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April 3, 1998

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American Petroleum Institute and Western States Petroleum Association Comments on Minerals Management Service Supplementary Proposal on Valuation of Crude Oil Produced on Indian Leases 30 CFR 206, 63 FR 6113 (February 6, 1998)

Dear Mr. Guzy:

Attached are two full sets of the joint API-WSPA comments on the MMS' February 6, 1998 crude oil valuation proposal. They are unbound to facilitate your immediate copying and docketing needs. For your information, I am having extra bound sets made for distribution to API and WSPA members. I will set aside a few and send them to you within a few days in case your colleagues may find them more convenient to use.

Sincerely,

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Before the United States
Department of the Interior
Minerals Management Service

American Petroleum Institute and Western States Petroleum Association Comments on Minerals Management Service Supplementary Proposal for Valuation of Crude Oil Produced on Federal Leases

63 FR 6113 (February 6, 1998)
30 CFR Part 206

Volume I - Comments

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American Petroleum Institute and
Western States Petroleum Association
Comments on Minerals Management Service
Supplementary Proposal on
Valuation of Crude Oil Produced on Federal Leases
30 CFR 206, 63 FR 6113 (February 6, 1998)

Dear Mr. Guzy:

The American Petroleum Institute ("API") is a national trade association representing about 400 member companies. The Western States Petroleum Association ("WSPA") is a regional trade association representing 39 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 federal 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") crude oil valuation rulemaking.

API and WSPA, along with other associations and individual member companies, have participated actively at every stage of this rulemaking, filing several sets of comments[1] and participating in MMS workshops. Today's comments incorporate

[1] *See,e.g.*, 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

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our prior comments by reference and, to the fullest extent possible, focus on the MMS' February 6, 1998, supplementary proposed rule ("February 1998 Proposal").

Although there are marginal improvements over past proposals, the MMS' February 1998 Proposal still has core flaws. Despite MMS claims, it does not offer certainty, it does not reduce administrative costs, it does not reduce litigation, and does not arrive at the value of production at the lease. Although the appended comments describe these flaws in detail, the highlights are as follows:

- For arm's length transactions, the February 1998 Proposal's expansive definition of "affiliate" still unduly excludes many bona fide arm's length transactions from the application of gross proceeds for valuation of crude oil production for royalty purposes. ***The MMS should retain the existing regulation's definitions of "arm's length contract" and " affiliate."*** *See* Part I at 1-2.

- For non-arm's length transactions, the February 1998 Proposal employs an approach that differs appreciably among three geographic regions. For large companies operating in more than one region, this necessitates the creation of parallel and different administrative systems, needlessly magnifying compliance costs and creating artificial differences in valuation standards. ***The MMS should abandon its three-region approach and instead revise its existing regulations to include a menu of suitable benchmarks (e.g., viable tender program), flexible enough to accommodate different transactional settings while arriving at the "value of production" at the lease.*** *See* Part II at 2-3.

- For non-arm's length transactions, the details of the three-region approach pose particular problems. The use of Alaska North Slope (ANS) spot prices is unsatisfactory for the valuation of crude oil production in California and Alaska because it does not reflect the value of that production. For the Rocky Mountain Region, the use of an ordered benchmark menu (comprising an illusory tendering program, volume-weighted average gross proceeds accruing to sellers, and NYMEX futures prices at Cushing) is unwieldy at best. For all areas outside California, Alaska and the Rocky Mountain Region, the reliance on spot prices ignores the fundamental shortcomings of spot prices for valuation of crude oil. ***The MMS should abandon its three-region approach and instead revise its regulations to include a menu of suitable benchmarks (e.g., a viable tender program), flexible enough to accommodate different transactional settings while arriving at the "value of production" at the lease.*** *See* Part II at 3-4.

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

- The February 1998 Proposal's duty to market free of charge and mandatory use of indexing in combination with imprecise location/quality differentials moves valuation well downstream of the lease and leads to values well in excess of any reasonable "value of production," the royalty standard required by applicable mineral leasing statutes, applicable oil and gas leases, and the most relevant court decisions. ***The MMS should allow reasonable deductions for post-production marketing costs and services in order to arrive at the "value of production" at the lease.*** *See* Part III at 5 and Part IV at 5-6 .

- The February 1998 Proposal's categorical elimination of FERC tariffs for transportation allowances is arbitrary and capricious. ***The MMS should leave the existing regulations unchanged and permit use of FERC tariffs.*** *See* Part V at 7-8.

- Notwithstanding the MMS' early professed goal of certainty, the February 1998 Proposal is riddled with uncertain requirements. Many of these provisions are simply vague. Many others presume an unchanging environment and do not explain how a lessee is expected to handle changes in circumstances. Many provisions would impose complex demonstration and ambiguous information collection requirements on lessees, yet the most the MMS is willing to offer is "non-binding guidance determinations." ***The MMS should undertake a fundamental revision of its proposed valuation procedures to eliminate its vague and uncertain requirements and offer meaningful valuation determinations that can be relied on by lessees.*** *See* Part VI at 8-14.

- The February 1998 Proposal's obsession with the "ultimate purchaser" leads to tracing requirements that are especially laborious and costly and, in some cases, impossible to satisfy because of antitrust prohibitions, proprietary data limitations, and the identity-masking consequences of commingling. ***The MMS should focus on the "value of production" at the lease and eliminate unnecessary downstream tracing requirements; this could involve reasonable valuation procedures or use of royalty-in-kind.*** *See* Part VII at 14-16.

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API urges the MMS to redirect this wrongheaded rulemaking to address the systemic problems set forth above. If nothing else, the February 1998 Proposal underscores the need to explore royalty-in-kind as a meaningful alternative for conventional crude oil valuation procedures. If you have questions, please call David Deal of my staff at (202) 682 - 8261.

Sincerely,

G. William Frick
Vice President, General
Counsel and Secretary

Enclosures

American Petroleum Institute and
Western States Petroleum Association
Comments on Minerals Management Service
Supplementary Proposal on
Valuation of Crude Oil Produced on Federal Leases
30 CFR 206, 63 FR 6113 (February 6, 1998)

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American Petroleum Institute and
Western States Petroleum Association
Comments on Minerals Management Service
Supplementary Proposal on
Valuation of Crude Oil Produced on Federal Leases
30 CFR 206, 63 FR 6113 (February 6, 1998)

The American Petroleum Institute ("API") and the Western States Petroleum Association ("WSPA"), and industry generally, have participated actively at every stage of this rulemaking, filing several sets of comments[1] and participating in Minerals Management Service ("MMS") workshops. Today's comments incorporate our prior comments by reference and, to the fullest extent possible, focus on the MMS' February 6, 1998, supplementary proposed rule ("February 1998 Proposal").[2]

As our comments show, the February 1998 Proposal does not satisfy the MMS' own claims.[3] It would not offer simplicity or certainty. It would not reduce compliance and administrative costs. It would not reduce the need for valuation determinations or litigation. And it would not arrive at the value of production at the lease.

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[1] *See, e.g.,* API May 27, 1997, comments on the MMS' initial proposal at 62 FR 3742 (January 24, 1997), August 1, 1997, comments on the MMS' supplementary proposal at 62 FR 16116 (April 4, 1997), November 4, 1997, comments on the alternatives for rulemaking and related workshops at 62 FR 49460 (September 22, 1997), and, Joint Association December 5, 1997, comments on the core rulemaking issues.

[2] 63 FR 6113-6141(February 6, 1998), enclosed as Attachment "**A**."

[3] In its 1998 economic analysis of the February 1998 Proposal, the MMS states:

> Specifically, the proposed rule would result in:
> - simplification of pricing, coupled with certainty,
> - reductions in valuation determinations and litigation,
> - *reduction in industry group compliance costs, and*
> - receipt of market value of oil produced from Federal leases.

Economic Analysis of Proposed Federal Oil Royalty Valuation Rule under Executive Order 12866," MMS, 1998, at 24.

I. The Proposal's Provisions for Valuation of Arm's Length Contracts Arbitrarily and Capriciously Exclude Many Bona Fide Arm's Length Contracts.

By its terms, §206.101 would be inapplicable to transactions involving affiliates. And §206.100 would define "affiliate" to include "a person who owns, is owned by, or is under common ownership with another person to the extent of 10 percent or more of the voting securities of any entity, interest in a partnership or joint venture, or other forms of ownership." Together, these provisions of the February 1998 Proposal arbitrarily and capriciously exclude an unduly large segment of the arm's length transaction universe from gross proceeds-type valuation under §206.102.

With minimal explanation, the February 1998 Proposal would abandon the careful compromise reached in the 1988 regulations. Based on BLM coal leasing regulations, which remain unchanged,[4] the 1988 MMS royalty valuation regulations avoid the simplistically low 10 percent threshold of the present February 1998 Proposal. Instead, the 1988 regulations reflect a sensible and fair control approach:

(i) *Ownership in excess of 50 percent constitutes control;*
(ii) Ownership of 10 through 50 percent creates a presumption of control; and
(iii) Ownership of less than 10 percent creates a presumption of noncontrol.[5]

To the extent the MMS' speculative, "gaming" concerns had some foundation,[6] the "misconduct" provisions of §206.102(c)(2)(i) would carry forward existing regulations[7] These regulations already provide the MMS with ample means to deal with any sham arrangement employed to understate actual control. What the MMS should do is use such existing authority to curb real misuse of gross proceeds valuation on a case-by-case basis. What the MMS should not do is use anecdotal information on an isolated situation as the pretext for adopting a narrow definition of arm's length contract to unduly narrow use of gross proceeds for valuation.

II. The Proposal's Provisions for Valuation of Non-Arm's Length Contracts Are Arbitrary and Capricious.

Our concerns over valuation of non-arm's length transactions involve the unnecessary complications of a three-region approach and the separate problem of

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[4] 43 CFR 3400.0-5(rr)(3)(1998). Curiously, but commendably, the MMS' most recent proposal for valuation of crude oil on Indian lands retains the existing control approach. 63 FR 7089, 7099 (February 12,1998).

[5] 30 CFR 206.101(1997).

[6] *See* February 1998 Proposal at 63 FR 6117 (1st col.), *citing* the use of a cooperative venture addressed in Xeno, Inc. 134 IBLA 172 (1995).

[7] *See* 30 CFR 206.102(b)(1)(iii)(1997).

using indexing in its various forms. The February 1998 Proposal deals with neither satisfactorily.

A. Geographic Non-Uniformity

In comments submitted earlier in the rulemaking,[8] industry emphasized that geographically non-uniform valuation regulations impose extra burdens on companies that produce oil and gas in several geographic regions. If the valuation regulations vary appreciably from region to region, different administrative systems would be needed to support them, i.e., different software and additional staff.

In dismissing industry's non-uniformity concerns as a "one size fits all" approach,[9] the MMS misses the point altogether. In explaining the extra costs and complications of the MMS' rigid, three-region approach, industry has not promoted another even more rigid approach. From the outset of this rulemaking, industry has urged the MMS to revise the single menu approach of the existing regulations.[10] Such a revised menu, which could, for example, eliminate the posted price benchmark and include a tendering benchmark, would be flexible enough to accommodate radically different circumstances inside and outside any geographic area.

Stated most simply, in revising its valuation regulations, the MMS should focus on variations in transactional settings, not arbitrary geographical boundaries.

B. Valuation of Non-Arm's Length Transactions Generally

Geographic differences aside, earlier industry comments also explained why indexing in combination with MMS-set differentials do not arrive at a reasonable "value of production." However, the February 1998 Proposal fails to address the core concerns raised by industry.

1. §206.103(a) California and Alaska

Previously filed comments explain at length why Alaska North Slope (ANS) spot prices are a wholly unsatisfactory measure of the value of production.[11] Yet without responding to these comments, the February 1998 Proposal simply carries the MMS' January 1997 Proposal forward without any discernible change. The use of ANS spot prices offers no safeguards to protect either the operator -- or the MMS-- if the ANS

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[8] API November 1997 Comments at 5-6; Joint Association December 1997 Comments at 3.

[9] "Federal Crude Oil Valuation Rulemaking," MMS Congressional Briefings, February 1998, enclosed as Attachment "**B**," and "MMS Proposes Further Amendments to Federal Crude Oil Valuation Rule," MMS News Release, February 5, 1998, enclosed as Attachment "**C**."

[10] API May 1997 Comments at 7-9; API November 1997 Comments at 4-5; Joint Association December 1997 Comments at 2-3.

[11] API May 1997 Comments at 10-14; API November 1997 Comments at 4; Joint Association December 1997 Comments at 4.

Index and the value of California crude deviate from each other because of short term market conditions (e.g., refinery supply requirements).

ANS spot prices simply do not reflect the "value of production" at the lease and we urge the MMS again to abandon this flawed approach.

2. §206.103(b) Rocky Mountain Region

The February 1998 Proposal's treatment of the Rocky Mountain Region has several flaws. First, proposed §206.101 defines "Rocky Mountain Region," but excludes New Mexico. As the preamble to the February 1998 Proposal suggests, [12] at least the northwest portion of New Mexico should be included in the Rocky Mountain Region.

Second, proposed §206.103(b)(1) permits use of an MMS-designed tendering program whose myriad limitations all but eliminate the tendering program as a meaningful option, even for the Rocky Mountain Region. These undue limitations in §206.103(b)(1) include the requirement that 33 1/3 percent of production be offered and sold, the requirement that at least three bids be received, the requirement that bidders not have a tendering program of their own, and the prospect of other criteria to be published in the MMS' "Oil and Gas Payor Handbook."

Third, even though the MMS has abandoned NYMEX index prices in general, proposed §206.103(b)(3) would still use them for the Rocky Mountain Region. Given the demonstrably flawed character of NYMEX index prices as a measure of the value of production,[13] NYMEX index prices should be abandoned altogether, even in the Rocky Mountain Region.

Fourth, and most fundamental, the MMS offers no rationale for limiting use of a tendering program to the Rocky Mountain Region. Although the MMS' Fall 1997 workshops demonstrated a broad base of support for the use of a properly designed tendering program as an alternative to indexing generally, the February 1998 Proposal is an unfounded de facto rejection of the concept. API urges the MMS to reassess its rejection of tendering as a generally applicable method for valuation and eliminate the crippling operational and geographic limitations for its use.

3. §206.103(c) Other Areas

The February 1998 Proposal's treatment of the bulk of the nation and the vast bulk of its production remains riddled with fundamental problems. Although the February 1998 Proposal would use spot prices instead of the January 1997 Proposal's use of NYMEX prices, the February 1998 Proposal offers no response to the focused criticism of crude oil spot prices as a measure of value for royalty purposes. As earlier

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[12] February 1998 Proposal at 63 FR 6116 (third col.).

[13] API May 1997 Comments at 15-23; API November 1997 Comments at 2-3.

API comments have painstakingly explained,[14] spot prices for crude oil (unlike spot prices for gas) are an altogether inappropriate measure of the value of production and the MMS should abandon their use for valuation purposes. API urges the MMS to avoid the use of crude oil spot prices that are a demonstrably inaccurate measure of the "value of production" at the lease.

As noted above, the MMS should instead revise the existing benchmark regulations to provide an menu of suitable valuation measures from which lessees could select the one best suited to fit the particular transactional circumstances.

III. The Proposal Unlawfully Requires That Production Be Marketed at No Cost to the Lessor.

Although the MMS continues to claim that "royalty must be based on the value of production,"[15] that position is hard to square with the February 1998 Proposal's treatment of marketing costs. Like the original January 1997 Proposal, proposed §206.106 states:

> You must place oil in marketable condition and market the oil for the mutual benefit of the lessee and the lessor at no cost to the federal government unless otherwise provided in the lease agreement . . . . If you use gross proceeds under an arm's length contract in determining value, you must increase those gross proceeds to the extent that the purchaser, or any other person, provides services that the seller normally would be responsible to perform to place the oil in marketable condition or to market the oil. (Emphasis supplied.)

As earlier comments make clear,[16] an express duty to market free of charge is not a clarification of existing law, but is a substantial change. To "place the oil in marketable condition," the requirement of existing regulations,[17] does not encompass "marketing the oil." This change contravenes the "value of production" language of applicable mineral leasing statutes, and the most relevant court decisions interpreting that language.[18] Furthermore, there is no implied covenant to market free of charge.

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[14] API November 1997 Comments at 2-3.

[15] MMS Congressional Briefings, February 1998; MMS News Release, February 5, 1998.

[16] API May 1997 Comments at 34-39; API November 1997 Comments at 3-4; Joint Association December 1997 Comments at 3.

[17] 30 CFR 30 CFR 206.102(f)(1997).

[18] *See, e.g.*, Diamond Shamrock Exploration Company v. Hodel, 853 F.2d 1159(5th Cir. 1988).

Regrettably, the MMS seems intractable on this issue and industry legal challenges have already been filed in connection with the related gas transportation allowance rulemaking to obtain a judicial interpretation of this core issue.[19]

IV. The Proposal Unlawfully Moves the Point of Valuation Downstream of the Lease Without Allowing Deductions for All Post-Production Marketing Costs and Services.

Independent of the Proposal's attempt to unlawfully impose on the lessee a duty to market free of charge, the Proposal contains several other provisions, which, like the use of spot prices, effectively move the valuation point downstream, away from the lease and point of production. Starting downstream inherently complicates the valuation process, because other parties and other records are involved and because the identity of the production is obscured through commingling. However, it can approach the "value of production," provided ample allowances are permitted for post-production costs and services, beyond the costs of placing the production in marketable condition.

Yet the February 1998 Proposal does not account for such added value. As noted above in Part 3, §206.106 categorically denies deductions for marketing costs. Moreover, as earlier comments explain, once production moves downstream, it acquires various increments of value linked with the process of marketing beyond the simple physical treatment to put it in marketable condition.[20]

What aggravates the problem is February 1998 Proposal's stifling treatment of arm's length transactions and the inordinate requirement for downstream tracing of proceeds. For example, even where §206.102 would be applicable, it would in many cases be available only after one or more resales have occurred. As explained in Part I of these comments, the §206.101 definition of "affiliate" would deny the use of gross proceeds under §206.102 for many bona fide of arm's length transactions. As a result, §206.101(a)(3) would permit the use of gross proceeds only after the crude oil is "ultimately sold" under an arm's length contract.[21]

Likewise, where no arm's length contract (by the MMS definition) exists, even downstream, §206.103 would require, except for some limited cases in the Rocky Mountain Region, the use of spot prices or NYMEX index prices (together with location/quality differentials) that are by definition prices far downstream. Here again, prior API comments explain why the use of spot prices or NYMEX index prices used in

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[19] *See, e.g.*, 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).

[20] API May 1997 Comments at 24-25.

[21] MMS February 1998 Proposal at 63 FR 6116(third col.). *See also,* proposed §206.103(b)(3) that, for certain transactions in the Rocky Mountain Region, would permit a lessee to use the gross proceeds from sales or resales of crude.

combination with clumsy differentials almost invariably lead to values higher than a reasonable "value of production," values which capture increments of value added as the crude oil moves downstream.[22]

If the MMS were to abandon its contracted view of arm's length transactions and its correlative reliance on index-type prices, the MMS could avert this downstream valuation problem.

V. The Proposal Unlawfully Limits Transportation Allowances

Without any further commentary or response to industry comments, the February 1998 Proposal carries forward the treatment of FERC tariffs in the January 1997 Proposal. Under the existing regulations, a lessee can use the actual costs of transportation or apply for use of FERC or state-approved pipeline tariffs.[23] Under the February 1998 Proposal, §206.105 would eliminate the use of tariffs altogether using the rationale that "a FERC-approved tariff is no longer a viable alternative since FERC ruled that it lacks jurisdiction to enforce the Interstate Commerce Act. See Oxy Pipeline. Inc., 61 FERC 61,051 (1992) and Bonito Pipe Line Company, 61 FERC 61,050 (1992)."[24]

API's May 1997 Comments point out that the Oxy and Bonito cases by their own terms are limited to offshore pipelines.[25] More importantly, API's May 1997 Comments also show that the MMS itself has rejected the sweeping significance now claimed.[26] Yet nowhere does the February 1998 Proposal respond to these earlier comments. Moreover, the February 1998 Proposal is arbitrary and capricious for several other reasons:

First, the MMS offers no explanation of how the February 1998 Proposal satisfies OCS Lands Act §§5(e) and (f).[27] These sections oblige the Secretary to prohibit unlawful discrimination in oil and gas transportation arrangements on the OCS. Yet the transportation allowance provided by the February 1998 Proposal requires the lessee to move the Federal Government's produced oil at a rate presumptively lower than that provided for movement of third party production, even if it is moved through the same pipeline on the same day. In effect, the MMS would penalize the lessee whose affiliate

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[22] API May 1997 Comments at 15-23; API November 1997 Comment at 2.

[23] 30 CFR §206.103(b)(5) (1997).

[24] 62 FR 3742, 3747 (January 24, 1997).

[25] API May 1997 Comments at 29-31.

[26] Id., *citing* Torch Operating Co., MMS-94-0655-OCS at 5 (January 18, 1997). The Assistant Secretary's more recent February 4, 1998, decision rejecting use of FERC tariffs also cites the FERC decision in Ultramar, Inc. V. Gaviota Terminal Co., 80 FERC 61,201 (1997), but does not alter this situation.

