Notes--7/22/98 meeting on MMS's proposed oil royalty valuation rule

Meeting held at Senate Dirksen Building. Participants at table included:

Senator Hutchison (Texas)
Senator Breaux (Louisiana)
Senator Domenici (New Mexico)
Senator Bingaman (New Mexico)
Senator Thomas (Wyoming)
Cynthia Quarterman, Director, MMS
Bob Armstrong, Assistant Secretary for Land and Minerals Management
Claire Farley (Texaco North American Production)
Diemer True (True Oil Co.)
Thomas P. White (Vision Resources Inc.)
Peter Robertson (Chevron U.S.A. Co.)
Robert L. Keiser (Oryx Energy Co.)
Jack E. Little (Shell Oil Co.)
George Yates (Harvey E. Yates Co.)

Senator Hutchison convened the meeting at 2:10 p.m. She noted she wasn't able to attend the July 9 meeting, but got a report on it and felt good progress was made. She said she was one of the people who put the amendment forward to delay publication of MMS's rule, and more time was needed to discuss the rule. It's a critical time for the oil industry, and not a time for negative impacts on them. She wants a result that's right for taxpayers and producers alike, so tax revenues are maintained, jobs are preserved, and industry is stabilized.

Senator Hutchison then asked for briefs from MMS and industry on the issues involved and their status.

Ms. Quarterman noted that at the last meeting Senator Breaux asked for a summary of issues that MMS was to address in the interim between meetings. She pointed to the MMS's July 16, 1998 Federal Register notice in response to that request. The notice addresses 1) the affiliate definition, 2) language added to the proposed rule on "second guessing" lessees' marketing decisions, 3) requirements for applying gross proceeds under arm's-length sales following an exchange agreement, and 4) a request for comments on allowability of gathering costs as transportation under certain circumstances.

Senator Hutchison asked whether the Federal Register notice represented a supplemental proposed rule. Ms. Quarterman said yes. Senator Bingaman then noted that the same Interior Department officials had met yesterday with Representative Miller and others and wanted to know if other changes to the rule resulted from that meeting. Mr. Armstrong replied that no other changes had been made based on the other meeting. Senator Bingaman asked whether other changes were contemplated, and Ms. Quarterman said minor detail changes might be made, but otherwise the changes were done. She noted that the supplemental rule was meant to summarize those issues in which the Department had determined to move in the direction of industry as Senator Breaux requested.

Senator Hutchison then asked for a statement from Senator Bingaman.

Senator Bingaman said it seems progress has been made since the last meeting. But he noted that comments are expected on the web page July 23, and the comment period ends the next day. This didn't seem a realistic time frame for commenters to respond, and he suggested expanding the comment period.

Senator Hutchison noted that she was looking at an October 1, 1999, date for MMS to publish its rule, while MMS was looking to October 1, 1998. She believed extending the comment period would be helpful to solve the issues involved.

Mr. Armstrong said that he wanted to limit everyone's contributions at this stage to new items only and that he was trying to meet the Secretary's 10/1/98 deadline to publish the rule. But he agreed that the short time between posting of the meeting notes and closing the comment period might justify an extension and he would look into it. He noted, however, that he doesn't want meeting after meeting on this issue.

Senator Bingaman said he understood that the Department's legal counsel warn that the Department can't have substantive talks with Senators or others on the rule after the comment period closes. Mr. Armstrong concurred. Senator Bingaman said that's another reason the comment period should be extended. Senator Hutchison agreed. She believed meaningful discussions could be held, and they should not be limited by legal concerns. Mr. Armstrong said, however, that at some point soon the issue must be wrapped up.

Ms. Hutchison then asked Mr. Little for a summary.

Mr. Little expressed his thanks for this opportunity and hoped for a win/win solution. He said, however, that he didn't share the optimism that others had shown so far. He said he would provide a number of specific suggestions responding to all issues raised to date. He agreed that MMS had published proposed changes, but only one of them represented an improvement. He said that over the past several years MMS has held a number of hearings in which industry has offered lots of comments, but MMS hasn't really listened. He said he would cover six specific issues.

The first issue was the affiliate definition. He said MMS's change was acceptable and he appreciated it. He also noted that the gathering issue is still open and MMS is awaiting comments on it. But he felt MMS had regressed on four other issues: benchmarking, marketing costs, duty to market, and exchanges. He said he would provide concrete data and suggestions. At that point he distributed a document summarizing industry suggestions and turned to Mr. True for comment.

