INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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

Re: Valuation of Oil From Federal and Indian Leases

Dear Mr. Guzy:

This letter constitutes the written comments of the Independent Petroleum Association of America (IPAA) on the Minerals Management Service's (MMS) Advance Notice of Proposed Rulemaking regarding the valuation of oil from Federal and Indian leases. IPAA is the national trade association representing approximately 5,300 domestic independent crude oil and natural gas explorers/producers in all 33 producing states. As you know, our members are very active on public lands and the Outer Continental Shelf.

IPAA has no comment on the "validity" of posted prices as a method of valuation for non-arm's-length transactions and any corresponding alternatives. We encourage you to take into account the views of the lessees that are party to the pending litigation before proceeding with alternative oil valuation proposals.

Regarding arm's-length valuation methods for oil, IPAA members are directly impacted because the vast majority of independent producers sell their oil production in arm's-length transactions at or near the wellhead. The advance notice suggests that alternative methods for valuing oil not sold under arm's-length contracts could impact the acceptability of posted prices for valuing oil sold at arm's-length contracts. This comment greatly concerns IPAA because it implies that even though an independent producer receives payment for the sale of oil based on posted prices, the MMS will reject these actual proceeds and require an alternative which may or may not approximate actual proceeds.

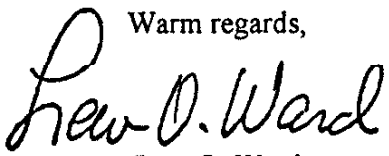
Depending on the method used to estimate proceeds, independents could be forced into an unacceptable position of having to pay royalties on phantom proceeds. The requirement to pay royalties on amounts greater than actual proceeds received effectively increases the royalty rate above the highest rate established under lease terms and applicable statutes. If the federal government took its oil in-kind and sold it at the wellhead, it too would receive proceeds based on posted prices thereby demonstrating that such prices are fair market value for that area. We encourage the MMS to undertake an oil in-kind program similar to the in-kind pilot program that was successfully implemented for gas produced in the Outer Continental Shelf.

The Federal Register notice states that the Secretary has considerable discretion in determining value for royalty purposes. This is true, but when considering alternatives to the 1988 valuation regulations, we encourage MMS to look to statutes and lease terms for guidance when determining fair market value. Royalties should be based on what a willing buyer and seller would pay for oil production at the wellhead. If the purchase point is downstream of the wellhead, then all downstream costs should be deductible from proceeds received as the determination of royalty value.

The advance notice inquired about the "process" for determining alternative methods for valuing oil production. IPAA supports a process whereby affected constituents are consulted prior to issuance of a proposed rule and that separates Federal and Indian lease issues. We understand, and support, the position that many lessees may not be able to participate in a rulemaking process due to their pending litigation. If MMS concludes that a rulemaking process is appropriate, we ask in advance that you consult with IPAA about how we might be able to improve the decision making process that was adopted for the gas valuation committee. To limit the voice of independents to a single vote through one organization does not promote consensus decision making among the diverse independent community.

We appreciate the opportunity to comment on MMS' inquiry into the valuation of Federal and Indian crude oil, and encourage you to contact our office to discuss this matter further.

Warm regards,



Lew O. Ward

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