[27] 43 USC § 1334(e) and (f).

undertakes the installation of pipeline infrastructure in deep water. The MMS would deny a full transportation allowance to the party who undertook the cost, risk, and research and development expense, while granting to other parties using the line at arm's length a full transportation allowance. Such a result is discriminatory and unfair.

Second, the MMS offers no justification for its failure to satisfy the OCS Lands Act § 5(a) requirement that the Secretary cooperate with other federal agencies.[28] As the agency charged by statute to set pipeline rates, FERC deserves to have its ratemaking procedures recognized by the MMS absent a clear and compelling reason in the administrative record. The MMS offers none because there is none.

Third, the February 1998 Proposal's limitation of transportation allowances is inconsistent with the basic principle that royalty be based on the "value of production," because the value of production should not include any increment of the cost of transportation.

Fourth, the proposed methodology for transportation allowances, when viewed in combination with the proposed methodology for arriving at the value of production, underscores the arbitrary and capricious nature of the February 1998 Proposal. In Part I of these comments, we showed how the MMS takes great pains to limit the definition of "arm's length contract" through recourse to an expansive definition of "affiliate."[29] This has the practical effect of requiring an unduly high number of transactions to be considered non-arm's length transactions; because this leads to use of spot prices in combination with imprecise location/quality differentials, the result is an unlawful increase in the imputed value of production. Yet for transportation costs, the February 1998 Proposal chooses to ignore what third parties, unaffiliated by anyone's definition, pay to move production through the same pipeline. These unaffiliated third party costs are plainly comparable and discernible, given the availability of published FERC rates, and are plainly the best measure of transportation costs. Yet ignoring them results in an unlawful decrease in transportation allowances, further increasing a lessee's net royalty obligation.

Fifth, the February 1998 Proposal's treatment of transportation allowances falls especially harshly on offshore production where the costs of construction and installation of transportation infrastructure especially high and risky. As a de facto increase in royalty rates, an unduly limited transportation allowance policy is at odds with the public policy recognizing the need for royalty relief as an incentive for offshore development [30] and the Secretary's overarching statutory obligation to make the OCS available for "expeditious and orderly development."[31]

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[28] 43 USC § 1334(a).

[29] *See* Part I, *supra* at 1-2.

[30] Outer Continental Shelf Deep Water Royalty Relief Act, P.L. 104-58, 109 Stat. 563, codified at 43 USC § 1337(a), OCS Lands Act § 8(a).

[31] 43 USC §1332(2).

For all of these legal and policy reasons, the MMS should abandon the February 1998 Proposal's categorical rejection of FERC tariffs.

VI. The Proposal Establishes a Valuation Scheme Riddled with Uncertainty.

At the outset of this rulemaking, the MMS professed the need for valuation certainty, yet that element is conspicuously lacking from the February 1998 Proposal and related MMS briefing materials.[32] Indeed, key elements of the February 1998 Proposal fail to give payors meaningful guidance. Indeed, if anything, the heavy requirement for tracing of proceeds downstream increases complexity and uncertainty.

In many places, key provisions are simply vague. In other places, critical decision criteria are unspecified altogether. In still other places, key provisions leave unaddressed how changes in circumstances impact royalty obligations.

§206.100

- If under § 206.100(b) the "express provision of an oil and gas lease" would override any regulation, as it must, what happens when the gross proceeds provision of a lease arrives at a different value than indexing?

- Under § 206.100(b), the regulations would not apply where "inconsistent with a federal statute, a settlement agreement between the United States and a lessee resulting from administrative or judicial litigation, or an express provision of an oil and gas lease. . . . " This litany of overriding provisions should also include existing and future royalty reduction agreements entered into by the MMS and operators. These agreements have a clear statutory basis and are critical for the development of certain oil reserves.

§206.101

- *"Aggregation point"*: How often would MMS publish its list? How do changes in the list affect payors that have relied on prior lists? How would the regulation deal with OCS aggregation points, many of which are located on the seafloor at a location not generally in use by producers? Since the distance of such aggregation points is not delineated, how would that distance be calculated? Since in some instances producers have already paid to move the production from the lease to the shore, how would that rate be pro rated for royalty purposes?

- "*Area*": Defining this term as a "geographic region at least as large as the limits of an oil field in which the oil has similar quality, economic, and legal characteristics" suggests the possibility of an unduly expansive definition as applied. In recent

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[32]The February 1998 Proposal and the MMS Congressional Briefings, February 1998, do not include certainty as an objective. Yet at earlier stages in the rulemaking, certainty was a primary objective. *See, e.g.*, January 1997 Proposal at 62 FR 3742; September 1997 Notice at 62 FR 49460, 49461 .

California-related orders, the MMS has taken the position that the entire state is the field or area; such an expansive definition severely limits the viability of tendering programs included in §206.103(b).

- *Arm's-length contract*": Inasmuch as the proposed definition of arm's length contract depends so much on an expansive definition of "affiliate" and looks beyond the time of execution of the original agreement, the proposed definition does not clearly and fairly deal with the changes in circumstances that can occur between parties after they have executed an arm's length contract? For example, where two parties enter into an agreement that satisfies the MMS' own definition of arm's length contract, then later become more closely related, why should that agreement later be considered a non-arm's length contract if the substantive terms of the original agreement are unchanged?

- "*Index pricing point*": If the list of MMS-approved publications changes, how would this affect payors that have at one point relied on the current list of approved publications?

- *"Gathering"*. The distinction between gathering and transportation should be clarified and revised to reflect modern technology. This is especially true for deep water OCS leases where the traditional distinctions between gathering and transportation do not apply. Subsea development requires movement of production for distances of 20-800 miles and for such distances to deny a transportation allowance altogether would be arbitrary and capricious. In addition, deep water above surface structures (e.g., TLP, SPAR) require an associated shelf jump off location; in such cases, movement of production from the lease to the shelf should be classified as transportation.

- *"Gross proceeds"*: What elements are included in "marketing"? Why has the phrase "accuring to an oil and gas leasee" be deleted? Its deletion blurs the fundamental principle that the lessee has the royalty obligation. This key phrase should be restored to the definition.

- "*Index pricing*": What constitutes "other" appropriate crude oil spot prices for royalty valuation?

- "*Market center*": How would changes in market centers affect payors?

- *"Spot price*": What does "a specified period of short duration" mean?

- "*Tendering program*": What does the phrase "other geographical/physical unit" mean?

§206.102

- How and when would MMS determine that an agreement reflects "reasonable location and quality differentials" under §206.103(c)(3)? no criteria have been prescribed.

- How and when would a lessee demonstrate that an agreement is arm's length under §206.102(d)(1)?

- Would payor "certification" under (d)(2) be subject to later review by the MMS? Before an audit? If the MMS is only willing to offer a "non-binding determination" under §206.107, how can the MMS require a certification from the payor, then review it?

§206.103

- What criteria would be used by the MMS for review of a tendering program under §206.103(b)(1) to implement the 33 1/3, three bidders, and 50% requirements? What time period does the MMS have in mind? Can a payor slip in and out of eligibility? When will additional criteria appear in the MMS "Oil and Gas Payor Handbook"? When would the MMS approve a tendering program? How would a payor know with certainty whether a potential bidder has what the MMS considers an acceptable tendering program?

- What does "the MMS Director may establish an alternative valuation method" mean? Is this a case-by-case option or does it suggest that the MMS may at some unspecified point in the future establish another generally applicable valuation method? If the former, would the decision be binding on the MMS or is that also subject to later reconsideration by the MMS? If the latter, is it appropriate to experiment with a radical change in valuation methodology given the high costs of system conversion?

- How and when does the MMS determine under (d) if index prices are "unavailable or no longer represent reasonable royalty value"? What are "other relevant matters"?

- Under §206.103(e), would the payor and the MMS be locked into an alternative for some prescribed time period?

§206.104

- How often would the MMS review or revise its approved publication list?

§206.107

- How does the availability of "non-binding determinations of guidance" under §107 promote certainty? The MMS should offer determinations comparable to Internal Revenue Service (IRS) private letter rulings[33] for specific taxpayers based on

[33] IRS Rev. Proc. 80-20, 1980-1 C.B. 633, *as modified by* Rev. Proc. 81-33, 1981-2 C.B. 564.

specific facts. Such IRS rulings can be revoked, but they are not "non-binding" ab initio.

- Would there be guidelines for gauging whether the MMS "promptly" reviews a lessee-proposed valuation method?

- Would interest and penalties apply where the payor relies on an MMS "non-binding determination" to its detriment? Would the MMS then be free to disavow its own determination of value by seeking to use the civil and criminal penalties of FOGRMA and other statutes to cow lessees? Since such an MMS determination would be "non-binding," could a lessee disregard it with impunity?

§206.109

- How would subsea transportation be handled? *See* comments under §206.101 above.

§206.110

- Under §206.110(a), how would a payor demonstrate that a transportation-related contract is arm's length?

- How and when does the MMS determine under §206.110(a)(1) that the "contract reflects more than the consideration actually transferred either directly or indirectly" to the transporter for transportation?

- Under §206.110(b)(2), would alternative allocation methods, once approved, be binding?

§206.112

- Under §206.112(b)(2), if the use of Form 4415-generated location/quality differentials is subject to audit, how promptly would revisions be made?

- Under §206.112(b)(2), what criteria would the MMS use to exclude apparent anomalous differentials from the calculation of differentials applicable to each aggregation point?

- How would the proposed regulations deal with the impact of blending crude oils of different grades? Such blending occurs away from the lease and the MMS as lessor has no claim on the value added-- or lost-- away from the lease.

- Under § 206.112(b)(3), would the MMS revise the location/quality differential retroactively? Any such changes should be prospective only.

- What would happen if the transportation costs in a succeeding year far exceed the transportation costs of the preceding year that had been used to calculate the differentials? How would a payor ever catch up in an escalating transportation cost

scenario? What would happen when volumes differ because of production shut-in caused by development or expansion?

- Under §206.112(d), would lessees bear the entire administrative/interest/penalty burden if the MMS revises the location/quality differentials?

- Under §206.112(e), how would quality differences be accounted for where no formal quality bank exists? Quality banks are not employed in every case, but are the result of market forces mediated by the respective bargaining positions of shippers and transporters.

§206.113

- What does the term "directly" mean in connection with moving lease production under §206.113(b) & (c)?

- Under §206.113(b), if crude oil passes through a market center en route to a refinery, would the transportation allowance be limited only to the lease-to-market center segment?

§206.114

- What criteria would the MMS employ in the approval process for an alternative location/quality differential? When would these criteria be available to a payor? Would MMS approval be binding?

- Does the MMS contemplate prescribing a period for ruling on a lessee-proposed differential (e.g., 60 days)? Why not establish a presumption in favor of granting such a request in order to keep the process moving without undue delay?

§206.115

- Does the MMS intend to preserve the ability to retroactively modify its list of aggregation points and market centers? Should not such revisions be prospective only?

§206.116 & §206.117

- Given the use of the term "may," under what circumstances would a payor have to submit "transportation contracts, production agreements, and related documents" (under §206.116) or "all data" (under §206.117)? What would the MMS do with this huge amount of information?

- How would an affiliate file a Form MMS-2014? Under what statutory authority does such an obligation rest?

- What would the consequences for a payor be if its affiliate files incorrect information on Form MMS-2014?

§206.118

- Are the first two sentences consistent? The first sentence requires information "related to all your and your affiliate's production," yet the second sentence requires only information on "differentials between MMS-defined market centers and aggregation points."

§206.122

- Why has the MMS eliminated references to the point of settlement approved by the MMS for offshore leases?

- Why is there no adjustment provided for offshore leases where the quality/quantity is different from quality/quantity at the point of settlement?

Form MMS-4415

- If MMS-4415 is limited to federal production, and federal production is commingled with non-federal production, what should be reported?

- What if the sulfur differential is not referenced in the contract?

- Would a certification be required of a party who signs Form MMS-4415? The step-by-step instructions for the form use the heading "certification" but the form itself does not.

- If the MMS has reserved the right to review any information on Form MMS-4415 relating to non-federal production, how long would a payor have to retain this information? Until an audit? Under what statutory authority does the MMS regulate a non-lessee?

Left uncorrected, these deficiencies are more than a burden; they pose for lessees an unreasonable dilemma. In the absence of clarification--or even with "non-binding determinations of guidance" from the MMS -- is a lessee expected to overpay as a hedge against an interpretation later deemed wrong? Even if a lessee makes his own good faith interpretation, and procures MMS "non-binding guidance," and overpays, how does that protect against bogus, after the fact, assertions of non-compliance with federal laws? Stated most simply, under the February 1998 Proposal, payors simply cannot conduct their business with reasonable assurance that they are satisfying their royalty obligation.

VII. Many Requirements of the Proposal Are Unduly Costly or Unworkable.

A. Costs

Even if the vagaries listed above under Part VI of these comments were eliminated, the February 1998 Proposal contemplates changes that would impose very significant implementation costs. Although the costs would vary from company to

company, and cannot be estimated because of the February 1998 Proposal's vagueness on several core issues, the changes are pervasive.

Even as revised, Form MMS-4415 would require the collection of substantially more information. New or modified computer systems would be necessary to capture sales and exchange data, calculate prices, perform recalculations when any component of the price changes, especially if downstream tracking is required. For a company producing in more than one region, the February 1998 Proposal's three-region approach further compounds the problem. All of these requirements require new systems and more personnel to address the additional complexity.

To a large degree, the changes that would be required by the February 1998 Proposal are driven by the collection of voluminous information to be submitted on existing Form MMS-2014 and proposed Form MMS-4415. However, two reports submitted recently to the Office of Management and Budget reveal many profound problems with that proposed data collection effort.

For example, the Barents Form 2014 Report[34] shows that the MMS, in attempting to satisfy its Paperwork Reduction Act obligations, has grossly underestimated the increased burden for completion of Form MMS-2014. This underestimate is attributable to significant computation errors[35] and gross underestimates of the new information collection requirements implied by the February 1998 Proposal.[36]

Likewise, the Barents Form 4415 Report[37] shows that the MMS has ignored the impact of the February 1998 Proposal on existing forms,[38] underestimated the effort to complete form MMS-4415,[39] and underestimated the costs of payor system changeover and implementation.[40] The 4415 Report also shows that the form completion requirements are open to misinterpretation[41] and that the MMS' intended use of the

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[34] "Analysis of the Department of Interior, Minerals Management Service's Request for Extension of the Existing collection Authority for Form MMS-2014," Barents Group, March 6, 1998, ("Barents Form 2014 Report"), enclosed as Attachment "**D.**"

[35] Id. at 2-3.

[36] Id. at 8-11.

[37] "Analysis of the Department of Interior, Minerals Management Service's Form MMS-4415 under the *Supplementary Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases* under the Paperwork Reduction Act," Barents Group, March 10, 1998 ("Barents Form 4415 Report"), enclosed as Attachment "**E.**"

[38] Id. at 11-12.

[39] Id. at 12-13.

[40] Id. at 14.

[41] Id. at 16-17.

information is not clear.[42] Finally, the 4415 Report shows that the contemplated method for calculation of location and quality differentials ignores the commingling of federal and non-federal lease oil,[43] presents statistical validity problems[44] and will not lead to accurate valuation estimates.[45]

In sum, the February 1998 Proposal contemplates information collection and system changes far more burdensome than the MMS has estimated. If, indeed, the February 1998 Proposal is intended to satisfy the MMS' objective to " reduce administrative costs of royalty valuation,"[46] it fails. It certainly fails on the industry side and we believe on the MMS side as well. Moreover, if the use of some form of indexing is to result in "rules that reflect market value," that objective too fails. The valuation procedures contemplated will not arrive at the valuation outcomes predicted by the MMS: the "value of production" at the lease.

B. Workability

The valuation procedures contemplated by the February 1998 Proposal are not simple nor are they even simpler than the existing procedures. Our best assessment of the February 1998 Proposal's regulatory scheme is that it is not only unnecessarily complex and burdensome, but that it simply cannot work. Notwithstanding the MMS' occasional claims of certainty, Attachment "F"[47] shows graphically how the valuation procedures contemplated by the February 1998 Proposal are hopelessly complicated and riddled with the myriad uncertainties set forth in detail in Part VI above.

To a large degree, these complications are linked to the Proposal's pervasive and extraordinary tracing requirements. For example, even for the small fraction of bona fide arm's length transactions that could use the gross proceeds methodology of §206.102, tracing would be required where multiple exchanges occur before the "ultimate purchase" occurs. Indeed, under the February 1998 Proposal, a lessee seeking to use §206.102 would have to obtain and retain records for every downstream exchange, even though only a fraction might ultimately result in an arm's length sale. For the larger universe of transactions, where one of the three proposed sets of region-specific indexing methodologies would be used, tracing would still be required to arrive at transportation allowances.

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[42] Id. at 17-18.

[43] Id. at 14.

[44] Id. at 14-15.

[45] Id. at 15-16.

[46] *See* "Federal Crude Oil Valuation Rulemaking," MMS Congressional Briefings, February 1998.

[47] "How Will Royalty Value Be Calculated under MMS Proposed Rule," enclosed as Attachment "F."

Yet nowhere does the Proposal address the core problems of downstream tracing: Antitrust laws prohibit the exchange of certain market information. Proprietary concerns, sometimes reinforced by other statutory requirements, inhibit the exchange of information among parties.[40] Commingling of streams, essential for pipeline efficiency and operation, eliminates the identity of production because multiple streams of federal and non-federal production are often aggregated and disaggregated as the crude oil moves downstream. And even without commingling, lessees cannot reasonably be expected to have or acquire records for every downstream transaction when so many so many parties outside the control of the lessee may be involved.

In sum, the February 1998 Proposal presumes a level of access to basic downstream information that simply does not exist because of antitrust, competitive and operating reasons beyond the control of a lessee. What the MMS should do is revise its existing regulations to provide workable and reasonable valuation procedures and make full use of royalty-in-kind to avoid this unnecessary problem.

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[48] For example, §§3 and 41(I) of the Interstate Commerce Act prohibit a covered common carrier pipeline from discriminating in favor of one shipper over its other shippers; indeed, §41(I) makes such discriminatory conduct a criminal offense. A common carrier generally has no reason to provide detailed information concerning its actual costs for any pipeline movement to all of its shippers and it cannot provide that information to any one shipper.

Before the United States
Department of the Interior
Minerals Management Service

American Petroleum Institute and Western States Petroleum Association Comments on Minerals Management Service Supplementary Proposal for Valuation of Crude Oil Produced on Federal Leases

63 FR 6113 (February 6, 1998)
30 CFR Part 206

Volume II - Attachments

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April 3, 1998

Counsel for
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List of Attachments

Attachment A	"Establishing Oil Value for Royalty Due on Federal Leases," 30 CFR Part 206, 63 FR 6113 (February 6, 1998).
Attachment B	"Federal Crude Oil Valuation Rulemaking," MMS Congressional Briefings, February 1998.
Attachment C	"MMS Proposes Further Amendments to Federal Crude Oil Valuation Rule," MMS News Release, February 5, 1998.
Attachment D	"Analysis of the Department of Interior, Minerals Management Service's Request for Extension of the Existing Collection Authority for Form MMS-2014," Barents Group, March 6, 1998.
Attachment E	"Analysis of the Department of Interior, Minerals Management Service's Form MMS-4415 under the Supplementary Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases under the Paperwork Reduction Act," Barents Group, March 10, 1998.
Attachment F	"How Will Royalty Value Be Calculated under MMS Proposed Rule?"

Attachment A

"Establishing Oil Value for Royalty Due on Federal Leases," 30 CFR Part 206, 63 FR 6113 (February 6, 1998).

repeal of Commission Regulation 33.4(a)(2) which requires the full upfront payment of commodity option premiums. The proposed repeal was initially published for comment on December 19, 1997 (62 FR 66569) with comments on the proposal due by February 2, 1998. The effect of the repeal would be to permit the futures-style margining of commodity options traded on regulated futures exchanges and is discussed in the initial notice of proposed rulemaking. In order to give those persons affected by the proposed repeal sufficient time to fully assess its ramifications, the Commission has determined to extend the comment period on this proposal for an additional 30 days. The extended deadline for comments on this proposed rulemaing is March 4, 1998.

Any person interested in submitting written data, views, or arguments on the proposal should submit their views and comments by the specified date to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581. In addition, comments may be sent by facsimile transmission to facsimile number (202) 418-5521, or by electronic mail to secretary@cftc.gov.

DATES: Comments must be received on or before March 4, 1998.

FOR FURTHER INFORMATION CONTACT: Thomas Smith, Attorney, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. Telephone: (202) 418-5495.

Issued in Washington, D.C., on this 2nd day of February, 1998, by the Commodity Futures Trading Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 98-3073 Filed 2-5-98; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Part 206

RIN 1010-AC09

Establishing Oil Value for Royalty Due on Federal Leases

AGENCY: Minerals Management Service, Interior.

ACTION: Supplementary proposed rule.

SUMMARY: The Minerals Management Service (MMS) is proposing further changes to its proposed rules amending the regulations governing the royalty valuation of crude oil produced from Federal leases. MMS is seeking comments on this proposed rulemaking that includes changes resulting from comments received on oil valuation proposals published in the **Federal Register** and at several hearings and workshops.

DATES: Submit comments on or before March 23, 1998.

ADDRESSES: Send your written comments to David S. Guzy, Chief, Rules and Publications Staff, Royalty Management Program, Minerals Management Service, P.O. Box 25165, MS 3021, Denver, Colorado 80225-0165; or e-Mail David_Guzy@mms.gov.