Mr. True noted he represents IPAA and that after much discussion, they concluded that MMS's recent changes are regressive and only add confusion. He believed the arm's-length provisions should be the simplest part of the rule, but the changes just made things more complicated. He said also that the language MMS added to allay industry concerns about "second guessing" was confusing. He also wondered who will determine a "breach of duty to market" or whether production is sold "substantially below" market value, and what standards would apply. He said anything below the average price could be considered below the market value. Industry thinks these changes add confusion and subjectivity. He indicated a third problem deals with treatment of exchanges.

Mr. White said that in his role as a producer with a marketing affiliate, he often must enter more than one exchange to get the oil where it's needed. But if he does so, under the proposed rule he would be forced to index pricing. It would throw a number of transactions into the index scheme and would represent a step back from where the rule was at 1 ½ years ago. He also supported Mr.True's position regarding the possibility of auditors coming back for past periods and second-guessing. The "significantly below market value" language of MMS's proposed rule is troublesome. He gave an example where he was happy to get a specific price in a given situation even where it may have been considered below average, so this provision caused him concern. He stressed that arm's-length transactions should be accepted without question.

At this point Ms. Quarterman said she thought there was a misunderstanding regarding MMS's duty to market position. Senator Breaux asked whether this meant, in the absence of a breach of the lessee's duty to market, MMS would not look at the transaction again? Ms. Quarterman replied yes, MMS has included specific language that MMS wouldn't then second-guess industry business decisions.

Mr. White thought it would help if MMS just used the word misconduct. Mr. True added that he objects to the subjectivity involved. Mr. White added that industry would have to live day-to-day with this uncertainty. Peter Schaumberg of the Department's Solicitor's office interjected that the language concerning MMS not second-guessing the lessee was meant to give comfort to industry. Senator Breaux noted that it didn't work and that industry apparently was willing to have MMS remove this language. Senator Hutchison then asked the industry representatives if they wanted to revert to the previous language, and the consensus was yes.

Ms. Quarterman then addressed exchange agreements, noting that in its latest proposal MMS had gone back to accepting arm's-length sales values following a single exchange as royalty value, but requiring index pricing if multiple exchanges occurred. She distributed copies of previous industry press releases giving conflicting positions on this issue--one release saying that companies should have the option of using arm's-length gross proceeds following multiple exchanges and another saying that tracing value through multiple transactions was too complicated. Ms. Quarterman added that MMS can accept arm's-length values after one exchange or multiple exchanges, as is evidenced by its having proposed this issue both ways in the rulemaking process. She stated MMS needed to understand which position was the industry position on this issue.

Mr. White said it's not so much an issue of the number of exchanges--the IPAA simply looked at this as part of a menu of options they wanted. One option involved using values received after multiple exchanges as royalty value. There is nothing magic about 1, 2, or 3 exchanges...the number is not significant.

Mr. Armstrong added that industry's position on this issue apparently was different in February 1998 than it is today. It's hard to address concerns when the Department doesn't know what industry wants.

Mr. White said that under the proposed rule, a lessee can either:

1) sell its production at or near the lease at arm's length and use its gross proceeds subject to the regulatory limitations for royalty payments, or

2) if it sells its production downstream and uses only one exchange, use the subsequent arm's-length sale value with only a transportation deduction, or

3) if it enters into more than one sequential exchange, it must use index pricing.

Senator Breaux then asked how Mr. White would propose to correct this situation. Mr. White responded that permitting a tendering program at the lease was the number one objective. Senator Breaux asked how exchanges should be handled, and Mr. White replied that the question was moot if sales at the lease occurred as in tendering.

Mr. True then added that the MMS procedures have moved the valuation determination downstream and made the process more complicated. Variables have been added downstream that didn't previously exist.

Senator Breaux then asked how the situation could be clarified. Ms. Quarterman replied that she still wasn't sure of the meeting participants' stance on exchange agreements. Mr. Armstrong then asked how the proposed rule would affect those who now pay royalties on arm's-length proceeds, especially in the Rocky Mountains. Ms. Quarterman noted that for arm's-length sales, everyone should stay on the same basis as under the existing rule.

Senator Breaux then asked, where there is a sale at the wellhead, is that royalty value? Mr. White added that maybe he had misunderstood the proposed rule; if he sells some production at arm's length to a third party and continues to sell other production otherwise, can he use the arm's-length sales values as a royalty value basis applicable to the other sales?

Ms. Quarterman replied that the arm's-length sales values could be applied only to that production sold at arm's length. Mr. White then asked if selling one-sixth of his production at arm’s length would satisfy the royalty value requirements. Ms. Quarterman replied no, that MMS would look to all the lessee’s dispositions to value production.

Mr. White stated that the real goal is to establish certainty. To do so, a bona fide tendering program should be permitted as the basis for royalty payments. Regardless of what he does downstream otherwise, he thought tendering should apply.

