever. The NYMEX never looks at location, specific gravity, local supply and demand, refinery stocks, transportation, quality banks, weather, or equipment failure, all of which directly affect the price of a barrel of oil at the wellhead.

The MMS suggestion that using the retail price at a downstream location as an appropriate benchmark for valuing crude oil in a producing field is also highly questionable for many of the same reasons. MMS is unwilling to allow oil companies to use "net back" methodologies to make the necessary adjustments. Therefore, the premise on which MMS bases its valuation seems faulty to begin with, and will not result in proper and correct valuations of crude oil at or near the lease.

RMOGA is also very surprised to find out that MMS is proposing to collect information and publish its own differentials to deal with the vagaries of the commercial publication of spot prices and other indices and benchmarks. In the Rocky Mountain region alone, the differences in location, grade, quality, specific gravity, etc., and general day-to-day and hour-to-hour market conditions would make this an impossible task. From our reading of the proposal, it seems to us that it would be the intention of MMS to publish annually a specific set of quality/location differentials for designated areas to use as averages for current production. These "averages" have no correlation to current prices of "arm's-length" transactions at the lease so the comparable data could be as much as a year out of date when pricing current production. MMS also seems intent on creating a new form, MMS Form 4416, which seems to "fly in the face" of the Paperwork Reduction Act. In previous submissions of RMOGA comments, RMOGA has appended a Barents Group Analysis dealing with the creation of the new form MMS 4415 for federal leases. The proposal, MMS Form 4416 on Indian Oil, has the same problems that were addressed by the Barents Analysis that dealt with Form 4415.

We believe that the MMS has far more pressing needs than to begin a data collection and publishing service simply to promulgate a rule that is fraught with inconsistencies and will not accomplish either of the two major goals it set out to achieve. RMOGA finds it difficult, if not impossible to understand how the Minerals Management Service intends to meld all of these "new" concepts into an oil valuation scheme that gives more certainty to the valuation process, and to measure the actual price of Indian Oil. The proposal ignores the market issues that drive oil sales, and thus drive the price of the oil, whether from Indian Leases or from Federal Leases. This proposal forgets that the market at the lease is dynamic, and that supply and demand change from season to season with whatever grade and specific gravity of oil produced. This proposal conveniently forgets that Field A is very different from Field B and that many factors, including pipeline capacity vs. trucking, location, weather, refining capacity, the amount of oil already in the marketplace and a host of other differentials can and do alter the price of a barrel of oil, a wet barrel of oil and not a hedged/speculative barrel.

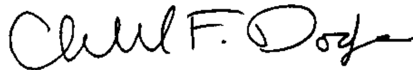
RMOGA and its member companies believe the only real answer to the questions and problems surrounding the valuation of oil and gas on both Indian Lands and Federal Lands is for MMS to implement a "royalty-in-kind" program. RMOGA has been supporting this approach for federal leases, as have other players in the oil and gas industry. The industry has put aside their differences and come together and agreed on a set of six principles that an RIK program can be successfully built upon. Members of Congress are now looking at and talking about RIK. Unfortunately, MMS is also talking about RIK, but the news articles we read here in the West are far more negative than positive. RMOGA finds it hard to believe that MMS and the Indian Nations have not considered other alternatives for establishing value at the lease such as royalty-in-kind or a tendering program.

RMOGA believes the oil and gas industry is at a crossroads. This industry has no desire to spend all of its time and hundreds of millions of dollars fighting with the federal government over the value of the product. This industry wants to deliver to the federal government its rightful share of the oil and gas produced, and get on with the business of finding more energy for the next century. Instead, the current system finds the industry spending time and money on justifying the prices paid for oil and gas five and ten years ago. The government, on the other hand, employs legions of inspectors and auditors, and the never-ending process continues. It should not be this way, and it would not be this way if an RIK program for both Federal and Indian Lands were adopted.

RIK would give both the government and the private sector (Indian Lands included) the best of both worlds. There would be no argument over the price of the product. Both the private sector and the government (oil and gas and the federal government) would sell the product at the best possible price, and the only audit function would be to make certain the proper amount of oil and/or gas was actually delivered.

Again, RMOGA urges the MMS to withdraw this proposed rule and to join with the industry to develop a system that works for the good of the citizens of the United States.

Sincerely,



Clifford F. Dodge
Executive Vice President
Rocky Mountain Oil and Gas Association