FOR FURTHER INFORMATION CONTACT: David S. Guzy, Chief, Rules and Publications Staff, Royalty Management Program, Minerals Management Service, telephone (303) 231-3432, fax (303) 231-3385, or e-Mail David_Guzy@mms.gov.

SUPPLEMENTARY INFORMATION: The principal authors of this proposed rule are David A. Hubbard, Charles Brook, and Deborah Gibbs Tschudy of the Royalty Management Program (RMP) and Peter Schaumberg and Geoff Heath of the Office of the Solicitor in Washington, D.C.

MMS is specifying a deadline for comments that is less than the 60 days recommended by Executive Order No. 12866. MMS believes that a 45 day comment period is appropriate in this instance, because it previously extended and reopened the comment periods for several earlier proposed versions of this rule. MMS also held numerous workshops across the country to obtain public input on this proposed rulemaking. MMS is also planning to hold several hearings during the 45-day comment period to give interested parties the opportunity to fully discuss and comment on this supplementary proposed rule. MMS will publish specific dates and locations for the hearings in the **Federal Register**. MMS will consider comments filed beyond the deadline to the extent practicable.

I. Background

MMS first published notice of its intent to amend the current Federal oil valuation regulations, which appear in 30 CFR part 206, on December 20, 1995 (60 FR 65610). The goal of this rulemaking effort is to decrease reliance on oil posted prices, develop valuation rules that better reflect market value, and add more certainty to valuing oil produced from Federal lands.

The proposed amendments are brought about by changes in the domestic petroleum market. Oil postings traditionally represented prices oil purchasers were willing to pay for particular crude oils in specific areas. Because they often provided the basis for prices in arm's-length transactions, MMS generally considered them representative of market value. Consequently, MMS heavily relied on them for royalty valuation. However, recent studies commissioned by States and an analysis performed for MMS by an interagency task force ("Final Interagency Report on the Valuation of Oil Produced from Federal Leases in California," May 16, 1996) concluded that the postings used by most companies are considerably less than the true market value of oil. These studies also indicated that integrated oil companies rarely sell crude oil at the lease. Instead, they rely on various exchange arrangements, which do not always reference a price, to transfer oil to refineries. Even where exchange agreements reference a price, the transaction's purpose is to exchange oil for oil rather than money for oil; therefore, MMS cannot rely on the price stated to be reflective of actual market value.

Based on these studies and subsequent MMS audits and investigations, MMS believes that the current benchmarks used to value Federal oil not sold at arm's length, which rely heavily on posted prices, no longer result in reflecting the market value of the oil.

On January 24, 1997, MMS published its initial notice of proposed rulemaking to amend the current Federal crude oil valuation regulations (62 FR 3742). The comment period on this proposal ended March 25, 1997, but was twice extended to April 28, 1997 (62 FR 7189), and May 28, 1997 (62 FR 19966). We also held public meetings in Lakewood, Colorado, on April 15, 1997, and Houston, Texas, on April 17, 1997, to hear comments on the proposal.

In response to the variety of comments received on the initial proposal, particularly with regard to the limitations on using arm's-length gross proceeds as value, we published a supplementary proposed rulemaking on July 3, 1997 (62 FR 36030). The comment period on this proposal closed August 4, 1997.

Because comments on both proposals were substantial, we reopened the public comment period on September 22, 1997 (62 FR 49460), and requested comments on alternatives suggested by commenters before proceeding with the rulemaking. The initial comment period for this request closed October 22, 1997, and was extended to November 5, 1997

(62 FR 55198). We held public workshops to discuss valuation alternatives in Lakewood, Colorado, on September 30 and October 1, 1997 (62 FR 50544); Houston, Texas, on October 7, 8, and 14, 1997 (62 FR 50544); Bakersfield, California, on October 16, 1997 (62 FR 52518); Casper, Wyoming, on October 16, 1997 (62 FR 52518); Roswell, New Mexico, on October 21, 1997 (62 FR 52518); and Washington, D.C. on October 27, 1997 (62 FR 55198).

After reviewing over 2,600 pages of comments along with records of the workshops and public meetings, MMS has decided to issue another supplementary proposed rule. This rule maintains the concept of "index" pricing but allows for the use of indicies closer to the lease and recognizes geographical differences in the marketplace, all points raised by commenters in response to our earlier proposed rulemakings. This rule is intended as another of the processes to develop a rule that meets the needs of the varied constituents.

However, because we are still in the deliberative process, in this rulemaking, MMS is not responding to the individual comments made on the five alternatives or on the previous proposals. Once MMS decides on a framework for a final rule, we intend to thoroughly respond to all comments received. For this reason, it is not necessary for commenters to resubmit earlier comments.

II. Summary of Public Comments

This further supplementary proposed rulemaking results from the comments received in response to the January 24, July 3, and September 22, 1997, notices and from comments made at the public workshops. We summarized the comments received on the January 24 and July 3, 1997, proposals in the September 22, 1997, notice. We summarize the comments received on the September 22, 1997, notice here.

Because of the numerous comments from both States and industry questioning the use of New York Mercantile Exchange (NYMEX) prices as the basis for valuing crude oil not sold under arm's-length contracts, we posed five alternatives, suggested by the commenters, in the September 22, 1997, notice to value "non-arm's-length" oil: (1) A value based on prices received under bid-out or tendering programs; (2) a value determined from benchmarks using arm's-length transactions, royalty-in-kind (RIK) sales, or a netback method; (3) a value based on geographic indexing using MMS's own system data, but excluding posted prices; (4) a value based on index (NYMEX and ANS) prices but using fixed-rate differentials; and (5) a value using published spot prices instead of NYMEX prices. With regard to Alternatives 1, 2, and 3, we also asked whether the Rocky Mountain Area should have separate and specific valuation standards.

We received 28 written comments from independent oil and gas producers, major oil and gas companies, petroleum industry trade associations, States, a municipality, a government oversight group, and a royalty owner. Sixty individuals provided commentary at the public workshops. The summary of comments follows.

Alternative 1—Bid-Out or Tendering Program

Industry and some States supported tendering as a viable alternative to determine value at the lease. They assert that the prices received under tendering transactions were evidence of market value at or near the lease. However, industry cautioned that tendering would not be applicable in every situation (it would be too expensive for some companies to develop and administer) and should be only used as one of several alternatives available for valuation. In fact, two commenters noted that tender-based valuation was not feasible in California because no one is presently engaged in tendering programs in that State. To be acceptable for valuing the lessee's non-arm's-length production, one commenter recommended that the minimum tendered volume should be MMS's royalty share plus 2 percent, or if transported by a truck or tank car, a volume equal to a full load. Another commenter recommended 10 to 20 percent as the minimum volume, with a minimum of three bids.

Alternative 2—Benchmarks

Industry and some States generally supported some form of benchmark system based on actual arm's-length or affiliate resale prices, RIK prices, or a netback method using an index price to value non-arm's-length oil. (Nonetheless, many commenters remained opposed to NYMEX- and ANS-based pricing.) Industry, however, advocated that lessees be permitted to select the valuation method best suited to their situation; in other words, they wanted the benchmarks to be a menu, rather than a hierarchy. States objected to this selection concept. Industry also urged MMS to abandon the requirement that royalty value is the greater of the lessee's gross proceeds or the benchmark value.

One State recommended separate valuation standards for lessees with affiliated refiners and those without. That State also recommended, for the Rocky Mountain region only, that lessees with affiliated refiners determine value by benchmarks using tendered prices, lease-based comparable sales, and netback from spot price. It further recommended, for all lessees without affiliated refiners who sell their oil non-arm's-length, that value be based on the oil's resale price. Industry objected to this affiliated-refiners distinction because they stated not all integrated producers sell or transfer their oil production to their affiliated refiner.

For netback valuation, industry urged MMS to recognize all costs associated with midstream marketing as allowable deductions from the index or resale price. However, one State commenter argued that industry has failed to demonstrate any entitlement to a marketing deduction as a matter of law or fact, citing, for example, that midstream marketing costs are already factored into transportation tariffs and location differentials.

Two commenters representing State of California interests objected to any benchmark valuation scheme for that State. They argued that the California crude oil market is not competitive. Thus, they believed that any non-arm's-length valuation scheme based on arm's-length prices would not reflect true market value. They maintained that ANS prices are the only viable method of valuing crude oil in California.

Alternative 3—Geographic Indexing

Most commenters believed the proposed geographic indexing method would be unworkable. They mainly objected to the time difference between the production month and publication of the index price. They argued that the published indices always would be out of date and require unnecessary adjustments to prior reporting months.

Alternative 4—Differentials

In concert with their objections to basing value on index (NYMEX and ANS) prices, industry commenters opposed using any fixed (or other) differentials without deductions for midstream marketing activities. Specifically for California, two commenters representing State interests urged MMS to use the gravity factor in the Four Corners and All America Pipeline tariffs to adjust for quality differences between ANS and California crude oils. For location differentials, they reiterated their position that the only relevant information is from "in/out" exchanges. As an option to determining separate location differentials for the various California

aggregation points/market center pairs, they proposed fixed-rate differentials for given geographic zones.

Alternative 5—Spot Prices

Comments on the proposed spot price methodology were mixed. Some commenters thought it was a workable approach, indicating that the net result would be the same as starting with a NYMEX price and adjusting back to the lease. A few commenters noted that spot prices are published only for a limited number of domestic crude oils, and no reliable spot prices are published for the Rocky Mountain Area. One commenter questioned the accuracy of the reported prices. Industry commenters remained concerned with the disallowance of marketing costs in using spot prices, but in general, preferred spot prices to NYMEX.

Rocky Mountain Area

There was general consensus among commenters that the Rocky Mountain Area exhibited particular oil marketing characteristics that would justify different royalty valuation standards. Production is controlled by relatively few companies in the Rocky Mountain Area. The number of buyers is also more limited than in the Texas, Gulf Coast, or Mid-continent areas and there are limited third party shippers and less competition for transportation services in this area. Finally, there is less spot market activity and trading in this area as a result of this control over production and refining and because crude oil production is smaller and more diffuse than in the Gulf Coast and Permian Basin areas. Some commenters, both industry and State, supported the notion of separate valuation standards for the region. Others, however, disagreed with any regional separation, preferring instead a single, nationwide, lease-based valuation scheme or menu of benchmarks.

III. Section-by-Section Analysis

The content of many of the sections has not changed significantly from the January 1997 notice of proposed rulemaking, but we rewrote the proposed rule to better reflect plain English. We also added and renumbered sections and further reorganized the rule for readability. This preamble focuses primarily on those sections whose content we significantly changed. While the preambles of the January 1997 proposed rule and the July 1997 supplementary proposed rule discuss earlier changes, this preamble highlights changes that have been made as a result of comments received throughout this rulemaking. Note that the renumbering and reorganization resulted in the following modifications to the previous proposals:

Section	Modification
§§ 206.100 and 206.101	Revised.
§ 206.102	Revised and redesignated as §§ 206.102, 206.103, 206.104, 206.105, 206.106, 206.107, and 206.108.
§§ 206.103 and 206.104	Redesignated as §§ 206.122 and 206.109, respectively.
§ 206.105	Revised and redesignated as §§ 206.110, 206.111, 206.116, 206.117, 206.119, 206.120, and 206.121.
§ 206.106	Revised and redesignated as § 206.123.
New §§ 206.112, 206.113, 206.114, 206.115, and 206.118.	Added.

In addition, all sections of the existing rule not previously proposed to be revised were rewritten in plain English so the entire rule would read consistently.

Before proceeding with the section-by-section analysis, it is necessary to explain the conceptual framework of the proposed rule. When crude oil is produced, it is either sold at arm's length or is refined without ever being sold at arm's length. If crude oil is exchanged for other crude oil at arm's length, the oil received in the exchange is either sold at arm's length or is refined without ever being sold at arm's length. Under this proposed rule, oil that ultimately is sold at arm's length before refining generally will be valued based on the gross proceeds accruing to the seller under the arm's-length sale. (The few exceptions reflect particular circumstances in which MMS believes the arm's-length sale does not or may not reliably reflect the real value.) Similarly, if oil is exchanged at arm's length and the oil received in exchange is ultimately sold at arm's length, the value of the oil produced will be based on the arm's-length sale of the oil received in exchange, with appropriate adjustments. If oil (or oil received in exchange) is refined without being sold at arm's length, then the value will be based on appropriate index prices or other methods, as explained below.

These principles apply regardless of whether oil is sold or transferred to one or more affiliates or other persons in non-arm's-length transactions before the arm's-length sale, and regardless of the number of those non-arm's-length transactions. They also apply regardless of how many arm's-length exchanges have occurred before an arm's-length sale. Lessees and producers may structure their business arrangements however they wish, but MMS would look to the ultimate arm's-length disposition in the open market as the best measure of value. Similarly, if oil is refined without being sold at arm's length, MMS believes that the valuation methods prescribed in this proposed rule are the best measures of value regardless of internal, inter-affiliate, or other non-arm's-length transfers.

Another important concept of the proposed rule is that MMS is proposing separate valuation procedures for California/Alaska, the Rocky Mountain Area, and the rest of the country. In California and Alaska, if oil is not sold under an arm's-length contract, value would be based on ANS spot prices, adjusted for location and quality. MMS chose this indicator because it believes, as the interagency task force concluded, that ANS is the best measure of market value in that area when oil is not sold at arm's length. In the Rocky Mountain Area, if oil is not sold under an arm's-length contract, market value is more difficult to measure because of the isolated nature of the Area from the major oil market centers. Therefore, MMS is proposing to accept values established by a company-administered tendering program as the first benchmark. In cases where tendering does not happen or it does not meet our requirements, the second benchmark would be a weighted-average of arm's-length sales and purchases exceeding 50 percent of the lessee's and its affiliate's production in the field or area. NYMEX with location and quality adjustments would be used as the third benchmark, because no acceptable published spot price exists in the Rocky Mountain

Area. For other areas, value would be based on the nearest spot price, adjusted for quality and location. MMS believes that because the spot market is so active in areas other than the Rocky Mountain Area, it is the best indicator of value. MMS chose spot prices over NYMEX because studies indicated that when the NYMEX futures price, properly adjusted for location and quality differences, is compared to spot prices, it nearly duplicates those spot prices. Further, application of spot prices would remove one portion of the necessary adjustments to the NYMEX price—the leg between Cushing, Oklahoma, and the market center location.

Proposed Section 206.100 What is the Purpose of this Subpart?

This section includes the content of the existing section except for minor wording changes to improve clarity. We have added some further language clarifying the respective roles of lessees and designees. (Those terms are defined in the proposed § 206.101, and those definitions follow the definitions contained in section 3 of the Federal Oil and Gas Royalty Management Act, 30 U.S.C. 1702, as amended by section 2 of the Federal Oil and Gas Royalty Simplification and Fairness Act, Pub. L. No. 104–185, 110 Stat. 1700.)

Specifically, if you are a designee and you or your affiliate dispose of production on behalf of a lessee, references to "you" and "your" in the proposed rule refer to you or your affiliate. In this event, you must report and pay royalty by applying the rule to your and your affiliate's disposition of the lessee's oil. If you are a designee and you report and pay royalties for a lessee but do not dispose of the lessee's production, the references to "you" and "your" in the proposed rule refer to the lessee. In that case, you as a designee would have to determine royalty value and report and pay royalty by applying the rule to the lessee's disposition of its oil. Some examples will illustrate the principle.

Assume that the designee is the unit operator, and that the operator sells all of the production of the respective working interest owners on their behalf and is the designee for each of them. For each of those working interest owners, the operator, as designee, would report and pay royalties on the basis of the operator's disposition of the production. For example, if the operator transferred the oil to its affiliate, who then resold the oil at arm's length, the royalty value would be the gross proceeds accruing to the designee's affiliate in the arm's-length resale under proposed § 206.102, as explained further below.

Alternatively, assume the operator is the designee but a lessee disposes of its own production. Assume the lessee transfers its oil to an affiliate, who then resells the oil at arm's length. In this case, the operator would have to obtain the information from the lessee, and report and pay royalties on the basis of the gross proceeds accruing to the lessee's affiliate in the arm's-length resale under proposed § 206.102.

In some cases, the designee is the purchaser of the oil. Assume the operator disposes of the lessee's oil and that the operator is not affiliated with the designee-purchaser. Because the lessee's sale to the designee is an arm's-length transaction, then under § 206.102 the designee would report and pay royalty on the total consideration (the gross proceeds) it paid to the lessee.

Proposed Section 206.101 Definitions

The definitions section remains largely the same as in the January 1997 notice of proposed rulemaking. However, MMS made several additions and clarifications consistent with changes in this further supplementary proposed rule.

Specifically, the July 3, 1997, supplementary proposed rule (62 FR 36030) added a definition of *non-competitive crude oil call* to help describe circumstances under which crude oil sales proceeds could be used for royalty valuation. We incorporated a simplified version of that definition in this further supplementary proposed rule, as well as a new definition of *competitive crude oil call* to assist in understanding the differences between these two contract terms.

We modified the definition of *arm's-length contract* to remove the criteria for determining affiliation. Instead, these criteria would be included in the new definition of *affiliate* discussed below.

We also modified the definition of *exchange agreement* to delete the statement that exchange agreements do not include agreements whose principal purpose is transportation. MMS believes that transportation exchanges, while having different purposes than other types of exchanges, properly should be included under the generic definition of exchange agreements.

We also modified the definition of *gross proceeds* to clarify that they would include payments made to reduce or buy down the purchase price of oil to be produced later. The concept that such payments are part of gross proceeds was included in the January 1997 proposed rulemaking at § 206.102(a)(5). Moving this provision directly to the gross proceeds definition not only further clarifies the components of gross proceeds, but also makes the structure of this further supplementary proposed rule more logical.

Also, since this further supplementary proposed rule would apply spot prices for crude oil other than Alaska North Slope oil as a valuation basis in some cases, we changed the definitions of *index pricing* and *MMS-approved publication* to include other spot prices.

Finally, we added four new definitions of terms used in this further supplementary proposed rule. They are *affiliate, prompt month, Rocky Mountain Area*, and *tendering program*.

MMS requests comments on the *Rocky Mountain Area* definition. Specifically, are there other States or regions that should be included in this definition and, conversely, are there States or regions that should be deleted? For example, although some participants in MMS's workshops believed the entire State of New Mexico belongs outside the Rocky Mountain Area for purposes of applying this rule, others believed that oil marketing in the northwest portion of New Mexico is similar to that in the other Rocky Mountain States. Some commenters suggested that northwest New Mexico (not including the Permian Basin) more appropriately should be included in the Rocky Mountain Area. MMS has excluded New Mexico from the proposed definition but would like comments on this issue.

MMS also requests any other comments you may have on these proposed new and revised definitions.

Proposed Section 206.102 How Do I Calculate Royalty Value for Oil That I or My Affiliate Sell Under an Arm's-Length Contract?

In an effort to improve the organization and readability of the proposed rule, § 206.102 as written in the January 1997 proposed rule and the July 1997 supplementary proposed rule would be revised and reorganized. We propose to revise § 206.102 to specifically address valuation of oil ultimately sold under arm's-length contracts. That sale may occur in the first instance, or may follow one or more non-arm's-length transfers or sales of the oil or one or more arm's-length exchanges.

Paragraph (a) would state that value is the gross proceeds accruing to you or your affiliate under an arm's-length contract, less applicable allowances. This also includes oil you sell in exercising a competitive crude oil call. Similarly, if you sell or transfer your Federal oil production to some other person at less than arm's length, and

that person or its affiliate then sells the oil at arm's length, royalty value would be the other person's (or its affiliate's) gross proceeds under the arm's-length contract. For example, a lessee might sell its Federal oil production to a person who is not an "affiliate" as defined, but with whom its relationship is not one of "opposing economic interests" and therefore is not at arm's length. An illustrative example would be a number of working interest owners in a large field forming a cooperative venture that purchases all of the working interest owner's production and resells the combined volumes to a purchaser at arm's-length. The sale proceeds then would be distributed proportionately to those persons who contributed volumes. *Xeno, Inc.*, 134 IBLA 172 (1995), involved a similar situation in the context of a gas field. If no one of the working interest owners owned 10 percent or more of the new entity, the new entity would not be an "affiliate" of any of them. Nevertheless, the relationship between the new entity and the respective working interest owners would not be at arm's length. In this instance, it would be appropriate to value the production based on the arm's-length sale price the cooperative venture received for the oil.

In all these circumstances you would be required to value the production based on the gross proceeds accruing to you, your affiliate, or other person to whom you transferred the oil when the oil ultimately was sold at arm's length.

Proposed paragraph (b) would clarify how to value your oil when you sell or transfer it to your affiliate or to another person, and your affiliate, the other person, or an affiliate of either of them sells the oil at arm's-length under multiple arm's-length contracts. In this case, value would be the volume-weighted average of the values established under § 206.102 for each contract.

However, paragraph (c), which replaces paragraph (a)(1) from the January 1997 proposed rule, specifies several exceptions to the use of arm's-length gross proceeds. As stated in the July 1997 supplementary proposed rule, it would also require you to apply the exceptions to each of your contracts individually. For example, you may have multiple arm's-length and non-arm's-length exchange agreements involving your Federal oil production. Depending on its ultimate disposition under each exchange agreement, you might value some of the production under § 206.102 and some under § 206.103.

