George C. Rule
Business Development Manager
Exploration Production
North America

Conoco Inc.
600 North Dairy Ashford Road
Permian Building 1042
P. O. Box 2197
Houston, Texas 77252
(281) 293-6219

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Minerals Management Service
Royalty Management Program
Building 85, Denver Federal Center
Denver, Colorado 80225

Attn: David S. Guzy, Chief - Rules and Procedures Staff

Re: Supplementary Proposed Rule for Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, 30 C.F.R. Part 206, 62 F.R. 36030 (July 3, 1997)

Dear Mr. Guzy:

Conoco Inc. ("Conoco") welcomes this opportunity to submit the enclosed comments to the Minerals Management Service ("MMS") with respect to the above-referenced supplementary proposed rule concerning the value of federal royalty on crude oil production.

Conoco is a wholly-owned subsidiary of E. I. DuPont de Nemours and Company. In 1996 its worldwide production of crude oil, condensate, and natural gas liquids averaged 378,000 barrels per day and its worldwide natural gas production averaged 1,285 million cubic feet per day. During the five-year period ending December 31, 1996, Conoco remitted royalty payments to the MMS in excess of $393 million.

Conoco further endorses the comments filed by the American Petroleum Institute, the comments filed jointly by the Independent Petroleum Association of America and the Domestic Petroleum Council, the Council of Petroleum Accountants Societies, the Rocky Mountain Oil and Gas Association, and the Barents Report. Conoco is concerned that the Supplementary Proposed Rule did not address the many issues raised by industry in this matter, including the use of a benchmarking system with a competitive bid program.

Thank you for the opportunity to comment on this matter.

Very truly yours,

GC Rule

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Conoco Inc. Comments Re: MMS Supplementary Rulemaking for Oil Valuation

The MMS issued, on July 3, 1997, a Supplementary Proposed Rule for Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, 30 CFR Part 206. The Supplementary Proposed Rule was offered to modify the MMS proposed rulemaking published on January 24, 1997 (62 FR 3742) to correct certain deficiencies noted by the Independent Petroleum Association of America (IPAA) and the Independent Petroleum Association of Mountain States (IPAMS). Comments from the rest of the industry seemed to have been ignored by the MMS. Conoco hereby provides these additional comments regarding the modifications proposed by the MMS. These comments are intended to be additive to the comments previously submitted by Conoco on the January 24, 1997 notice of proposed rulemaking.

I. The MMS Proposed Oil Valuation Rulemaking Remains Inequitable to the Lessee Even After the Modifications Proposed by the MMS

The MMS continues to support a method to value federal royalty crude oil that is inherently inequitable to lessees. The MMS has not rectified the problems of using a distant market to value lease crude. The MMS continues to leapfrog over the real market value existing at the field level in favor of using some paper trading market. This MMS method continues to impose significant reporting burdens on lessees through the use of a new form MMS-4415. The MMS continues to expect that buy/sell exchange differentials collected from the industry in a given year will somehow be reflective of the market for the ensuing year. However, these trade differentials change as market conditions change and can fluctuate by 50¢ or more per barrel from time to time. For instance, there have been times when West Texas Intermediate (WTI) quality crude traded at Cushing, Oklahoma has commanded a premium over South Louisiana Sweet crude. However, because of market conditions, sometimes this differential has changed in favor of South Louisiana Sweet over WTI at Cushing. From year to year this differential swing has been as much as 50¢ per barrel. Thus, the MMS would have lessees pay a value for federal crude oil that is not market-based.

The MMS has also not repaired the problem of using West Texas Sour crude to value Rocky Mountain Sour crudes. These crudes are not the same, do not go to the same end-user markets, do not compete with each other, and are not influenced by the same overall regional market forces. Hence, the MMS' use of West Texas Sour crude value as a proxy for valuing Rocky Mountain Sour crudes is unrealistic, unreasonable and creates an economic distortion to the lessee.

II. The MMS Failed to Include in Their Supplementary Proposed Rule a Competitive Bid Valuation as Recommended By Conoco Inc.

In its original January 24, 1997 proposed rulemaking the MMS asked for alternative ways to value federal royalty oil. Conoco offered such an alternative at the public meeting on April 17, 1997 in Houston, Texas. This alternative was explained as a competitive bid program that Conoco had begun effective with delivery of first oil on April 1, 1997. The essence of the program is that a representative volume of crude oil is identified by region and that crude oil would become the proxy for all oil valuation for crude in that region. The selected crude would be offered for bids and sold under arm's-length arrangements. The highest qualifying bid would be used to value all Conoco controlled crude in that region, including federal royalty oil. A written description of Conoco's program, along with copies of the actual bid letters and conditions for bidding, were distributed at the April 17, 1997 public meeting. The MMS has ignored this program in their Supplementary Proposed Rule for reasons unknown.