Proposed paragraphs (c)(1) and (c)(2) would replace paragraphs (a)(2) and (a)(3) from the January 1997 proposed rule. Although the wording changes slightly, the content remains the same. Note, however, that in the supplementary proposed rule of July 3, 1997, a proposed revision under paragraph (a)(4)(ii) said that where an arm's-length contract price does not represent market value because an overall balance between volumes bought and sold is maintained between the buyer and seller, royalty value would be calculated as if the sale were not arm's length. MMS decided to remove that language as a specific, separate provision. Rather, in considering whether an arm's-length contract reflects your or your affiliates' total consideration or market value (proposed paragraphs (c)(1) and (c)(2)), MMS also would examine whether the buyer and seller maintain an overall balance between volumes they bought from and sold to each other. Under these paragraphs, if an overall balance agreement is found to exist, you would be required to value your production under § 206.103 or the total consideration received, whichever is greater.

In the supplementary proposed rule of July 3, 1997, MMS proposed to modify paragraph (a)(4) of the January 1997 proposed rule regarding exchange agreements and crude oil calls. It also proposed a new paragraph (a)(6) regarding exchange agreements. See the preamble to the supplementary proposed rule at 62 FR 36031 for a complete explanation of the changes proposed. In this further supplementary proposed rule, we have further modified the exchange agreement language at paragraphs (a)(4)(i) and (a)(6) of the supplementary proposed rule and combined it in paragraph (c)(3). Revised paragraph (c)(3) would require you to use § 206.103 to value oil you dispose of under an exchange agreement. But if you enter into one or more arm's-length exchange agreements, and after these exchanges you or your affiliate dispose of the oil in an arm's-length sale, you would value the oil under paragraph (a) on the basis of the gross proceeds received under the arm's-length contract for the sale of the oil received in exchange. You would adjust the value determined under paragraph (a) for location or quality differentials or any other adjustments you receive or pay under the arm's-length exchange agreement(s). However, if MMS finds that any such differentials or adjustments aren't reasonable, it could require you to value the oil under § 206.103.

This concept is similar to paragraph (6)(i) of the July 1997 supplementary proposed rule, but with three differences. First, the July language referred to exchange agreements with a person not affiliated with you. The revision proposed here would expand coverage to arm's-length exchange agreements. This means that not only must you be unaffiliated with your exchange partner, but there must be opposing economic interest regarding the exchange agreement. MMS believes this would limit instances where inappropriate or unreasonable location, quality, or other adjustments would be applied. MMS proposes to limit this provision to arm's-length exchanges because it believes transportation, location, and quality differentials stated in non-arm's-length exchange agreements are not reliable.

Second, MMS proposes to clarify that the same valuation procedure would apply if there is more than one arm's-length exchange. For example, if you enter into two sequential arm's-length exchanges for your Federal oil production and then you or an affiliate sell the reacquired oil at arm's length, you would value your production under paragraph (a). MMS believes that as long as the integrity of the differentials and adjustments is maintained, there is no reason not to look to the ultimate arm's-length sale proceeds.

Third, under paragraph (a)(6)(i) of the supplementary proposed rule, if you disposed of your oil under an exchange agreement with a non-affiliate and after the exchange you sold the acquired oil at arm's length, you could have elected to value your oil either at your gross proceeds or under index pricing. MMS proposes to eliminate this option. We believe that the actual arm's-length disposition should govern valuation. That is, the provisions of §§ 206.102 or 206.103 should be applied according to your actual circumstances. This change also leads to the deletion of the previously-proposed paragraph (a)(6)(iii), which related to the election we now propose to eliminate.

As a result of the changes discussed above, MMS also proposes to eliminate paragraph (a)(6)(ii) of the July 1997 supplementary proposed rule. This paragraph would have required you to use index pricing if you either transferred your oil to an affiliate before the exchange occurred, transferred the oil you received in the exchange to an affiliate, or entered into a second exchange for the oil you received back under the first exchange. We have already discussed the permissibility of multiple exchanges under this further supplementary proposed rule. Our reasoning for eliminating the rest of paragraph (a)(6)(ii) of the July 1997

supplementary proposed rule is that if you transfer your production to an affiliate and the affiliate then enters into an arm's-length exchange and sells the oil received in the exchange at arm's length, the arm's-length proceeds should be the measure of value. Likewise, if you enter an arm's-length exchange but then transfer the oil received to an affiliate who resells the oil at arm's length, the arm's-length proceeds should be the measure of value. For any exchanges where the oil received in return is not resold but instead is refined, index prices would apply as discussed under § 206.103.

Proposed paragraph (c)(4) would remain essentially the same as paragraph (a)(4)(iii) of the supplementary proposed rule. It states that you must use § 206.103 to value oil you dispose of in exercising a non-competitive crude oil call. In response to the supplementary proposed rule and in MMS's public workshops, commenters asserted that in many instances producers negotiate competitive prices even if a non-competitive call provision exists and a call on production is exercised. However, we continue to believe that if your purchaser exercises a non-competitive call, you could not effectively demonstrate that the price received is competitive and that value should be determined using index pricing.

Paragraph (a)(5) of the January 1997 proposed rule dealt with inclusion in gross proceeds of payments made to reduce or buy down the price of oil to be produced in later periods. We removed this paragraph in this further supplementary proposed rulemaking but added the concept within the definition of *gross proceeds* as discussed above.

Currently-proposed § 206.102 (d), *What else must I do if I value oil under paragraph (a)?*, has the same content as § 206.102 (b) of the January 1997 proposed rule. A minor difference is a clarification that you must be able to demonstrate that an exchange agreement, as well as a contract, is arm's length. Also, since this further supplementary proposed rule would require arm's-length gross proceeds as royalty value regardless of whether the lessee or an affiliate or another arm's-length purchaser is the person who ultimately sells at arm's length, all of these persons come within the term "seller."

Proposed Section 206.103 How Do I Value Oil That I Cannot Value Under § 206.102?

This section would replace § 206.102(c) of the January 1997 proposed rule. It deals specifically with valuation of oil you cannot value under § 206.102 because the oil is not ultimately sold at arm's length or because it is otherwise excepted under § 206.102.

One change from the January 24, 1997, proposal would apply where value is based on index prices. In MMS' initial proposal, where either NYMEX or spot prices were applied in valuation, the prices for the month following the lease production month were used. This was meant to reflect the fact that NYMEX futures prices for the prompt month, as well as spot prices for the next month, are determined *during* the month of production. MMS believed this best reflected market value at the time of production. However, various commenters asserted that, for application of spot or futures prices, the lease production month should coincide with the spot or futures *delivery* month. This would effectively match production to index prices for deliveries in the same month. Although we believe the effects of such a change over time would be minimal, we now propose to change the timing of application of index prices so that the lease production month and the spot or futures delivery month would coincide.

Also, § 206.102(c)(1) of the January 1997 proposed rule would have permitted you an option if you first transferred your oil production to an affiliate and that affiliate or another affiliate disposed of the oil under an arm's-length contract. The option was to value your oil at either the gross proceeds accruing to your affiliate under its arm's-length contract or the appropriate index price. But this option is not available in this further supplementary proposed rule. MMS believes that where arm's-length transactions satisfying the provisions of proposed § 206.102 occur, royalty value should be the arm's-length gross proceeds. Otherwise, the provisions of this proposed § 206.103 should apply directly. This process would remove some uncertainty among lessees about how and when to apply this section. More importantly, MMS believes this process best reflects the actual value of the oil.

Another change from January proposed rule is an additional geographic breakdown for valuation purposes. The original proposed rule included separate valuation procedures for California/Alaska and the rest of the country. But based on the various written comments MMS received in response to its January, July, and September 1997 rulemaking notices, and comments made at the various valuation workshops, it became apparent that oil marketing and valuation in the Rocky Mountain Area is significantly different from other areas.

Also, the only published spot price in the Rocky Mountain Area is at Guernsey, Wyoming. Commenters consistently maintained that the spot price there is thinly traded. The combination of geographical remoteness from midcontinent markets, unique marketing situations, and the lack of a meaningful published spot price led MMS to add the Rocky Mountain Area as a third royalty valuation area. MMS requests comments on the revised geographical breakdown for valuation purposes, as well as the composition of the *Rocky Mountain Area*.

Proposed § 206.103(a) would apply to production from leases in California or Alaska. It would replace § 206.102(c)(2)(ii) of the January 1997 proposed rule. The only differences in this further supplementary proposed rule are a more direct explanation of how to calculate the spot prices and a clarification that the applicable spot prices are those published during the month preceding the production month. To calculate the daily mean spot prices, you would average the published daily high and low prices for the applicable month, only using the days and corresponding prices for which spot prices are published. You would not include weekends, holidays, or any other days when spot prices are not published. For example, assume the month preceding the production month has 31 days, including 8 weekend days and a holiday, and the publication publishes spot prices for all other days. You would average together the published high and low spot prices for each of the 22 remaining days.

Proposed § 206.103(b) would apply to production from leases in the Rocky Mountain Area, a defined term. As discussed above, production in the Rocky Mountain Area is controlled by relatively few companies and the number of buyers is more limited than in the Texas, Gulf Coast, or Mid-contintent areas. As a result, there is less spot market activity and trading in this area due to the control over production and refining. For these reasons, we derived the following valuation hierarchy for Rocky Mountain Area:

(1) If you have an MMS-approved tendering program (a defined term), the value of production from leases in the area the tendering program covers would be the highest price bid for tendered volumes. Under tendering program you would have to offer and sell at least 33⅓ percent of your production from both Federal and non-Federal leases in that area. You also would have to receive at least three bids for the tendered volumes from bidders who do not have their own tendering programs that cover some or all of the same area.

To ensure receipt of market value under tendering programs, MMS proposes the several qualifications listed above. First, royalty value must be the highest price bid rather than some other individual or average value. Second, you must offer and sell at least 33⅓ percent of your production from both Federal and non-Federal leases in that area. The rationale for this minimum percentage is to ensure that the lessee puts a sufficient volume of its own production share up for bid to minimize the possibility that it could "game" the system for Federal royalty or State tax payment purposes. MMS chose the 33⅓ percent figure because it exceeds the typical combined Federal royalty rate and effective composite State tax and royalty rates for onshore oil leases by roughly 10 percent. Likewise, the tendering program would be required to include non-Federal lease production volumes in the 33⅓ percent determination to ensure that the program isn't aimed at limiting Federal royalty value.

Third, to ensure receipt of competitive bids, your tendering program must result in at least three bids from bidders who do not have their own tendering programs covering some or all of the same area. MMS believes that requiring a minimum number of bidders is needed to ensure receipt of market value. Further, MMS is concerned about the possibility of cross-bidding between companies at below-market prices, which could otherwise satisfy the minimum number of bidders requirement. That is why we added the stipulation that bids must come from bidders who do not also have their own tendering programs in the area.

MMS requests comments on use of tendering programs in general in establishing royalty value. Also, please provide comments on the proposed specific qualifications. Should we limit qualified bids to those who do not have tendering programs *anywhere*, and not just in the same area? Should a tendering program be a first or second benchmark? Please provide any related comments you may have.

(2) Under the second criterion, which would apply only if you could not use the first criterion, value would be the volume-weighted average gross proceeds accruing to the seller under your or your affiliates' arm's-length contracts for the purchase or sale of production from the field or area during the production month. The total volume purchased or sold under those contracts must exceed 50 percent of your and your affiliates' production from both Federal and non-Federal leases in the same field or area during that month.

MMS proposes this method as the next alternative if a qualified tendering program does not exist. It is an effort to establish value based on actual transactions by the lessee or its affiliate(s). We received a number of comments during the public workshops that MMS should look not only to sales by the lessee, but also purchases a lessee or its affiliates make in the field or area. Just as for the tendering program, MMS believes a floor of the lessee's and its affiliates' production should be set to prevent any "gaming." The 50 percent minimum figure is not necessarily a higher standard than the 33⅓ percent floor associated with the tendering program, because it applies to the lessee's and its affiliates' sales *and* purchases in the field or area. For example, Company A produces 10,000 barrels of crude oil in a given field during the production month. Company A sells 1,000 barrels under an arm's-length contract. Company A also has a refining affiliate, Company B, that purchases the remaining 9,000 barrels of Company A's production and 5,000 barrels of oil under arm's-length purchase contracts with other producers in the same field. Together the arm's-length sales by Company A and the arm's-length purchases by Company B are 6,000 barrels, or 60 percent of the lessee's and its affiliates' production in the field that month. The volume-weighted arm's-length gross proceeds accruing to Company A and paid by Company B for these 6,000 barrels represents royalty value for the 9,000 barrels of Company A's Federal lease production in the field that cannot be valued under § 206.102.

MMS proposes using the unadjusted volume-weighted average gross proceeds accruing to the seller in all of the lessee's or its affiliates' arm's-length sales or purchases, not just those that may be considered comparable by quality or volume. We believe that production in the same field or area generally will be similar in quality. Further, given that these sales and purchases must be greater than 50 percent of all of the lessee's production in the field or area, we believe that it is not necessary to distinguish comparable contracts.

(3) If you could not apply either of the first two criteria, the value would be the average of the daily NYMEX futures settle prices at Cushing, Oklahoma, for the light sweet crude oil contract for the prompt month that is in effect on the first day of the month preceding the production month. You would use only the days and corresponding NYMEX prices for which such prices are published. You must adjust the value for applicable location and quality differentials, and you may adjust it for transportation costs, under § 206.105(c) of this subpart.

This paragraph essentially duplicates § 206.102(c)(2)(i) of the January 1997 proposed rule. The only real difference is that we correlated the NYMEX futures delivery month with the production month as discussed earlier. As described for the spot price calculations for California and Alaska, you would use only the days for which NYMEX futures prices are published. MMS proposes to make this the third method, to be used only if the first two do not apply, because of distances between Rocky Mountain Area locations and Cushing, Oklahoma, and the additional difficulties in deriving location/quality differentials.

(4) If you should demonstrate to MMS' satisfaction that paragraphs (b)(1) through (b)(3) result in an unreasonable value for your production as a result of circumstances regarding that production, the MMS Director could establish an alternative valuation method.

MMS proposes this method as the last alternative, to be used only in very limited and highly unusual circumstances. We also propose that there should be very few such alternative valuation methods and each one should be subject to careful review.

Proposed § 206.103(c) would apply to production from leases not located in California, Alaska, or the Rocky Mountain Area. MMS proposes to modify § 206.102(c)(2)(i) of the January 1997 proposed rule that applied to locations other than California and Alaska. That paragraph would have required you to value your oil at the average daily NYMEX futures settle prices. This further supplementary proposed rule would state that value is the average of the daily mean spot prices:

(1) For the market center nearest your lease where spot prices are published in an MMS-approved publication;

(2) For the crude oil most similar in quality to your oil (for example, at the St. James, Louisiana, market center, spot prices are published for both Light Louisiana Sweet and Eugene Island crude oils. Their quality specifications differ significantly); and

(3) For deliveries during the production month.

You would calculate the daily mean spot price by averaging the daily high and low prices for the month in the selected publication. You would also use only the days and corresponding spot prices for which such prices are published. You would be required to adjust the value for applicable location and quality differentials, and you would be permitted to adjust it for transportation costs, under §§ 206.112 and 206.113 of this subpart.

Another difference from the January 1997 proposed rule is the application of spot, rather than NYMEX, prices. MMS made this change for several reasons. First, we believe that when the NYMEX futures price, properly adjusted for location and quality differences, is compared to spot prices, it nearly duplicates those spot prices. Second, application of spot prices would remove one portion of the necessary adjustments to the NYMEX price—the leg between Cushing, Oklahoma, and the market center location.

MMS did not propose any of the alternatives here that it proposes for the Rocky Mountain Area for oil that cannot be valued under proposed § 206.102. That is because, unlike the Rocky Mountain Area, there are meaningful published spot prices applicable to production in the other areas (Cushing, Oklahoma; St. James, Louisiana; Empire, Louisiana; Midland, Texas). With the exception of the Rocky Mountain Area, in the United States, spot and spot-related prices drive the manner in which crude oil is bought and traded. Spot prices play a significant role in crude oil marketing in terms of the basis upon which deals are negotiated and priced and are readily available to lessees via price reporting services. We believe that spot prices are the best indicator of value for production from leases not located in California, Alaska, or the Rocky Mountain Area; therefore, it is not necessary to consider other less accurate means of valuing production not sold arm's-length from this area.

MMS is not proposing to allow the costs of marketing production as an allowable deduction from index or gross proceeds-based pricing. The lease requires the lessee to market production at no cost to the lessor. The Interior Board of Land Appeals has consistently upheld MMS on this position. *See Walter Oil and Gas Corp.*, 111 IBLA 260, 265 (1989), October 25, 1989, and *Arco Oil and Gas Co.*, 112 IBLA 8, 11 (1989). Therefore, in this proposed rule MMS is not altering its long-standing policy.

Proposed § 206.103(d) is § 206.102(c)(3) of the January 1997 proposed rule with minor clarifying word changes. If MMS determines that any of the spot or NYMEX-based prices are no longer available or no longer represent market value, then MMS will exercise the Secretary's authority to establish value based on other relevant matters including well-established market basket formulas.

Proposed Section 206.104 What Index Price Publications Are Acceptable to MMS?

Proposed § 206.104 is paragraphs (c)(4), (c)(5), and (c)(6) of § 206.102 from the January 1997 proposed rule with an added reference to spot prices for crude oil other than ANS.

Proposed Section 206.105 What Records Must I Keep to Support My Calculations of Value Under This Subpart?

Proposed § 206.105 is a clarification that you must be able to show how you calculated the value you reported, including all adjustments. This is important because if you are unable to demonstrate on audit how you calculated the value you reported to MMS, you could be subjected to sanctions for false reporting.

Proposed Section 206.106 What Are My Responsibilities to Place Production Into Marketable Condition and to Market Production?

Proposed § 206.106 is § 206.102(e)(1) of the January 1997 proposed rule with minor clarifying word changes. Also, MMS proposes to delete § 206.102(e)(2) of the January 1997 proposed rule. It referred to potential improper value determinations and related interest, which are already covered in other parts of MMS's regulations.

Proposed Section 206.107 What Valuation Guidance Can MMS Give Me?

Proposed § 206.107 includes the substance of § 206.102(f) of the January 1997 proposed rule in shortened and simplified terms. Also, MMS proposes to delete § 206.102(g) of the January 1997 proposed rule. It discussed audit procedures related to value determinations, and these are covered sufficiently in other parts of MMS's regulations.

Proposed Section 206.108 Does MMS Protect Information I Provide?

Proposed § 206.108 is § 206.102(h) of the January 1997 proposed rule, but with minor wording changes for clarity.

Proposed Section 206.109 When May I Take a Transportation Allowance in Determining Value?

Proposed § 206.109 includes the substance of § 206.104 of the January 1997 proposed rule with only minor wording changes.

Proposed Sections 206.110 and 206.111 How Do I Determine a Transportation Allowance Under an Arm's-Length Transportation Contract, and How Do I Determine a Transportation Allowance Under a Non-Arm's-Length Transportation Contract?

Proposed §§ 206.110 and 206.111 are existing § 206.105(a) and (b) respectively, rewritten to reflect plain English, except that existing § 206.105(b)(5) is deleted as discussed in the January 1997 proposed rule preamble.

Proposed Section 206.112 What Adjustments and Transportation Allowances Apply When I Value Oil Using Index Pricing?

Proposed § 206.112 is a modified version of § 206.105(c) of the January 1997 proposed rule. Proposed § 206.112 lists the various location differentials, quality differentials, and transportation allowances that could apply depending on your individual circumstances. In other words, § 206.112 is a "menu" of possible adjustments that could apply in different circumstances. Section 206.113 then prescribes which of the adjustments from the "menu" apply to specific circumstances.

One difference from the January 1997 proposed rule is that we eliminated the location differential between the index pricing point and the market center. This is because under the valuation procedures in this further supplementary proposed rule, the index pricing point and market center would be synonymous in all cases except for the Rocky Mountain Area. Where proposed § 206.102 of this further supplementary proposed rule does not apply in the Rocky Mountain Area and NYMEX prices would apply, we propose at § 206.112(f) to designate Cushing, Oklahoma, as the market center for adjustment purposes.

The other difference from the January 1997 proposed rule is that we have added, at proposed § 206.112(e), a separate adjustment to reflect quality differences between your oil as produced at the lease and the oil at the

aggregation point or market center applicable to your lease. You would make these quality adjustments according to the pipeline quality bank specifications and related premia or penalties that may apply in your specific situation. If no pipeline quality bank applies to your production, then you would not take this quality adjustment. Likewise, if a quality adjustment is already contained in an arm's-length exchange agreement from the lease to the market center, you would not also claim a pipeline quality bank adjustment from the lease to the aggregation point or market center. MMS believes this additional adjustment would more accurately reflect actual quality adjustments made by buyers and sellers. MMS requests comments on this change and on the overall location/quality/transportation adjustments proposed.

Proposed Section 206.113 Which Adjustments and Transportation Allowances May I Use When I Value Oil Using Index Pricing?

Paragraphs 206.105(c)(2) and (c)(3) of the January 1997 proposed rule listed the specific adjustments and allowances permitted for leases not located in California/Alaska and those in California/Alaska, respectively. We propose to combine these paragraphs in § 206.113 of this further supplementary proposed rule. This new paragraph would cover all situations regardless of lease location, so no geographical breakdown of adjustments and allowances would be needed. As explained above, § 206.113 would prescribe which adjustments of the § 206.112 "menu" apply to your circumstances. Section 206.113 as here proposed covers all circumstances in which index price is used for all geographical areas. Otherwise, there are only two major differences from the methods described in the January 1997 proposed rule. First, you would be permitted to take a separate quality adjustment between your lease and the associated aggregation point or market center as discussed above.

Second, proposed § 206.113(d)(2) of this further supplementary proposed rule would address situations where you dispose of production at the lease in exercising a non-competitive crude oil call and thus are required to use index pricing. In such cases, you would have access to MMS's published differentials between the market center and aggregation point, but you may not have access to the actual cost information from the lease to the aggregation point. In such cases, which should be infrequent, MMS proposes to permit you to request approval for a transportation allowance. In determining the allowance for transportation from the lease to the aggregation point, MMS will look to transportation costs and quality adjustments reported for other oil production in the same field or area, or to available information for similar transportation situations.

Proposed § 206.113(a) covers situations where you transport your oil to an MMS-recognized aggregation point, then enter into an arm's-length exchange agreement between that point and the market center. To arrive at the royalty value, you would adjust the index price by the elements described in § 206.112(a), (c), and (e). The first element is the location/quality differential in your arm's-length exchange agreement between the market center and the aggregation point for your lease. This adjustment results in a value at the aggregation point, recognizing that oil originating there may be of significantly different quality from that of your oil at the lease. The second adjustment reflects your actual transportation costs between the aggregation point and your lease. These costs are determined under §§ 206.110 or 206.111 depending on whether your transportation arrangement is arm's length or not. A third adjustment may be warranted if the quality of your lease production differs from that of the oil you exchanged at the aggregation point. This last adjustment would be based on pipeline quality bank premia or penalties, but only if such quality banks exist at the aggregation point or intermediate commingling points before your oil reaches the aggregation point.

For example, Company A transports its production from a platform in the Gulf of Mexico to an MMS-recognized aggregation point under an arm's-length transportation contract for $0.50 per barrel. Company A then enters into an arm's-length exchange agreement between the MMS-recognized aggregation point and the market center at St. James, Louisiana. Company A then refines the oil it receives at the market center so that it must determine value using an index price under § 206.103. The arm's-length exchange agreement contains a location/quality differential of $0.10 per barrel. The average of the daily mean spot prices for St. James (the market center nearest the lease with crude oil most similar in quality to Company A's oil) is $20.00 per barrel for deliveries during the production month. The value of Company A's production at the lease is $19.40 ($20.00—$0.10—$0.50) per barrel.

Paragraph 206.113(b) addresses cases where you move your production directly to your or your affiliate's refinery and not to an index pricing point, and establish value based on index prices under § 206.103. In this case, for the reasons explained below, you would deduct from the index price your actual costs of transporting production from the lease to the refinery under § 206.112(c) and any quality adjustments determined by pipeline quality banks under § 206.112(e). The index pricing point is the one nearest the lease.

For example, a lessee or its affiliate in the Gulf of Mexico might transport its production directly to a refinery on the eastern coast of Texas and not to an index pricing point. It may or may not pass through an MMS-identified aggregation point. If that production is not sold at arm's-length, the lessee must base value on the average of the daily mean spot prices for St. James less actual costs of transporting the oil to the refinery and any quality adjustments from the lease to the refinery. Likewise, if a lessee or its affiliate transports Wyoming sour crude oil directly to its refinery in Salt Lake City, Utah, and values the oil based on § 206.103(b)(3), the lessee must base value on the average of the daily NYMEX settled prices, less actual cost of transporting the oil from Salt Lake City and any quality adjustments from the lease to the refinery.

When production is moved directly to a refinery and value must be established using an index, issues arise because the refinery generally is not located at an index pricing point. Consequently, the lessee does not incur actual costs to transport production to an index pricing point, and in any event, the production is not sold at arm's-length at that point. The principle underlying the rules and cases granting allowances for transportation costs is that the lessee is not required to transport production to a market remote from the lease or field at its own expense. When the lessee sells production at a remote market, the costs of transporting to that market are deductible from value at that market to determine the value of the production at or near the lease. Where there are no sales at a distant market, the question of a transportation allowance, as that term always has been understood, does not arise. However, because the lease and the index pricing point may be distant from one another, there is a difference in the value of the production between the index pricing point and the location of the lease. The question becomes how to determine or how best to approximate that difference in value.

In theory, one solution would be for MMS to try to derive what it would cost a lessee to move production from the lease to the index pricing point. There are, in MMS's view, several problems with such an approach. First, it would require a burdensome information collection from industry and require substantial information collection costs from many parties to whom the calculation derived from the information may never be relevant. Second, in many cases it may well not be possible to obtain information on which to base such a calculation. MMS anticipates that many lessees may move production directly to their refineries without shipping the oil through MMS-recognized aggregation points. In many instances, it is likely that no production from the lease or field is transported to the index pricing point that applies under § 206.103. Consequently, in such cases there would be no useful data on which such a cost derivation could be based.

Another possible solution, in theory, would be for MMS to derive a location adjustment between the index pricing point and the refinery. This might be possible, for example, if there are arm's-length exchanges of significant volumes of oil between the index pricing point and the refinery, and if the exchange agreements provide for location adjustments that can be separated from quality adjustments. But establishing such location adjustments on any scale again would require a burdensome information collection effort. MMS also anticipates that in many cases there would be no useful data from which to derive a location adjustment.

MMS therefore believes that the best and most practical proxy method for determining the difference in value between the lease and the index pricing point is to use the index price as value at the refinery, and then allow the lessee to deduct the actual costs of moving the production from the lease to the refinery. This is not a "transportation allowance" as that term is commonly understood, but rather is part of the methodology for determining the difference in value due to the location difference between the lease and the index pricing point. Nevertheless, it is appropriate to include this deduction as part of the allowance "menu" for situations in which index pricing is used.

MMS proposed this same method in the January 24, 1997, proposed rule, and did not receive any suggestions for alternative methods. Absent better alternatives, MMS believes this method is the best and most reasonable way to calculate the differences in value due to location when production is not actually moved from the lease to an index pricing point.

However, if a lessee believes that applying the index price nearest the lease to production moved directly to a refinery results in an unreasonable value based on circumstances of the lessee's production, § 206.103(e) would allow MMS to approve an alternative method if the lessee can demonstrate the market value at the refinery.

It would be the lessee's burden to provide adequate documentation and evidence demonstrating the market value at the refinery. That evidence may include, but is not limited to (1) costs of acquiring other crude oil at or for the refinery; (2) how adjustments for quality, location, and transportation were factored into the price paid for the other oil; (3) the volumes acquired for the refinery; and (4) other appropriate evidence or documentation that MMS requires. If MMS approves a value representing market value at the refinery, there would be no deduction for the costs of transporting the oil to the refinery under §§ 206.113(b) and 206.112(c). Whether any quality adjustment would be available would depend on whether the oil passed through a pipeline quality bank or if an arm's-length exchange agreement used to get oil to the refinery contained a separately identifiable quality adjustment.

Proposed § 206.113(c) covers situations where you transport your oil directly to an MMS-identified market center. To arrive at the royalty value, you would adjust the index price by the elements described in § 206.112(d) and (e). The first element is the actual costs of transporting production from the lease to the market center. A second adjustment may be warranted if the quality of your lease production differs from quality of the oil at the market center. This last adjustment would be based on pipeline quality bank premia or penalties, but only if such quality banks exist at the aggregation point or intermediate commingling points before your oil reaches the market center.

For example, Company A transports its production from a platform in the Gulf of Mexico to St. James, Louisiana, under a non-arm's-length transportation contract with its affiliate. The actual costs of transporting production under § 206.111 is $0.50 per barrel. The average of the daily spot prices at St. James is $20.00 per barrel for deliveries during the production month. The value of Company A's production at the lease is $19.50 ($20.00—$0.50) per barrel.

Proposed paragraph (d)(1) covers situations where you cannot use paragraphs (a), (b), or (c) of § 206.113. To arrive at the royalty value, you would adjust the index price by the elements described in § 206.112(b), (c), and (e). For example, Company A transports its production from a lease in the Gulf of Mexico through its own pipeline to an MMS-recognized aggregation point. Company A's actual costs of transportation from the lease to the aggregation point are $0.10 per barrel. Company A then enters into an exchange agreement with its affiliate. After the exchange, Company A refines the oil so that it must value the oil using § 205.103. The MMS-published differential from the aggregation point to the market center is $0.50 per barrel. The average of the daily mean spot prices for St. James (the market center nearest the lease with crude oil most similar in quality to Company A's oil) is $20.00 per barrel for deliveries during the production month. The value of Company A's production at the lease is $19.40 ($20.00—$0.50—$0.10) per barrel.

MMS requests any comments you may have regarding the specific permissible adjustments and transportation allowances under different oil disposal situations.

Proposed Section 206.114 What if I Believe the MMS-Published Location/Quality Differential is Unreasonable in My Circumstances?

This section would include the substance of § 206.105(c)(4) of the January 1997 proposed rule. It would provide that MMS may approve an alternate location/quality differential if you can show that the MMS-calculated differential under § 206.112(b) of this further supplementary proposed rule is unreasonable given your circumstances. However, we propose to eliminate the details of filing such a request as listed in the January 1997 proposed rule. Some of these details were confusing and some were unnecessary because they are covered in other parts of MMS's regulations. We believe it suffices to simply provide you an opportunity to request an alternate differential. Please provide us any comments you may have regarding such requests.

Note also that MMS proposes to entirely eliminate § 206.105(c)(5), (c)(6), and (c)(7) of the January 1997 proposed rule. They referred to publications used to make index price adjustments based on spot price differences between the index pricing point and the market center. Since this adjustment no longer applies in the further supplementary proposed rule, we have removed these paragraphs.

Proposed Section 206.115 How Will MMS Identify Market Centers and Aggregation Points?

Proposed § 206.115 is § 206.105(c)(8) of the January 1997 proposed rule with only minor wording changes. In the January 1997 proposed rule preamble, MMS listed market centers for purposes of the rule. That list included Guernsey, Wyoming. MMS now proposes to eliminate Guernsey as a market center for the reasons given earlier. Also, MMS has attempted to refine and limit the aggregation points identified in the January 1997 proposed rule to better reflect actual locations where oil is aggregated. The current list of proposed aggregation points is included as Attachment B to this preamble. We note that, as this further supplementary proposed rule indicates, we would continue to refine the list of aggregation points and associated market centers. We would add and delete aggregation points as experience dictates. This will help to keep the location/quality/transportation adjustment process realistic and current.

Proposed Section 206.116 What Are My Reporting Requirements Under an Arm's-Length Transportation Contract?

Proposed § 206.116 is § 206.105(c)(1) of the existing rule rewritten in plain English.

Proposed Section 206.117 What Are My Reporting Requirements Under a Non-Arm's-Length Transportation Contract?

Proposed Section § 206.117 is § 206.105(c)(2) of the existing rule rewritten in plain English, except § 206.105(c)(2)(iv) would be deleted as described in the January 1997 proposed rule preamble.

Proposed Section 206.118 What Information Must I Provide To Support Index Pricing Adjustments, and How Is That Information Used?

Proposed § 206.118 includes the substance of § 206.105(d)(3) of the January 1997 proposed rule. This section describes information and filing requirements for proposed Form MMS-4415. The previous proposal stated that you must submit information on all your and your affiliates' crude oil production, and not just information related to Federal lease production. MMS received many comments on the form filing burden, including comments that reporting for non-Federal lease production should not be required. Consistent with its other attempts to streamline the differential process, MMS proposes to limit the information required on Form MMS-4415 to that associated with production from Federal leases only. However, we reserve the right to review information related to your non-Federal production under 30 CFR part 217. We clarified this point in the revised instructions included with Form MMS-4415, Attachment A. We have eliminated other reporting requirements on Form MMS-4415 and revised all the related instructions to clarify the information required.

MMS also received various comments on timing of submittal of Form MMS-4415. Some commenters believed the information should be submitted more often than yearly because the differential information can change rapidly. Others believed that differential changes did not change often and that MMS should require Form MMS-4415 submittal less frequently. On balance, MMS proposes to maintain the submittal frequency at once a year as originally proposed.

Also, in its written comments, one industry organization stated that few of their members have non-competitive calls that are exercised. It appears that most of the producers who would be required to pay on index prices would be doing so because they have affiliates that are physically moving or exchanging the oil to market centers. If that is true, they would be able to use their actual differentials and would not rely on MMS's published location differentials derived from Form MMS-4415 data. MMS requests comments on whether this is a fair representation and, if so, could MMS eliminate Form MMS-4415 entirely and deal with those who don't have access to the needed data on an exception basis?

Proposed Section 206.119 What Interest and Assessments Apply if I Improperly Report a Transportation Allowance?

Proposed § 206.119 is § 206.105(d) of the existing rule rewritten in plain English.

Proposed Section 206.120 What Reporting Adjustments Must I Make for Transportation Allowances?

Proposed § 206.120 is § 206.105(e) of the existing rule rewritten in plain English.

Proposed Section 206.121 Are Costs Allowed for Actual or Theoretical Losses?

Proposed § 206.121 is § 206.105(f) of the existing rule rewritten in plain English, except the reference to the Federal Energy Regulatory Commission or State regulatory agency approved tariffs would be deleted as described in the January 1997 proposed rule preamble.

Proposed Section 206.122 How Are the Royalty Quantity and Quality Determined?

Proposed § 206.122 is § 206.103 of the existing rule rewritten in plain English.

Proposed Section 206.123 How Are Operating Allowances Determined?

Proposed § 206.123 is § 206.106 of the existing rule rewritten in plain English.

Proposed Change to 30 CFR 208.4(b)(2)

In the January 1997 proposed rule, MMS proposed to modify the RIK valuation procedures to tie them directly to MMS's proposed index pricing provisions less a location/quality differential specified in the RIK contract. MMS has decided not to proceed with this approach. Instead, MMS is considering establishing future RIK pricing terms directly within the contracts it writes with RIK program participants. MMS's goal is still to achieve pricing certainty in RIK transactions. But because of its revised plans, MMS is dropping its proposed January 1997 change to 30 CFR 208.4(b)(2).

IV. Procedural Matters

The Regulatory Flexibility Act

The Department certifies that this rule will not have significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. § 601 *et seq.*). Approximately 600 payors pay royalties to MMS on oil production from Federal lands. The majority of these payors are considered small businesses under the Regulatory Flexibility Act definitions. This rule will not significantly impact a substantial number of small entities because this rule does not add significant or costly new reporting requirements. Only the integrated payors with either a refinery, marketing capability, or both will be impacted. As a whole, this set of payors is primarily made up of very large oil companies with over 500 employees. The proposed collection of information will likely also impact a few companies with less than 500 employees (small businesses by the Office of Management and Budget (OMB) definitions). However, if a company is small and they engage in very few contracts where oil is exchanged, they have less information to report. We estimate that smaller companies (i.e., companies with less than 10 million but greater than one million barrels of annual domestic production, which included 3.5 Federal lessees in 1996) will each have

approximately 50 exchange agreements to review to identify the relevant contracts needed for reporting under this proposed rule. Of those contracts, we estimate that each small company will have to report on 5 exchange agreements. We estimate that the burden for a small company is 29.25 hours including 20 hours to aggregate the exchange agreement contracts to a central location, 8 hours to sort the exchange agreement contracts, and 1.25 additional hours to extract the relevant information and complete Form MMS-4415 (¼ hour to complete each form). For the 35 small companies, we estimate that the burden is 1,023.75 hours. MMS believes that because of the very small number of companies impacted and the relatively small costs to those companies of complying with the information collection, this is not significant action.

Unfunded Mandates Reform Act of 1995

The Department of the Interior has determined and certifies according to the Unfunded Mandates Reform Act, 2 U.S.C. § 1502 *et seq.*, that this rule will not impose a cost of $100 million or more in any given year on local, tribal, or State governments, or the private sector.

Fairness Board and National Ombudsman Program

Your comments are important. The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 regional fairness boards were established to receive comments from small businesses about Federal agency enforcement actions. The Ombudsman will annually evaluate the enforcement activities and rate each agencies responsiveness to small businesses. If you wish to comment on the enforcement actions of MMS, call 1-888-734-3247.

Executive Order 12630

The Department certifies that the rule does not represent a governmental action capable of interference with constitutionally protected property rights. Thus, a Takings Implication Assessment need not be prepared under Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights.

Executive Order 12988

The Department has certified to OMB that this proposed rule meets the applicable civil justice reform standards provided in sections 3(a) and 3(b)(2) of this Executive Order.

Executive Order 12866

The Office of Management and Budget has determined this rule is a significant rule under this Executive Order 12866 section 3(f)(4). This states a rule is considered a significant regulatory action if it "Raises novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order." The Department's analysis of these proposed revisions to the oil valuation regulations indicate these changes will not have a significant economic effect, as defined by section 3(f)(1) of this Executive Order. However, the Executive Order 12866 regulatory compliance and review requirements will be met and are available upon request. MMS estimates that the economic impact of this rule will be about $66 million. This estimate is based on a comparison of royalty payments received from Federal onshore and offshore leases in 1996 to what would be required under the proposed rule. The analysis was completed for each of the three geographic divisions of the proposed rule. Producers without refinery capacity were not included in the analysis, as we assumed that those payors would continue to value their production based on gross proceeds received under an arm's-length contract. In the analysis, we compared index prices adjusted for location and quality to prices reported on Form MMS-2014 less any reported transported allowances to arrive at the overall net gain or loss associated with the proposed rulemaking.

Paperwork Reduction Act

This proposed rule contains a collection of information which has been submitted to OMB for review and approval under section 3507(d) of the Paperwork Reduction Act of 1995. As part of our continuing effort to reduce paperwork and respondent burden, MMS invites the public and other Federal agencies to comment on any aspect of the reporting burden. Submit your comments to the Office of Information and Regulatory Affairs, OMB, Attention: Desk Officer for the Department of the Interior, Washington, D.C. 20503. Send copies of your comments to Minerals Management Service, Royalty Management Program, Rules and Procedures Staff, P.O. Box 25165, MS 3021, Denver, Colorado 80225-0165; courier address is Building 85, Denver Federal Center, Denver, Colorado 80225; e-Mail address is David_Guzy@mms.gov.

OMB may make a decision to approve or disapprove this collection of information after 30 days from receipt of our request. Therefore, your comments are best assured of being considered by OMB if OMB receives them within that time period. However, MMS will consider all comments received during the comment period for this notice of proposed rulemaking.

The information collection will be on new Form MMS-4415 titled *Oil Location Differential Report*. Part of the valuation of oil not sold under arm's-length contract relies on price indices that lessees may adjust for location/quality differences between the market center and the aggregation point or lease. Federal lessees and their affiliates would be required to give MMS specific information from their various oil exchange agreements and sales contracts applicable to Federal production. From this data MMS would calculate and publish representative location differentials for lessees' use in reporting royalties in various areas. This process would introduce certainty into royalty reporting. Rules establishing the use of Form MMS-4415 to report oil location differentials are at proposed 30 CFR 206.118.

The number of exchange agreement contracts involving aggregation points and market centers required to be reported under this proposed rule is considerably less than required to be reported on under the January 24, 1997, proposed rule. While we recognize that the initial reporting burden will still be sizable, it is reasonable to expect that the burden in succeeding years will be less because of efficiencies gained in the initial filing of Form MMS-4415. Our estimate is for the initial reporting burden and is based upon review of comments from industry from the initial, supplemental and further supplementary proposed rulemakings, comments at public meetings and comments at the MMS workshops held in October 1997 and consultation with MMS auditors about their review of exchange agreement contracts that they have examined in their recent work.

While MMS requires that only aggregation point to market center exchange agreement contracts be reported, we anticipate that companies will have to sort through their exchange agreement contracts before the relevant exchange agreement contracts can be compiled and the required information extracted and reported. Almost all Federal lessees who will be required to file this exchange agreement contract information; that is, exchanges between aggregation points and market centers, will have annual total (Federal and non-Federal) domestic production in excess of one-million barrels of crude oil; fifty-

nine (59) lessees had annual total domestic production in excess of one-million barrels of crude oil in 1996.

We estimate that a large company, i.e., a company with over 30 million barrels annual domestic production (13 Federal lessees), will have approximately 1,000 exchange agreement contracts that they will have to review in order to identify the relevant contracts needed for reporting purposes under this proposed rule. We estimate that a large company will have to report on 100 exchange agreement contracts following a review of all of the company's exchange agreement contracts. We estimate that the burden associated with fulfilling the information collection requirements of this proposed rule for a larger company is 185 hours. The burden hour estimate of 185 hours includes 80 hours to aggregate the exchange agreement contracts to a central location, 80 hours to sort the exchange agreement contracts, and 25 additional hours to extract the relevant information and complete Form MMS–4415 (¼ hour to complete each form). For 13 larger companies, we estimate that the burden is 2,405 hours (185 hours × 13 larger companies); using a per hour cost of $35, we estimate the cost is $84,175.