Conoco's proposed alternative is superior to the MMS NYMEX netback method because it reflects the real market value at the lease level. When barrels are offered for bid, the bids received reflect contemporaneous market values in the field for that type of crude. It does not incorporate the use of differentials or some other market differentials from a past period that are obsolete for current market values.

In the Supplementary Proposed Rule the MMS allows the use of competitive arm's-length bidding to determine value for federal crude oil but only if the crude being bid is the federal crude in question. Thus, using a proxy of representative crude in a region is disallowed by the MMS even though federal royalty crude oil is being valued using a competitive arm's-length bid program. To the MMS it seems how federal crude oil physically moves off the lease is more important than the way federal crude oil is being valued. In Conoco's case, if Conoco were moving oil off a lease via a buy/sell transaction, then Conoco would be forced to use the MMS NYMEX netback valuation method even though the crude oil, including the federal royalty oil, is being valued separately from the buy/sell transaction. The MMS seems overly concerned that a buy/sell arrangement will somehow, in and of itself, cause the government to receive a value less than fair market value.

To illustrate just how equitable Conoco's proposed alternative is, Conoco would like to compare the results of its bid program values actually received versus the MMS NYMEX netback method values. Unfortunately, Conoco has no way of knowing what differentials the MMS would use between "trade or market centers" since it plans to use outdated information, nor do we know what transportation costs will be allowed. However, we can provide the following values derived from our bid program for the second quarter of 1997 for certain offshore production. These values represent the actual values paid the MMS based on the bid program. We believe these values exceed those that would be determined by the MMS NYMEX netback method.

	APRIL 1997	MAY 1997	June 1997
Ewing Bank	$19.32 per barrel	$ 20.19 per barrel	$ 18.38 per barrel
Eugene Island	First Bid in May	$ 20.19 per barrel	$ 18.38 per barrel
Grand Isle	$ 19.32 per barrel	$ 20.19 per barrel	$ 18.38 per barrel

Ewing Bank and Grand Isle crudes were both bid out at the same sales location and are of similar sweet quality; thus, they are priced the same. Eugene Island crude was bid out beginning with May delivery. This crude is sour in quality and it is just a coincidence that the highest qualifying bid price equalled the price paid for the Ewing Bank and Grand Isle sweet crudes.

Conoco believes that the MMS, by bypassing markets at the lease, are missing an opportunity to get fair market value when regional conditions cause lease prices to be higher than what would be generated through the NYMEX netback method. Of course, there may be times when regional conditions may cause lease prices to be less than what would be generated through the NYMEX netback method, but this is the essence of market dynamics and it is certainly more equitable to the lessee that they pay the MMS based on what market values actually are in the field versus some distant trade center, particularly when the MMS' method is to use old and non-market related trade differentials.

Unfortunately, there will be times under the MMS NYMEX netback method when dictated differentials will not actually exist in the market during the period of production and sale of crude and because the lessee cannot realize these values in marketing the crude oil, the lessee will consequently need to pay some royalty monies out-of-pocket.

Additional Comments

<u>206.101 - Non-competitive crude oil call</u> - Conoco disagrees with MMS' proposed definition. We disagree with MMS' belief that a "Most Favored Nations Clause" or similar language is required to make the call language competitive. Crude oil call language generally does not contain a "Most Favored Nations Clause." That clause is used in gas contracts, not crude oil calls. The crude oil call valuation basis should be used for royalty purposes unless the language specifically references a value to be less than the value under arm's-length transactions in the field or area.

<u>Form 4415</u> - In this supplementary proposed rule, MMS has clarified some of the questions related to the proposed new form, but they have done nothing to reduce the administrative burden placed on lessees by the proposed form. Furthermore, we still do not believe that the collection of these data is necessary.

MMS asked for comments on the following specific questions:

1. MMS was concerned about the lessee's ability to know whether the prices lessees are receiving are the highest prices under the Most Favored Nations Clause. Conoco does not believe this clause is necessary to make a call competitive; therefore, we believe MMS' concern is unwarranted.

2. MMS requested comments on whether they should require a lessee to certify that they are not maintaining an "overall balance" with their purchaser. Unless MMS intends to audit every certification, Conoco sees no benefit to MMS requiring certifications.

3. MMS requested comments on whether 206.102 (a)(6) as proposed in January should be modified to specify purchase levels below which a lessee would not be required to value their production using index value. Conoco supports the deletion of 206.102 (a)(6) in its entirety.