We estimate that a mid-sized company, i.e., a company with between 10 and 30 million barrels annual domestic production (11 Federal lessees), will have approximately 250 exchange agreement contracts that they will have to review in order to identify the relevant exchange contracts needed for reporting purposes under this proposed rule. We estimate that a mid-sized company will have to report on 25 exchange agreement contracts following a review of all of the company's exchange agreement contracts. We estimate that the burden associated with fulfilling the information collection requirements of this proposed rule for a mid-sized company is 106.25 hours. The burden hour estimate of 106.25 hours includes 60 hours to aggregate the exchange agreement contracts to a central location, 40 hours to sort the exchange agreement contracts, and 6.25 additional hours to extract the relevant information and complete Form MMS–4415 (¼ hour to complete each form). For 11 mid-sized companies, we estimate that the burden is 1168.75 hours (106.25 hours × 11 mid-sized companies); using a per hour cost of $35, we estimate the cost is $40,906.25.

We estimate that a small company, i.e., a company with less than 10 barrels annual domestic production (35 Federal lessees), will have approximately 50 exchange agreement contracts that they will have to review in order to identify the relevant exchange agreement contracts needed for reporting purposes under this proposed rule. We estimate that a small company will have to report on 5 exchange contracts following a review of all of the company's exchange agreement contracts. We estimate that the burden associated with fulfilling the information collection requirements of this proposed rule for a smaller company is 29.25 hours. The burden hour estimate of 29.25 hours includes 20 hours to aggregate the exchange agreement contracts to a central location, 8 hours to sort the exchange agreement contracts, and 1.25 additional hours to extract the relevant information and complete Form MMS–4415 (¼ hour to complete each form). For 35 smaller companies, we estimate that the burden is 1023.75 hours (29.25 hours × 35 larger companies); using a per hour cost of $35, we estimate the cost is $35,831.25.

We estimate that the total burden for all respondents is 4,597.5 hours. We estimate that the cost to the respondents for this information collection is $160,912.50.

In compliance with the Paperwork Reduction Act of 1995, section 3506 (c)(2)(A), we are notifying you, members of the public and affected agencies, of this collection of information, and are inviting your comments. Is this information collection necessary for us to properly do our job? Have we accurately estimated the public's burden for responding to this collection? Can we enhance the quality, utility, and clarity of the information we collect? Can we lessen the burden of this information collection on the respondents by using automated collection techniques or other forms of information technology?

National Environmental Policy Act of 1969

We have determined that this rulemaking is not a major Federal action significantly affecting the quality of the human environment, and a detailed statement under section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. § 4332(2)(C)) is not required.

V. Request for Comments

You should submit written comments, suggestions, or objections regarding this proposal to the location identified in the **ADDRESSES** section of this notice. You must submit your comments on or before the date identified in the **DATES** section of this notice.

List of Subjects 30 CFR Parts 206 and 208

Coal, Continental shelf, Geothermal energy, Government contracts, Indians-lands, Mineral royalties, Natural gas, Petroleum, Public lands—mineral resources, Reporting and recordkeeping requirements.

Dated: December 29, 1997.

Bob Armstrong,

Assistant Secretary—Land and Minerals Management.

For the reasons given in the preamble, MMS proposes to amend subpart C of part 206 in Title 30 of the Code of Federal Regulations as follows:

PART 206—PRODUCT VALUATION

Subpart C—Federal Oil

206.100 What is the purpose of this subpart?
206.101 Definitions.
206.102 How do I calculate royalty value for oil that I or my affiliate sell under an arm's-length contract?
206.103 How do I value oil that I cannot value under § 206.102?
206.104 What index price publications are acceptable to MMS?
206.105 What records must I keep to support my calculations of value under this subpart?
206.106 What are my responsibilities to place production into marketable condition and to market production?
206.107 What valuation guidance can MMS give me?
206.108 Does MMS protect information I provide?
206.109 When may I take a transportation allowance in determining value?
206.110 How do I determine a transportation allowance under an arm's-length transportation contract?
206.111 How do I determine a transportation allowance under a non-arm's-length transportation arrangement?
206.112 What adjustments and transportation allowances could apply when I value oil using index pricing?
206.113 Which adjustments and transportation allowances may I use when I value oil using index pricing?
206.114 What if I believe the MMS-published location/quality differential is unreasonable in my circumstances?
206.115 How will MMS identify market centers and aggregation points?
206.116 What are my reporting requirements under an arm's-length transportation contract?
206.117 What are my reporting requirements under a non-arm's-length transportation contract?
206.118 What information must I provide to support index pricing adjustments, and how is that information used?
206.119 What interest and assessments apply if I improperly report a transportation allowance?
206.120 What reporting adjustments must I make for transportation allowances?

206.121 Are costs allowed for actual or theoretical losses?
206.122 How are the royalty quantity and quality determined?
206.123 How are operating allowances determined?

Authority: 5 U.S.C. 301 *et seq.*; 25 U.S.C. 396 *et seq.*, 396a *et seq.*, 2101 *et seq.*; 30 U.S.C. 181 *et seq.*, 351 *et seq.*, 1001 *et seq.*, 1701 *et seq.*; 31 U.S.C. 9701, 43 U.S.C. 1301 *et seq.*, 1331 *et seq.*, and 1801 *et seq.*

§ 206.100 What is the purpose of this subpart?

(a) This subpart applies to all oil produced from Federal oil and gas leases onshore and on the Outer Continental Shelf (OCS). It explains how you as a lessee must calculate the value of production for royalty purposes consistent with the mineral leasing laws, other applicable laws, and lease terms. If you are a designee and if you dispose of production on behalf of a lessee, the terms "you" and "your" in this subpart refer to you. If you are a designee and only report for a lessee, and do not dispose of the lessee's production, references to "you" and "your" in this subpart refer to the lessee and not the designee. Accordingly, you as a designee must determine and report royalty value for the lessee's oil by applying the rules in this subpart to the lessee's disposition of its oil.

(b) This subpart does *not* apply in three situations. If the regulations in this subpart are inconsistent with a Federal statute, a settlement agreement between the United States and a lessee resulting from administrative or judicial litigation, or an express provision of an oil and gas lease subject to this subpart, then the statute, settlement agreement, or lease provision will govern to the extent of the inconsistency.

(c) MMS may audit and adjust all royalty payments.

§ 206.101 Definitions.

The following definitions apply to this subpart:

Affiliate means a person who owns, is owned by, or is under common ownership with another person to the extent of 10 percent or more of the voting securities of an entity, interest in a partnership or joint venture, or other forms of ownership. MMS may require the lessee to certify the percentage of ownership. Aside from the percentage ownership criteria, relatives, either by blood or by marriage, are affiliates.

Aggregation point means a central point where production is aggregated for shipment to market centers or refineries. It includes, but is not limited to, blending and storage facilities and connections where pipelines join. Pipeline terminations at refining centers also are classified as aggregation points. MMS periodically will publish in the **Federal Register** a list of aggregation points and associated market centers.

Area means a geographic region at least as large as the limits of an oil field, in which oil has similar quality, economic, and legal characteristics.

Arm's-length contract means a contract or agreement between independent persons who are not affiliates and who have opposing economic interests regarding that contract. To be considered arm's length for any production month, a contract must satisfy this definition for that month, as well as when the contract was executed.

Audit means a review, conducted under generally accepted accounting and auditing standards, of royalty payment compliance activities of lessees, designees or other persons who pay royalties, rents, or bonuses on Federal leases.

BLM means the Bureau of Land Management of the Department of the Interior.

Competitive crude oil call means a crude oil call that contains a clause basing the price on what other parties are willing to competitively bid to purchase the production.

Condensate means liquid hydrocarbons (normally exceeding 40 degrees of API gravity) recovered at the surface without processing. Condensate is the mixture of liquid hydrocarbons resulting from condensation of petroleum hydrocarbons existing initially in a gaseous phase in an underground reservoir.

Contract means any oral or written agreement, including amendments or revisions, between two or more persons, that is enforceable by law and that with due consideration creates an obligation.

Crude oil call means the right of one person to buy, at its option, all or a part of the second person's oil production from an oil and gas property. This right generally arises as a condition of the sale or farmout of that property from the first person to the second, or as a result of other transactions between them. The price basis may be specified when the property is sold or farmed out.

Designee means the person the lessee designates to report and pay the lessee's royalties for a lease.

Exchange agreement means an agreement where one person agrees to deliver oil to another person at a specified location in exchange for oil deliveries at another location. Exchange agreements may or may not specify prices for the oil involved. They frequently specify dollar amounts reflecting location, quality, or other differentials. Exchange agreements include buy/sell agreements, which specify prices to be paid at each exchange point and may appear to be two separate sales within the same agreement.

Field means a geographic region situated over one or more subsurface oil and gas reservoirs and encompassing at least the outermost boundaries of all oil and gas accumulations known within those reservoirs, vertically projected to the land surface. State oil and gas regulatory agencies usually name onshore fields and designate their official boundaries. MMS names and designates boundaries of OCS fields.

Gathering means the movement of lease production to a central accumulation or treatment point on the lease, unit, or communitized area, or to a central accumulation or treatment point off the lease, unit, or communitized area that BLM or MMS approves for onshore and offshore leases, respectively.

Gross proceeds means the total monies and other consideration accruing for the disposition of oil produced. Gross proceeds include, but are not limited to, the following examples:

(1) Payments for services such as dehydration, marketing, measurement, or gathering which the lessee must perform at no cost to the Federal Government;

(2) The value of services, such as salt water disposal, that the producer normally performs but that the buyer performs on the producer's behalf;

(3) Reimbursements for harboring or terminaling fees;

(4) Tax reimbursements, even though the Federal royalty interest may be exempt from taxation;

(5) Payments made to reduce or buy down the purchase price of oil to be produced in later periods, by allocating such payments over the production whose price the payment reduces and including the allocated amounts as proceeds for the production as it occurs; and

(6) Monies and all other consideration to which a seller is contractually or legally entitled, but does not seek to collect through reasonable efforts.

Index pricing means using NYMEX futures prices, Alaska North Slope (ANS) crude oil spot prices, or other appropriate crude oil spot prices for royalty valuation.

Index pricing point means the physical location where an index price is established in an MMS-approved publication.

Lease means any contract, profit-share arrangement, joint venture, or other

agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, development or extraction of, or removal of oil or gas products—or the land area covered by that authorization, whichever the context requires.

Lessee means any person to whom the United States issues an oil and gas lease, an assignee of all or a part of the record title interest, or any person to whom operating rights in a lease have been assigned.

Load oil means any oil used in the operation of oil or gas wells for wellbore stimulation, workover, chemical treatment, or production purposes. It does not include oil used at the surface to place lease production in marketable condition.

Location differential means the value difference for oil at two different points.

Market center means a major point MMS recognizes for oil sales, refining, or transshipment. Market centers generally are locations where MMS-approved publications publish oil spot prices.

Marketable condition means oil sufficiently free from impurities and otherwise in a condition a purchaser will accept under a sales contract typical for the field or area.

Minimum royalty means that minimum amount of annual royalty the lessee must pay as specified in the lease or in applicable leasing regulations.

MMS-approved publication means a publication MMS approves for determining NYMEX prices, ANS or other spot prices, or location differentials.

Netting means reducing the reported sales value to account for transportation instead of reporting a transportation allowance as a separate line on Form MMS–2014.

Non-competitive crude oil call means a crude oil call that does not contain a clause basing the price on what other parties are willing to competitively bid to purchase the production.

NYMEX means the New York Mercantile Exchange.

Oil means a mixture of hydrocarbons that existed in the liquid phase in natural underground reservoirs, remains liquid at atmospheric pressure after passing through surface separating facilities, and is marketed or used as a liquid. Condensate recovered in lease separators or field facilities is considered oil.

Outer Continental Shelf (OCS) means all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 2 of the Submerged Lands Act (43 U.S.C. 1301) and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control.

Person means any individual, firm, corporation, association, partnership, consortium, or joint venture (when established as a separate entity).

Prompt month means the nearest month for which NYMEX futures are traded on any given day. Futures trading terminates at the close of business on the third business day before the 25th calendar day of the month preceding the delivery month. For example, if November 25 is a Tuesday, futures trading for the prompt month of December would end November 20, the third-previous business day. Trading for the December prompt month would begin October 23, the day following the end of trading for the November prompt month.

Quality differential means the value difference between two oils due to differences in their API gravity, sulfur content, viscosity, metals content, and other quality factors.

Rocky Mountain Area means the States of Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming.

Sale means a contract between two persons where:

(1) The seller unconditionally transfers title to the oil to the buyer. The seller may not retain any related rights such as the right to buy back similar quantities of oil from the buyer elsewhere;

(2) The buyer pays money or other consideration for the oil; and

(3) The parties' intent is for a sale of the oil to occur.

Spot price means the price under a spot sales contract where:

(1) A seller agrees to sell to a buyer a specified amount of oil at a specified price over a specified period of short duration;

(2) No cancellation notice is required to terminate the sales agreement; and

(3) There is no obligation or implied intent to continue to sell in subsequent periods.

Tendering program means a company offer of a portion of its crude oil production from a field, area, or other geographical/physical unit for competitive bidding.

Transportation allowance means a deduction in determining royalty value for the reasonable, actual costs of moving oil to a point of sale or delivery off the lease, unit area, or communitized area. The transportation allowance does not include gathering costs.

§ 206.102 How do I calculate royalty value for oil that I or my affiliate sell under an arm's-length contract?

(a) The value of oil under paragraphs (a)(1) through (4) of this section is the gross proceeds accruing to the seller under the arm's-length contract, less applicable allowances determined under this subpart. See paragraph (c) of this section for exceptions. Use this paragraph to value oil that:

(1) You sell under an arm's-length sales contract;

(2) You sell or transfer to your affiliate and that affiliate, or another affiliate, then sells the oil under an arm's-length contract;

(3) You sell or transfer to another person under a non-arm's-length contract and that person, or an affiliate of that person, sells the oil under an arm's-length contract; or

(4) You sell in the exercise of a competitive crude oil call.

(b) If oil valued under paragraphs (a)(2) or (a)(3) of this section is sold under multiple arm's length contracts, the value of the oil is the volume-weighted average of the values established under this section for each contract.

(c) This paragraph contains exceptions to the valuation rule in paragraph (a) of this section. Apply these exceptions on an individual contract basis.

(1) If MMS determines that any arm's-length sales contract does not reflect the total consideration actually transferred either directly or indirectly from the buyer to the seller, MMS may require that you value the oil sold under that contract either under § 206.103 or at the total consideration received.

(2) You must value the oil under § 206.103 if MMS determines that the value under paragraph (a) of this section does not reflect the reasonable value of the production due to either:

(i) Misconduct by or between the parties to the arm's-length contract, or

(ii) Breach of your duty to market the oil for the mutual benefit of yourself and the lessor.

(3) You must use § 206.103 to value oil disposed of under an exchange agreement. However, if you enter into one or more arm's-length exchange agreements, and following those exchanges you dispose of the oil in a transaction to which paragraph (a) of this section applies, then you must value the oil under paragraph (a) of this section. Adjust that value for any location or quality differential or other adjustments you received or paid under the arm's-length exchange agreement(s). But if MMS determines that any arm's-length exchange agreement does not

reflect reasonable location or quality differentials, MMS may require you to value the oil under § 206.103.

(4) You must use § 206.103 to value oil disposed of in the exercise of a non-competitive crude oil call.

(d) *What else must I do if I value oil under paragraph (a)?*

(1) You must be able to demonstrate that a contract or exchange agreement is an arm's-length contract or exchange agreement.

(2) MMS may require you to certify that arm's-length contract provisions include all of the consideration the buyer must pay, either directly or indirectly, for the oil.

(3) You must base value on the highest price the seller can receive through legally enforceable claims under the contract. If the seller fails to take proper or timely action to receive prices or benefits it is entitled to, you must pay royalty at a value based upon that obtainable price or benefit. If the seller makes timely application for a price increase or benefit allowed under the contract but the purchaser refuses, and the seller takes reasonable documented measures to force purchaser compliance, you will owe no additional royalties unless or until the seller receives monies or consideration resulting from the price increase or additional benefits. This paragraph will not permit you to avoid your royalty payment obligation where a purchaser fails to pay, pays only in part, or pays late. Any contract revisions or amendments that reduce prices or benefits to which the seller is entitled must be in writing and signed by all parties to the arm's-length contract.

§ 206.103 How do I value oil that I cannot value under § 206.102?

This section explains how to value oil that you may not value under § 206.102.

(a) *Production from leases in California or Alaska.* Value is the average of the daily mean Alaska North Slope (ANS) spot prices published in any MMS-approved publication during the calendar month preceding the production month. To calculate the daily mean spot price, average the daily high and low prices for the month in the selected publication. Use only the days and corresponding spot prices for which such prices are published. You must adjust the value for applicable location and quality differentials, and you may adjust it for transportation costs, under §§ 206.112 and 206.113 of this subpart.

(b) *Production from leases in the Rocky Mountain Area.* Value your oil under the first applicable of the following paragraphs:

(1) If you have an MMS-approved tendering program, the value of production from leases in the area the tendering program covers is the highest price bid for tendered volumes. You must offer and sell at least 33⅓ percent of your production from both Federal and non-Federal leases in that area under your tendering program. You also must receive at least three bids for the tendered volumes from bidders who do not have their own tendering programs that cover some or all of the same area. MMS will provide additional criteria for approval of a tendering program in its "Oil and Gas Payor Handbook."

(2) Value is the volume-weighted average gross proceeds accruing to the seller under you or your affiliates' arm's-length contracts for the purchase or sale of production from the field or area during the production month. The total volume purchased or sold under those contracts must exceed 50 percent of your and your affiliates' production from both Federal and non-Federal leases in the same field or area during that month.

(3) Value is the average of the daily NYMEX futures settle prices at Cushing, Oklahoma, for the light sweet crude oil contract for the prompt month that is in effect on the first day of the month preceding the production month. Use only the days and corresponding NYMEX prices for which such prices are published. You must adjust the value for applicable location and quality differentials, and you may adjust it for transportation costs, under §§ 206.112 and 206.113 of this subpart.

(4) If you demonstrate to MMS's satisfaction that paragraphs (b)(1) through (b)(3) of this section result in an unreasonable value for your production as a result of circumstances regarding that production, the MMS Director may establish an alternative valuation method.

(c) *Production from leases not located in California, Alaska, or the Rocky Mountain Area.* Value is the average of the daily mean spot prices—

(1) For the market center nearest your lease where spot prices are published in an MMS-approved publication;

(2) For the crude oil most similar in quality to your oil (for example, at the St. James, Louisiana, market center, spot prices are published for both Light Louisiana Sweet and Eugene Island crude oils. Their quality specifications differ significantly); and

(3) For deliveries during the production month. Calculate the daily mean spot price by averaging the daily high and low prices for the month in the selected publication. Use only the days and corresponding spot prices for which such prices are published. You must adjust the value for applicable location and quality differentials, and you may adjust it for transportation costs, under §§ 206.112 and 206.113.

(d) If MMS determines that any of the index prices referenced in paragraphs (a), (b), and (c) of this section are unavailable or no longer represent reasonable royalty value, in any particular case, MMS may establish reasonable royalty value based on other relevant matters.

(e) *What if I transport my oil to my refinery and believe that use of a particular index price is unreasonable?*

(1) If you transport your oil directly to your or your affiliate's refinery, or exchange your oil at arm's length for oil delivered to your or your affiliate's refinery, and if value is established under this section at an index price, and if you believe that use of the index price is unreasonable, you may apply to the MMS Director for approval to use a value representing the market at the refinery.

(2) You must provide adequate documentation and evidence demonstrating the market value at the refinery. That evidence may include, but is not limited to:

(i) Costs of acquiring other crude oil at or for the refinery;

(ii) How adjustments for quality, location, and transportation were factored into the price paid for other oil;

(iii) Volumes acquired for and refined at the refinery; and

(iv) Any other appropriate evidence or documentation that MMS requires.

(3) If the MMS Director approves a value representing market value at the refinery, you may not take an allowance against that value under §§ 206.112(c) and 206.113(b).

§ 206.104 What index price publications are acceptable to MMS?

(a) MMS periodically will publish in the **Federal Register** a list of acceptable publications based on certain criteria, including but not limited to:

(1) Publications buyers and sellers frequently use;

(2) Publications frequently mentioned in purchase or sales contracts;

(3) Publications that use adequate survey techniques, including development of spot price estimates based on daily surveys of buyers and sellers of ANS and other crude oil; and

(4) Publications independent from MMS, other lessors, and lessees.

(b) Any publication may petition MMS to be added to the list of acceptable publications.

(c) MMS will reference the tables you must use in the publications to determine the associated index prices.

§ 206.105 What records must I keep to support my calculations of value under this subpart?

If you determine the value of your oil under this subpart, you must retain all data relevant to the determination of royalty value. You must be able to show how you calculated the value you reported, including all adjustments for location, quality, and transportation, and how you complied with these rules. Recordkeeping requirements are found at parts 207 and 217 of this title. MMS may review and audit such data, and MMS will direct you to use a different value if it determines that the reported value is inconsistent with the requirements of this subpart.

§ 206.106 What are my responsibilities to place production into marketable condition and to market production?

You must place oil in marketable condition and market the oil for the mutual benefit of the lessee and the lessor at no cost to the Federal Government unless otherwise provided in the lease agreement. If you use gross proceeds under an arm's-length contract in determining value, you must increase those gross proceeds to the extent that the purchaser, or any other person, provides certain services that the seller normally would be responsible to perform to place the oil in marketable condition or to market the oil.

§ 206.107 What valuation guidance can MMS give me?

You may ask MMS for guidance in determining value. You may propose a valuation method to MMS. Submit all available data related to your proposal and any additional information MMS deems necessary. MMS will promptly review your proposal and provide you with a non-binding determination of the guidance you request.

§ 206.108 Does MMS protect information I provide?

Certain information you submit to MMS regarding valuation of oil, including transportation allowances, may be exempt from disclosure. To the extent applicable laws and regulations permit, MMS will keep confidential any data you submit that is privileged, confidential, or otherwise exempt from disclosure. All requests for information must be submitted under the Freedom of Information Act regulations of the Department of the Interior at 43 CFR part 2.

§ 206.109 When may I take a transportation allowance in determining value?

(a) *What transportation allowances are permitted when I value production based on gross proceeds?* This paragraph applies when you value oil under § 206.102 based on gross proceeds from a sale at a point off the lease, unit, or communitized area where the oil is produced, and the movement to the sales point is not gathering. MMS will allow a deduction for the reasonable, actual costs to transport oil from the lease to the point off the lease under §§ 206.110 or 206.111, as applicable. For offshore leases, you may take a transportation allowance for your reasonable, actual costs to transport oil taken as royalty-in-kind (RIK) to the delivery point specified in the contract between the RIK oil purchaser and the Federal Government. However, for onshore leases, you may not take a transportation allowance for transporting oil taken as RIK.

(b) *What transportation allowances and other adjustments apply when I value production based on index pricing?* If you value oil using an index price under § 206.103, MMS will allow a deduction for certain costs associated with transporting oil as provided under §§ 206.112 and 206.113.

(c) *Are there limits on my transportation allowance?*

(1) Except as provided in paragraph (c)(2) of this section, your transportation allowance may not exceed 50 percent of the value of the oil as determined under this subpart. You may not use transportation costs incurred to move a particular volume of production to reduce royalties owed on production for which those costs were not incurred.

(2) You may ask MMS to approve a transportation allowance in excess of the limitation in paragraph (c)(1) of this section. You must demonstrate that the transportation costs incurred were reasonable, actual, and necessary. Your application for exception (using Form MMS–4393, Request to Exceed Regulatory Allowance Limitation) must contain all relevant and supporting documentation necessary for MMS to make a non-binding determination. You may never reduce the royalty value of any production to zero.

(d) *Must I allocate transportation costs?* You must allocate transportation costs among all products produced and transported as provided in §§ 206.110 and 206.111. You must express transportation allowances for oil as dollars per barrel.

(e) *What additional payments may I be liable for?* If MMS determines that you took an excessive transportation allowance, then you must pay any additional royalties due, plus interest under 30 CFR 218.54. You also could be entitled to a credit with interest under applicable rules if you understated your transportation allowance. If you take a deduction for transportation on Form MMS–2014 by improperly netting the allowance against the sales value of the oil instead of reporting the allowance as a separate line item, MMS may assess you an amount under § 206.119.

§ 206.110 How do I determine a transportation allowance under an arm's-length transportation contract?

(a) If you or your affiliate incur transportation costs under an arm's-length transportation contract, you may claim a transportation allowance for the reasonable, actual costs incurred for transporting oil under that contract, except as provided in paragraphs (a)(1) and (a)(2) of this section. You must be able to demonstrate that your contract is arm's length. You do not need MMS approval before reporting a transportation allowance for costs incurred under an arm's-length contract.

(1) If MMS determines that the contract reflects more than the consideration actually transferred either directly or indirectly from you or your affiliate to the transporter for the transportation, MMS may require that you calculate the transportation allowance under § 206.111.

(2) If MMS determines that the consideration paid under an arm's-length transportation contract does not reflect the reasonable value of the transportation due to either:

(i) Misconduct by or between the parties to the arm's-length contract; or

(ii) Breach of your duty to market the oil for the mutual benefit of yourself and the lessor, then you must calculate the transportation allowance under § 206.111.

(b)(1) If your arm's-length transportation contract includes more than one liquid product, and the transportation costs attributable to each product cannot be determined from the contract, then you must allocate the total transportation costs in a consistent and equitable manner to each of the liquid products transported in the same proportion as the ratio of the volume of each product (excluding waste products which have no value) to the volume of all liquid products (excluding waste products which have no value). You may not claim an allowance for the costs of transporting lease production which is not royalty-bearing without MMS approval except as provided in this section.

(2) You may propose to MMS a cost allocation method on the basis of the values of the products transported. MMS will approve the method unless it is not consistent with the purposes of the regulations in this subpart.

(c) If your arm's-length transportation contract includes both gaseous and liquid products, and the transportation costs attributable to each product cannot be determined from the contract, you must propose an allocation procedure to MMS. You may use your proposed procedure to calculate a transportation allowance until MMS accepts your cost allocation. You must submit your initial proposal, including all available data, within 3 months after the last day of the month for which you claim a transportation allowance.

(d) If your payments for transportation under an arm's-length contract are not on a dollar-per-unit basis, you must convert whatever consideration is paid to a dollar value equivalent.

(e) If your arm's-length sales contract includes a provision reducing the contract price by a transportation factor, MMS will not consider the transportation factor to be a transportation allowance. You may use the transportation factor in determining your gross proceeds for the sale of the product. You must obtain MMS approval before claiming a transportation factor in excess of 50 percent of the base price of the product.

§ 206.111 How do I determine a transportation allowance under a non-arm's-length transportation arrangement?

(a) If you or your affiliate have a non-arm's-length transportation contract or no contract, including those situations where you or your affiliate perform your own transportation services, calculate your transportation allowance based on the reasonable, actual costs provided in this section.

(b) Base your transportation allowance for non-arm's-length or no-contract situations on your or your affiliate's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either:

(1) Depreciation and a return on undepreciated capital investment under paragraph (b)(4)(i) of this section, or

(2) A cost equal to the initial capital investment in the transportation system multiplied by a rate of return under paragraph (b)(4)(ii) of this section.

(c) Allowable capital costs are generally those for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.

(1) Allowable operating expenses include:

(i) Operations supervision and engineering; operations labor;

(ii) Fuel;

(iii) Utilities;

(iv) Materials;

(v) Ad valorem property taxes;

(vi) Rent;

(vii) Supplies; and

(viii) Any other directly allocable and attributable operating expense which you can document.

(2) Allowable maintenance expenses include:

(i) Maintenance of the transportation system;

(ii) Maintenance of equipment;

(iii) Maintenance labor; and

(iv) Other directly allocable and attributable maintenance expenses which you can document.

(3) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(4) Use either depreciation or a return on depreciable capital investment. After you have elected to use either method for a transportation system, you may not later elect to change to the other alternative without MMS approval.

(i) To compute depreciation, you may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the transportation system services, or a unit-of-production method. After you make an election, you may not change methods without MMS approval. A change in ownership of a transportation system will not alter the depreciation schedule you or your affiliate established for purposes of the allowance calculation. With or without a change in ownership, you may only depreciate a transportation system once. You may not depreciate equipment below a reasonable salvage value.

(ii) For transportation facilities first placed in service after March 1, 1988, you may use as a cost an amount equal to the initial capital investment in the transportation system multiplied by the rate of return under paragraph (5) of this section. You may not claim an allowance for depreciation.

(5) The rate of return is the industrial rate for Standard and Poor's BBB rating. Use the monthly average rate published in "Standard and Poor's Bond Guide" for the first month of the reporting period for which the allowance applies. Calculate the rate at the beginning of each subsequent transportation allowance reporting period.

(d)(1) Calculate the deduction for transportation costs based on your or your affiliate's cost of transporting each product through each individual transportation system. Where more than one liquid product is transported, allocate costs in a consistent and equitable manner to each of the liquid products transported in the same proportion as the ratio of the volume of each liquid product (excluding waste products which have no value) to the volume of all liquid products (excluding waste products which have no value). You may not take an allowance for transporting lease production which is not royalty-bearing without MMS approval, except as provided in this paragraph.

(2) You may propose to MMS a cost allocation method on the basis of the values of the products transported. MMS will approve the method if it is consistent with the purposes of the regulations in this subpart.

(e) Where both gaseous and liquid products are transported through the same transportation system, you must propose a cost allocation procedure to MMS. You may use your proposed procedure to calculate a transportation allowance until MMS accepts your cost allocation. You must submit your initial proposal, including all available data, within 3 months after the last day of the month for which you request a transportation allowance.

§ 206.112 What adjustments and transportation allowances could apply when I value oil using index pricing?

When you use index pricing to calculate the value of production under § 206.103, you must adjust the index price for the location and quality differentials and you may adjust it for certain transportation costs, as prescribed in this section and § 206.113. This section describes the different adjustments and transportation allowances that could apply.

Section 206.113 specifies which of these adjustments and allowances apply to you depending upon how you dispose of your oil. These adjustments and transportation allowances are as follows:

(a) A location/quality differential determined from your arm's-length exchange agreement that reflects the difference in value of crude oil between the aggregation point and the market center, or between your lease and the market center.

(b)(1) An MMS-specified location/quality differential that reflects the difference in value of crude oil between the aggregation point and the market center.

(2) MMS will publish annually a series of differentials applicable to various aggregation points and market centers based on data MMS collects on Form MMS-4415. MMS will calculate each differential using a volume-

weighted average of the differentials reported on Form MMS–4415 for similar quality crudes for the aggregation point-market center pair for the previous reporting year. MMS may exclude apparent anomalous differentials from that calculation. MMS will publish separate differentials for different crude oil qualities that are identified separately on Form MMS–4415 (for example, sweet versus sour or varying gravity ranges).

(3) MMS will publish these differentials in the **Federal Register** by [the effective date of the final regulation] and by January 31 of all subsequent years. Use the MMS-published differential to report the value of production occurring during the calendar year.

(c) Actual transportation costs between the aggregation point and the lease determined under § 206.110 or 206.111.

(d) Actual transportation costs between the market center and the lease determined under § 206.110 or 206.111.

(e) Quality adjustments based on premia or penalties determined by pipeline quality bank specifications at intermediate commingling points, at the aggregation point, or at the market center that applies to your lease.

(f) For purposes of this section and § 206.113, the term market center means Cushing, Oklahoma, when determining location/quality differentials and transportation allowances for production from leases in the Rocky Mountain Area.

§ 206.113 Which adjustments and transportation allowances may I use when I value oil using index pricing?

(a) If you dispose of your production under an arm's-length exchange agreement, use § 206.112 (a), (c), and (e) to determine your adjustments and transportation allowances. For non-arm's-length exchange agreements, use paragraph (d) of this section.

(b) If you move lease production directly to an alternate disposal point (for example, your refinery), use § 206.112 (c) and (e) to determine your actual costs of transportation and to adjust for quality. Treat the alternate disposal point as the aggregation point to apply § 206.112(c).

(c) If you move your oil directly to a MMS-identified market center, use § 206.112 (d) and (e) to determine your actual costs of transportation and to adjust for quality.

(d)(1) If you cannot use paragraph (a), (b), or (c) of this section, use § 206.112 (b), (c), and (e) to determine your location/quality adjustments and transportation allowances, except as provided in paragraph (d)(2) of this section.

(2) If you dispose of your production at the lease in the exercise of a non-competitive crude oil call, and if you cannot obtain information regarding the actual costs of transporting oil from the lease to the aggregation point, or pipeline quality bank specifications necessary to apply § 206.112 (c) and (e), you must request approval from MMS for any transportation allowance.

§ 206.114 What if I believe the MMS-published location/quality differential is unreasonable in my circumstances?

If you can demonstrate to MMS that the MMS-calculated differential under § 206.112(b) is unreasonable based on the circumstances of your production, MMS may approve an alternative location/quality differential.

§ 206.115 How will MMS identify market centers and aggregation points?

MMS periodically will publish in the **Federal Register** a list of aggregation points and the associated market centers. MMS will monitor market activity and, if necessary, add to or modify the list of market centers and aggregation points and will publish such modifications in the **Federal Register**. MMS will consider the following factors and conditions in specifying market centers and aggregation points:

(a) Points where MMS-approved publications publish prices useful for index purposes;

(b) Markets served;

(c) Pipeline and other transportation linkage;

(d) Input from industry and others knowledgeable in crude oil marketing and transportation;

(e) Simplification; and

(f) Other relevant matters.

§ 206.116 What are my reporting requirements under an arm's-length transportation contract?

You or your affiliate must use a separate line entry on Form MMS–2014 to notify MMS of an allowance based on transportation costs you or your affiliate incur. MMS may require you or your affiliate to submit arm's-length transportation contracts, production agreements, operating agreements, and related documents.

§ 206.117 What are my reporting requirements under a non-arm's-length transportation contract?

You or your affiliate must use a separate line entry on Form MMS–2014 to notify MMS of an allowance based on transportation costs you or your affiliate incur.

(a) For new transportation facilities or arrangements, base your initial deduction on estimates of allowable oil transportation costs for the applicable period. Use the most recently available operations data for the transportation system or, if such data are not available, use estimates based on data for similar transportation systems.

(b) MMS may require you or your affiliate to submit all data used to calculate the allowance deduction.

§ 206.118 What information must I provide to support index pricing adjustments, and how is that information used?

You must submit information on Form MMS–4415 related to all your and your affiliates' crude oil production from Federal leases. Provide information regarding differentials between MMS-defined market centers and aggregation points according to the instructions provided with Form MMS–4415. All Federal lessees (or their affiliates, as appropriate) must initially submit Form MMS–4415 no later than 2 months after the effective date of this reporting requirement, and then by October 31 of the year this regulation takes effect and by October 31 of each succeeding year.

§ 206.119 What interest and assessments apply if I improperly report a transportation allowance?

(a) If you or your affiliate net a transportation allowance against the royalty value on Form MMS–2014, you will be assessed an amount up to 10 percent of the netted allowance, not to exceed $250 per lease selling arrangement per sales period.

(b) If you or your affiliate deduct a transportation allowance on Form MMS–2014 that exceeds 50 percent of the value of the oil transported without obtaining MMS's prior approval under § 206.109, you must pay interest on the excess allowance amount taken from the date that amount is taken to the date you or your affiliate file an exception request MMS approves.

(c) If you or your affiliate report an erroneous or excessive transportation allowance resulting in an underpayment of royalties, you must pay the additional royalties plus interest under 30 CFR 218.54.

§ 206.120 What reporting adjustments must I make for transportation allowances?

If your or your affiliate's actual transportation allowance is less than the amount you claimed on Form MMS–2014 for each month during the allowance reporting period, you must pay additional royalties plus interest computed under 30 CFR 218.54 from the beginning of the allowance reporting

period when you took the deduction to the date you repay the difference. If the actual transportation allowance is greater than the amount you claimed on Form MMS–2014 for each month during the allowance form reporting period, you are entitled to a credit plus interest under applicable rules.

§ 206.121 Are costs allowed for actual or theoretical losses?

For other than arm's-length contracts, you are not allowed a deduction for oil transportation which results from payments (either volumetric or for value) for actual or theoretical losses.

§ 206.122 How are royalty quantity and quality determined?

(a)(1) Compute royalties based on the quantity and quality of oil as measured at the point of settlement approved by BLM for onshore leases.

(2) If the value of oil determined under this subpart is based upon a quantity and/or quality different from the quantity and/or quality at the point of royalty settlement approved by the BLM for onshore leases, adjust the value for those differences in quantity and/or quality.

(b) You may not claim a deduction from the royalty volume or royalty value for actual or theoretical losses. Any actual loss that you may incur prior to the royalty settlement metering or measurement point will not be subject to royalty provided that BLM determines that the loss is unavoidable.

(c) Except as provided in paragraph (b) of this section, royalties are due on 100 percent of the volume measured at the approved point of royalty settlement. You may not claim a reduction in that measured volume for actual losses beyond the approved point of royalty settlement or for theoretical losses that are claimed to have taken place either prior to or beyond the approved point of royalty settlement. Royalties are due on 100 percent of the value of the oil as provided in this part. You may not claim a deduction from the value of the oil for royalty purposes to compensate for actual losses beyond the approved point of royalty settlement or for theoretical losses that take place either prior to or beyond the approved point of royalty settlement.

8. Section 206.106 is revised and redesignated as § 206.123.

§ 206.123 How are operating allowances determined?

MMS may use an operating allowance for the purpose of computing payment obligations when specified in the notice of sale and the lease. MMS will specify the allowance amount or formula in the notice of sale and in the lease agreement.

Note: The following Attachments will not appear in the Code of Federal Regulations.

BILLING CODE 4310–MR–P

Attachment A

Federal Oil Location Differential Report

OMB Control Number: 1010-XXXX
Expiration date:

Lessee Name: _____ Lessee's Payor Code: _ _ _ _ _

Address: _____

City, State: _____ Zip: _____

Reporting Period (MM/DD/YY) _____ to (MM/DD/YY) _____

1. Contract Party Name	Other Exchange Party _____ Exchange Party's Payor Code (if available) _ _ _ _ _	
2. Contract Type and Identification	___ Buy/Sell, ___ Non-Cash Exchange, ___ In/Out Transportation Exchange Contract #	
3. Contract Term	Effective Date: ___/___/___ (MM/DD/YY) _____ No Change Initial Term: _____ (Months) Expiration Terms: _____ month-to-month extensions, _____ fixed duration.	
4. Exchange Pair Case (A) or Case (B)	**Oil You Transferred**	**Oil You Received**
	(A) Aggregation Point _____	Market Center _____
	(B) Market Center _____	Aggregation Point _____
5. Volume Terms	**Oil You Transferred**	**Oil You Received**
	All Available (_____ Est. B/D)	All Available (_____ Est. B/D)
	Fixed (_____ Fixed B/D)	Fixed (_____ Fixed B/D)
6. Exchange Differential	Exchange Differential Received (+) _____.__ $/BBL or Paid (-) _____.__ $/BBL	
7. Quality Information and Adjustments	**Oil You Transferred** API Gravity: Actual _____.__ ° API Deemed _____.__ ° API	**Oil You Received** API Gravity: Actual _____.__ ° API Deemed _____.__ ° API
	Gravity Adjustment Received (+)_____.__ $/BBL or Paid (-) _____.__$/BBL ___ No Gravity Adjustment	
	Sulfur: Actual Sulfur Content: _____.__ % Deemed Sulfur Content: _____.__ %	Sulfur: Actual Sulfur Content _____.__ % Deemed Sulfur Content _____.__ %
	Sulfur Adjustment Received (+) _____.__ $/BBL or Paid (-) ____.____ $/BBL___ No Sulfur Adjustment	
	Other Quality Adjustment _____ Adjustment Received (+) _____.__ $/BBL or Paid (-) _____.__ $/BBL	

Have you received any other consideration, in any form, for the sale or purchase of this crude oil, either at this location or at any other location? (__Yes, or __No). If Yes, explain: _____

Authorized Signature _____ **Date** _____

Form Preparer (Please print) _____ **Day time Phone ( ) -**

Paperwork Reduction Act of 1995 Statement

The Paperwork Reduction Act of 1995 requires us to inform you that this information is being collected to allow MMS to decrease reliance on oil posted prices, develop valuation rules that better reflect market value, and add more certainty to valuing oil produced from Federal leads. The public reporting burden for this information collection is estimated to average between 26 hours and 85 hours per response, including the time for aggregating, sorting, extracting and submitting the information. MMS will keep confidential, under applicable laws and regulations, any and all data submitted that is privileged, confidential, or otherwise exempt. Direct comments regarding the burden estimate or any other aspect of this questionnaire including suggestions for reducing this burden to the Information Collection Clearance Officer, MS 4230, MMS, 1849 C Street, N.W., Washington, DC 20240 and to the Office of Management and Budget, Office of Information and Regulatory Affairs, Attention: Desk Officer for the U. S. Department of the Interior, Washington, DC 20503. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number

Step-by-Step Instructions for Form MMS-4415

This form's purpose is to collect value differential information for oil exchanged under arm's-length exchange agreements between paired aggregation points and associated market centers. MMS will use this information to calculate and publish differentials for use by lessees and payors in determining quality and location adjustments to index prices used for royalty purposes. The proposed rule provides several situations where lessees must use index prices to value Federal oil because the oil is not sold under an arm's-length contract (§ 206.103). If lessees do not have actual quality and location differential information between the paired aggregation points and associated market centers to adjust the index price, they must rely on MMS to calculate and publish such information. The differentials may be related to quality, volume, or location. In the Preamble to the proposed rule (62 FR 3742). MMS identifies the paired aggregation points and associated market centers. To collect this information, MMS is requiring that you as a Federal lessee submit differential information on any oil produced from Federal leases and exchanged under an arm's-length agreement between these paired aggregation points and market centers. You must fill out the requested information on a separate Form MMS-4415 for each of your arm's-length exchange contracts in effect during the previous 12 month period involving Federal oil. All Federal lessees (or their affiliates, as appropriate) must initially submit Form MMS-4415 no later than 2 months after the effective date of this reporting requirement, and then by October 31 of the year this regulation takes effect and by October 31 of each succeeding year. Below are step-by-step instructions to complete Form MMS-4415.[1]

Company (Lessee) Information

Fill out your company name (whether lessee or affiliate), address, and zip code. Write in the reporting period this form covers. Forms are filed annually. Your company name, MMS payor code, and reporting period should appear on each form. If more than one form is needed to provide the required information, the address may be omitted from subsequent forms provided that the cover form containing the address is attached.

1. **Contract Party Name:** Write the name of the other party to your exchange agreement. If that party has an MMS payor code, write it in the space provided (if known).

2. **Contract Type and Identification:** Check the appropriate box to indicate the contract type. **[Buy/Sell** *is an exchange where monetary value is assigned to both volumes in the exchange.* **Non-Cash Exchange** *is a transaction where no*

[1] Paperwork Reduction Act of 1995 Statement

The Paperwork Reduction Act of 1995 requires us to inform you that this information is being collected to allow MMS to decrease reliance on oil posted prices, develop valuation rules that better reflect market value, and add more certainty to valuing oil produced from Federal lands. The public reporting burden for this information collection is estimated to average between 40 hours and 80 hours per response, including the time for aggregating, sorting, extracting and submitting the information. MMS will keep confidential, under applicable laws and regulations, any and all data submitted that is privileged, confidential, or otherwise exempt. Direct comments regarding the burden estimate or any other aspect of this questionnaire including suggestions for reducing this burden to the Information Collection Clearance Officer, MS 4230, MMS, 1849 C Street, N.W., Washington, DC 20240 and to the Office of Management and Budget, Office of Information and Regulatory Affairs, Attention: Desk Officer for the U. S. Department of the Interior, Washington, DC 20503. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Step-by-Step Instructions for Form MMS-4415

monetary value is assigned to either volume in the exchange; instead, a dollar amount is assigned to the difference in value between the two volumes. **In/Out transportation exchange** *is used for the purpose of transporting oil on proprietary pipelines where the shipper takes possession of the oil during transit and sells the oil back to the contracting party at the other end of the pipeline.* Also fill in the **Contract Number** -- use the I.D. that would allow a third party to clearly identify the document. This is important because MMS must identify cases where two sides of an exchange are reported so that the information will not be used twice. The contract number will also aid MMS later in the event that these contracts are audited.

3. **Contract Term:** Fill in the date the contract started (**Effective Date**) and its **Initial term** in months. Check the expiration term that applies to this contract -- either **month-to-month extensions** or **fixed duration**. (*Note: for contracts that are* ***month-to-month extensions****, if the same contract is in effect as when the last report was filed, you do not need to fill out the rest of the form; just check* ***(no change)*** *and sign the bottom portion of the form*).

4. **Exchange Pair:** You need to report information on oil exchanges between **aggregation points** and **market centers**. Clearly identify the **aggregation point** and **market center** involved (refer to the MMS listing of **aggregation point** and **market center** pairings published in the Federal Register). You will be either reporting on oil you transferred at an **aggregation point** in exchange for oil you received at a **market center** (case A) or on oil you gave up at a **market center** in exchange for oil you received at an **aggregation point** (case B). For **in/out transportation exchanges**, only the company who is contracting for the transportation exchange will need to report the exchange. For other exchanges, both parties may be required to report on the exchange if they are both Federal lessees and if both volumes of oil in the exchange involve oil from Federal leases.

5. **Volume Terms:** First, fill in the volume in barrels per day of oil you transferred. If the contract states that **all available** oil will be taken, write in the estimated barrels per day of oil provided and make any handwritten clarifications you believe appropriate. Otherwise, write in the **fixed** volume you transferred as specified in the contract. Next, fill in the barrels of oil you received under the terms of the exchange contract. If the contract states that **all available** oil will be taken, write in the estimated barrels per day of oil received together with any needed handwritten explanations. Otherwise, write in the **fixed** volume you received as specified in the contract.

6. **Exchange Differentials:** This section requests information about the differential received or paid by you under the exchange agreement. If your purpose under the exchange was to transport your oil on the other party's pipeline, the payment will reflect the cost of service to transport your oil. Any adjustments that were made to reflect gravity or sulfur content of your oil will be addressed in the next section.

Step-by-Step Instructions for Form MMS-4415

In cases where oil was exchanged between the two parties to the exchange contract, there may be a differential paid by the party whose oil is considered to be worth less than the other oil. This may be a result of differences in location, or quality differences between the oils that effect the value of the oil in the refining process.

Write the total of any differential payment you received or the total of any differential payment you made under the exchange agreement in the space provided.

7. **Quality Information and Adjustments:** This section requests information about the quality of oil involved in the exchange and about any adjustments to value that are part of the exchange agreement. The value of the oil you transferred in an exchange or transportation agreement may have been different than the value of the oil you received. To the extent that this difference is due to gravity or sulfur content, identify these value components.

API Gravity: If your exchange agreement references **actual** gravity of the oil you transferred, write the gravity to the nearest tenth of a degree in the space provided. Or, if the gravity is **deemed**, write the deemed API gravity to the nearest tenth of a degree in the space provided.

If this is an exchange for purposes of transporting oil on a pipeline, and you received a credit for oil you put into the pipeline because the gravity of your oil was higher than the oil you ultimately received at the other end of the pipeline, write the amount of the gravity credit you received in the space provided. If you paid a gravity penalty because the gravity of the oil you put into the pipeline made it worth less than the gravity of the oil you received at the other end of the pipeline, write that amount in the space provided (note whether a pipeline gravity bank was applied).

In other types of exchanges where there is reference to a gravity adjustment figure, write the amount you received or paid in the appropriate space provided.

If the contract does not include any reference to a gravity adjustment, place a check in the space provided and leave the gravity adjustment figure spaces blank.

Sulfur Content and Adjustment: If your exchange agreement references the **actual** sulfur content of the oil you transferred, write the **actual** sulfur content to the nearest tenth of a percent. If the sulfur content is **deemed**, write the **deemed** sulfur content to the nearest tenth of a percent in the space provided. If the **actual** sulfur content of the oil you receive in the exchange is referenced in the contract, write that content to the nearest tenth of a percent in the space provided. If the sulfur content of the oil you receive is **deemed**, write that content in the space provided.

Step-by-Step Instructions for Form MMS-4415

If this is an exchange for purposes of transporting oil on a pipeline, and you received a credit for oil you put into a pipeline because the sulfur content of your oil was lower than the oil you ultimately received at the other end of the pipeline, write the amount of the sulfur credit you received in the space provided. If you paid a penalty because the sulfur content of the oil you put into the pipeline was higher than the oil you received at the other end of the pipeline, write that amount in the space provided (note whether pipeline gravity schedules were applied).

In other types of exchanges, where there is a reference to a sulfur content adjustment figure, write the amount you received or paid in the appropriate space provided. Add any handwritten explanations needed.

If the contract does not include any reference to a sulfur adjustment, place a check in the space provided and leave the sulfur adjustment figure spaces blank.

If your exchange contract specifies any other value adjustments due to oil quality components other than gravity or sulfur content, identify the quality component in the space provided along with any credit received or penalty you paid. If there is insufficient space provided, use the back of this form to provide this additional information.

Certification: Check whether you received any other consideration for this oil. If you check "yes" provide an explanation. Use the back of this form to provide this explanation if additional space is required to adequately respond.

Authorized Signature: The form must be signed and dated by a person who has authority to represent the company.

Form Preparer: Please write the name of the individual who completed the form and a phone number where that person can be reached during normal business hours.

BILLING CODE 4310-MR-C

State	Station location	County/offshore location
	Aggregation Points for Saint James, & Empire, Louisiana	
LA	Conoco Jct	Calcasieu
LA	Lake Charles	Calcasieu.
LA	Texaco Jct	Calcasieu.
LA	Grand Chenier Term	Cameron.
LA	Grand Isle	Jefferson.
LA	Bay Marchand Term	Lafourche.
LA	Bayou Fourchon	Lafourche.
LA	Clovelly	Lafourche.
LA	Fourchon Terminal	Lafourche.
LA	Golden Meadow	Lafourche.
LA	Blk. 55	Offshore—South Pass.
LA	Blk. 13 (Wesco P.L. Subsea Tie-in)	Offshore—South Pelto.
LA	Blk. 172 Plat. D	Offshore—South Timbalier.
LA	Blk. 196 (Exxon P.L. System Tie-in)	Offshore—South Timbalier.
LA	Blk. 300	Offshore—South Timbalier.
LA	Blk. 35 Platform D.	Offshore—South Timbalier.
LA	Blk. 52 Plat. A	Offshore—South Timbalier.
LA	Blk. 30	Offshore—West Delta.
LA	Blk. 53	Offshore—West Delta.
LA	Blk. 53 Plat. B	Offshore—West Delta.
LA	Blk. 53B—Chevron P.L	Offshore—West Delta.
LA	Blk. 53B. Plat. Gulf Refining Co	Offshore—West Delta.
LA	Blk. 83	Offshore—West Delta.
LA	Blk. 28 Tie-in	Offshore—East Cameron.
LA	Blk 337 Subsea tie-in	Offshore—Eugene Island.
LA	Blk. 188 A Structure	Offshore—Eugene Island.
LA	Blk. 23	Offshore—Eugene Island.
LA	Blk. 259	Offshore—Eugene Island.
LA	Blk. 316	Offshore—Eugene Island.
LA	Blk. 361	Offshore—Eugene Island.
LA	Blk. 51 B Platform	Offshore—Eugene Island.
LA	Texas P.L. Subsea Tie-in	Offshore—Eugene Island.
LA	Blk. 17	Offshore—Grand Isle.
LA	Blk 69 B Plat	Offshore—Main Pass.
LA	Blk. 144 Structure A	Offshore—Main Pass.
LA	Blk. 298 Plat. A	Offshore—Main Pass.
LA	Blk. 299 Platform	Offshore—Main Pass.
LA	Blk. 42—Chevron P. L	Offshore—Main Pass.
LA	Blk. 42L	Offshore—Main Pass.
LA	Blk. 77 (Pompano P.L. Jct.)	Offshore—Main Pass.
LA	Blk. 169	Offshore—Ship Shoal.
LA	Blk. 203—Subsea Tie-in	Offshore—Ship Shoal.
LA	Blk. 208	Offshore—Ship Shoal.
LA	Blk. 208 B Structure	Offshore—Ship Shoal.
LA	Blk. 208 F	Offshore—Ship Shoal.
LA	Blk. 28	Offshore—Ship Shoal.
LA	Blk.154	Offshore—Ship Shoal.
LA	Ship Shoal Area	Offshore—Ship Shoal.
LA	Blk. 255	Offshore—Vermilion.
LA	Blk. 265 Platform A.	Offshore—Vermilion.
LA	Blk. 350	Offshore—Vermilion.
LA	Main Pass	Plaquemines.
LA	Main Pass Blk. 69—	Plaquemines.
LA	Ostrica Term.	Plaquemines.
LA	Pelican Island	Plaquemines.
LA	Pilottown	Plaquemines.
LA	Romere Pass	Plaquemines.
LA	South Pass Blk. 24	Plaquemines.
LA	South Pass Blk. 24 Onshore Plat	Plaquemines.
LA	South Pass Blk. 27 Onshore Facility	Plaquemines.
LA	South Pass Blk. 60A	Plaquemines.
LA	Southwest Pass Sta.	Plaquemines.
LA	West Delta Blk. 53	Plaquemines.
LA	Blk. 10—Structure A	Offshore—South Marsh Island
LA	Blk. 139	Offshore—South Marsh Island.
LA	Blk. 139 Subsea Tap Valve	Offshore—South Marsh Island.
LA	Blk. 207—Light House Point A	Offshore—South Marsh Island.
LA	Blk. 268—Platform A	Offshore—South Marsh Island.
LA	Blk. 58A	Offshore—South Marsh Island.
LA	Blk. 6	Offshore—South Marsh Island.
LA	Chalmette	St. Bernard.
LA	Norco (Shell Refinery)	St. Charles.

State	Station location	County/offshore location
LA	Burns Term.	St. Mary.
LA	South Bend	St. Mary.
LA	Caillou Island	Terrebonne.
LA	Gibson Term.	Terrebonne.
LA	Erath	Offshore—Vermillion.
LA	Forked Island	Offshore—Vermillion.
LA	Anchorage	West Baton Rouge.
TX	Buccaneer Term.	Brazoria.
TX	Mont Belvieu	Chambers.
TX	Winnsboro	Franklin.
TX	Texas City	Galveston.
TX	Houston	Harris.
TX	Pasadena	Harris.
TX	Webster	Harris.
TX	Beaumont	Jefferson.
TX	Lucas	Jefferson.
TX	Nederland	Jefferson.
TX	Port Arthur	Jefferson.
TX	Port Neches	Jefferson.
TX	Sabine Pass	Jefferson.
TX	Corsicanna	Navarro.
TX	American Petrofina	Nueces.
TX	Corpus Christi	Nueces.
TX	Harbor Island	Nueces.
TX	Blk. 474—Intrsction. seg. III, III–7	Offshore—High Island.
TX	Blk. A—571	Offshore—High Island.
TX	End Segmennt III—10 (Blk. 547)	Offshore—High Island.
TX	End Segment II	Offshore—High Island.
TX	End Segment III—10	Offshore—High Island.
TX	End Segment III—6	Offshore—High Island.
TX	Rufugio Sta.	Rufugio.
TX	Midway	San Patricio.
TX	South Bend	Young.
	Aggregation Points for Alaska North Slope Valuation	
CA	Coalinga	Fresno.
CA	Belridge	Kern.
CA	Fellows	Kern.
CA	Kelley	Kern.
CA	Lake	Kern.
CA	Leutholtz Jct	Kern.
CA	Midway	Kern.
CA	Pentland	Kern.
CA	Station 36–Kern River	Kern.
CA	Hynes Station	Los Angeles.
CA	Newhall	Los Angeles.
CA	Sunset	Los Angeles.
CA	Cadiz	San Bernadino.
CA	Avila	San Luis Obispo.
CA	Gaviota Terminal	Santa Barbara.
CA	Lompoc	Santa Barbara.
CA	Sisquoc Jct	Santa Barbara.
CA	Filmore	Ventura.
CA	Rincon	Ventura.
CA	Santa Paula	Ventura.
CA	Ventura	Ventura.
CA	Rio Bravo	County Unknown.
CA	Signa	County Unknown.
CA	Stewart	County Unknown.
	Aggregation Points for Midland Texas	
NM	Jal	Lea.
NM	Lovington	Lea.
NM	Ciniza	McKinley.
NM	Bisti Jct	San Juan.
NM	Navajo Jct	San Juan.
TX	Fullerton	Andrews.
TX	Crane	Crane.
TX	Caproch Jct	Ector.
TX	Odessa	Ector.
TX	North Cowden	Ector.
TX	Wheeler	Ector.

State	Station location	County/offshore location
TX	El Paso	El Paso.
TX	Roberts	Glasscock.
TX	Big Spring	Howard.
TX	Phillips Hutchinson	Howard.
TX	McKee	Moore.
TX	Beaver Station	Ochiltree.
TX	Kemper	Reagan.
TX	Mason Jct	Reeves.
TX	Eldorado	Scheicher.
TX	Basin Station	Scurry.
TX	Colorado City	Scurry.
TX	McCamey	Upton.
TX	Mesa Sta	Upton.
TX	Halley	Winkler.
TX	Hendrick/Hedrick-Wink	Winkler.
TX	Keystone	Winkler.
TX	Wink	Winkler.
	Aggregation Points for Cushing Oklahoma.	
CO	Denver	Adams.
CO	Cheyenne Wells Station	Cheyenne.
CO	Iles	Moffat.
CO	Sterling	Logan.
CO	Fruita	Mesa.
CO	Rangley	Rio Blanca.
MT	Silver Tip Station	Carbon.
MT	Alzada	Carter.
MT	Richey Station	Dawson.
MT	Baker	Fallon.
MT	Cut Bank Station	Glacier.
MT	Bell Creek Station	Powder River.
MT	Clear Lake Sta	Sheridan.
MT	Poplar Station	Roosevelt.
MT	Billings	Yellowstone.
MT	Laurel	Yellowstone.
ND	Fryburg Station	Billiings.
ND	Tree Top Station	Billiings.
ND	Lignite	Burke.
ND	Alexander	McKenzie.
ND	Keene	McKenzie.
ND	Mandan	Morton.
ND	Tioga	Ramberg.
ND	Ramberg	Williams.
ND	Thunderbird Refinery	Williams.
ND	Tioga	Williams.
ND	Trenton	Williams.
ND	Killdear	County Unknown.
UT	Salt Lake Station	Davis.
UT	Woods Cross	Davis.
UT	Salt Lake City	Salt Lake.
UT	Aneth	San Juan.
UT	Patterson Canyon Jct	San Juan.
UT	Bonanza Station	Uintah.
UT	Red Wash Station	Uintah.
WY	Byron	Big Horn.
WY	Central Hilight Sta	Cambell.
WY	Rocky Point	Cambell.
WY	Rozet	Cambell.
WY	Sinclair	Carbon.
WY	Big Muddy Sta	Converse.
WY	Pilot Butte Sta	Freemont.
WY	Cottonwood Jct	Hot Springs.
WY	Crawford Sta	Johnson.
WY	Reno	Johnson.
WY	Sussex	Johnson.
WY	Cheyenne	Laramie.
WY	Casper	Natrona.
WY	Noches	Natrona.
WY	Lance Creek Station	Niobrara.
WY	Frannie Sta	Park.
WY	Oregon Basin Sta	Park.
WY	Guersey	Platte.
WY	Wamsutter Sta	Sweetwater.

State	Station location	County/offshore location
WY	Bridger Station	Uinta.
WY	Divide Junction	Uinta.
WY	Evanston Sta	Uinta.
WY	Chatham Sta	Washakie.
WY	Butte Sta	Weston.
WY	Mush Creek Jct	Weston.
WY	Osage Station	Weston.

[FR Doc. 98-2704 Filed 2-5-98; 8:45 am]
BILLING CODE 4310-MR-P

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 110

[CGD01-97-014]

RIN 2115-AA98

Special Anchorage Area: Groton, CT

AGENCY: Coast Guard, DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to extend the boundaries of the special anchorage area currently existing off Groton, Connecticut, between Pine Island and Avery Point. This action is taken at the request of the City of Groton, and is intended to make space available within the special anchorage area for approximately 20 additional moorings.

DATES: Comments must be received on or before April 7, 1998.

ADDRESSES: Comments may be mailed to Commander, Aids to Navigation Branch, First Coast Guard District, 408 Atlantic Avenue, Boston, Massachusetts 02110-3350.

FOR FURTHER INFORMATION CONTACT: LT Matthew Stuck, Aids to Navigation Branch, First Coast Guard District, 408 Atlantic Avenue, Boston, Massachusetts 02110-3350, (617) 223-8347.

SUPPLEMENTARY INFORMATION:

Request for Comments

The Coast Guard encourages interested persons to participate in this rulemaking by submitting written data, views, or arguments. Persons submitting comments should include their names and addresses, identify this rulemaking (CGD01-97-014) and the specific section of this proposal to which each comment applies, and give the reason for each comment. Persons wanting acknowledgment of receipt of comments should enclose a stamped, self-addressed postcard or envelope. Comments should be submitted to the address under **ADDRESSES**.

The Coast Guard will consider all comments received during the comment period. It may change this proposal in view of the comments. The Coast Guard plans no public hearing; however, persons may request a public hearing by writing to the Signals Management Section at the address under **ADDRESSES**. If it is determined that the opportunity for oral presentations will aid this rulemaking, the Coast Guard will hold a public hearing at a time and place announced by a later notice in the **Federal Register**.

Discussion of Proposed Rules

The proposed rule is in response to a request made by the City of Groton to accommodate the increased number of vessels mooring in this area. The proposed rule would expand the existing special anchorage near Groton, Connecticut, described in 33 CFR 110.51, to allow its use by approximately 20 additional boats. Vessels not more than 65 feet in length when at anchor in any special anchorage shall not be required to carry or exhibit the white anchor lights required by the Navigation Rules. The proposed rule would provide approximately twenty additional moorings in which vessel owners may enjoy the convenience of a special anchorage. The existing anchorage, located near Pine Island and Avery Point, is split into two areas by a 210-foot wide fairway channel. The proposed change would reduce the width of the existing fairway to approximately 135 feet and extend the western boundary of the southern section of the anchorage by 75 feet. The note following section 33 CFR 110.51 would be updated to indicate the decrease in fairway channel width.

Regulatory Evaluation

This proposed rule is not a significant regulatory action under section 3(f) of Executive Order 12866, and does not require an assessment of potential costs and benefits under section 6(a)(3) of that Order. It has not been reviewed by the Office of Management and Budget under that Order. It is not significant under the regulatory policies and procedures of the Department of Transportation (DOT) (44 FR 11040; February 26, 1979).

The Coast Guard expects the economic impact of this proposal to be so minimal that a full Regulatory Evaluation under paragraph 10(e) of the regulatory policies and procedures of DOT is unnecessary. No person will be required to spend any money in order to comply with this regulation. The proposed regulation will exempt persons operating in the expanded area from complying with the more stringent vessel lighting regulations they would ordinarily be obliged to follow.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Coast Guard considers whether this proposed rule, if adopted, will have a significant economic impact on a substantial number of small entities. "Small entities" include small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. For the reasons discussed in the Regulatory Evaluation section above, the Coast Guard expects that this proposed rule, if adopted, will not have a significant impact on a substantial number of small entities. If, however, you think that your business or organization qualifies as a small entity and that this proposed rule will have a significant economic impact on your business or organization, please submit a comment (see **ADDRESSES**) explaining why you think it qualifies and in what way and to what degree this proposed rule will economically affect it.

Collection of Information

This proposed rule contains no collection of information requirements under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*).

Federalism

The Coast Guard has analyzed this proposed rule under the principles and criteria contained in Executive Order 12612 and has determined that this proposed rule does not have sufficient implications for federalism to warrant