Senator Breaux said that from what he heard Ms. Quarterman and Mr. Armstrong say, he thought there was much common ground concerning arm’s length sales. Mr. Robertson believed, however, that the proposed rule is tedious and complex in backing into wellhead values.
Ms. Farley said that she looks to tendering programs at the lease as a solution. She said Texaco tenders to 45 creditworthy buyers, many of whom are not affiliated with Texaco and are not major oil companies but who resell the oil. She wants to base royalty value on tendered volumes; at the same time this would take care of transportation issues. She believes tendering is a pragmatic solution for all and would like its use to be agreed to by MMS and industry.

Senator Breaux asked for MMS’s reaction.

Ms. Quarterman said the Department has heard this proposal before. MMS began this regulatory revision process to replace reliance on oil posted prices. Its intent was to reflect market value and to promote administrative simplicity as much as possible. But tendering is not set up to promote receipt of market value--rather, it is used for royalty payment purposes. Also, tendering programs could promote opportunities to “game” royalty payments.

Senator Hutchison then asked if there was a percentage of production lessees could offer under tendering programs that would give MMS a comfort level for royalty payment purposes. Ms. Quarterman replied that MMS has a minimum requirement of 33 1/3 percent in the Rocky Mountain Region under the proposed rule. Ms. Farley noted that Texaco has explored offering different percentages of production under its tendering programs, with no difference in results obtained. She said MMS should simply acknowledge there’s a competitive market and let it work. She said Texaco has explained this program to various States and they have acknowledged that tendering is appropriate. Ms. Farley believed industry and MMS jointly can make this program work.

Mr. Armstrong noted Texas has a royalty-in-kind program. Mr. Little said the State sells about half of its royalty share this way. Senator Breaux then asked if there was concern about price variations over time under a tendering program if for example the tendered portion went for a substantially lower price than the remaining majority of production.

Mr. White wanted to know if, under the proposed rule, tendering was available for everyone to use in the Rocky Mountain Region for valuing crude not sold at arm’s length. Ms. Quarterman said yes, it’s available to all.

Mr. Robertson said it was an honor to represent probably the largest royalty payor (Chevron). He said he is committed to proper royalty payments--timely and accurate. He emphasized that industry needs certainty, no second-guessing of its decisions later, and simplicity. He is not trying to minimize values, but to get a workable system. He said attempts to trace gross proceeds back through complicated systems and multiple exchanges don't meet tests of certainty and simplicity.

Ms. Quarterman then asked Mr. Robertson if he agreed with Mr. White on the multiple exchange issue, since Mr. White advocated the ability to use proceeds received after multiple exchanges. Mr. Robertson responded that he thinks they ultimately are in agreement. Multiple transactions should have multiple solutions--a menu should be available.

Mr. True then noted that True Oil Co. has a marketing affiliate, 88 Oil Company. In May 1998 they brokered 1.6 million barrels of oil, of which only about 6,500 were True's Federal royalty barrels. Moving valuation benchmarks to distant sales points and working back to royalty value is infinitely complex. He wants a benchmarking system at the lease.

Senator Breaux then asked if it's proper to value production at the wellhead. Mr. True responded that competitive markets exist there. MMS should allow value to be determined as close to the lease as possible. IPAA wants multiple valuation options to be available, including tendering.

Mr. Robertson said "the devil is in the detail" of tracing affiliated resale values back to the wellhead. Industry-proposed options would result in reasonable value at the wellhead without the complexities of MMS's proposal.

Ms. Quarterman then stated she didn't understand Mr. True's proposal. He responded that he wants benchmarks at the lease. A weighted volume of aggregated prices at the lease could be used. Industry should be able to estimate prices at the lease agreeable to MMS. Ms. Quarterman then asked for clarification on the 6,500 barrel figure Mr. True had referenced earlier. Mr. True said he was illustrating that the Federal share of total barrels moved was very small. He wants a valuation method that circumvents the complications of MMS's proposal.

Ms. Quarterman said that Mr. True should be paying royalties on the basis of its affiliate resales now. Mr. True said he has a genuine disagreement with that. He said the current rules establish benchmarks at the lease, and MMS is adding the value of marketing under its proposal.

At this point Ms. Deborah Gibbs Tschudy of MMS noted that Mr. True was correct that the current rules have a benchmark system for valuing oil not sold at arm's length. She pointed out, however, that the benchmark value is to be compared against the gross proceeds accruing to the lessee, which would be the affiliate's resale, with the higher of the two representing royalty value. Mr. True replied that MMS's proposal would eliminate this comparison. He also asked, under the present rules, who determines which of the two comparative values is higher, especially where the proportion of Federal barrels is so small. He stressed that industry needs options that the proposed rule does not allow.

Senator Hutchison asked for clarification. Ms. Quarterman replied that the current rule references average arm's length sale but it's almost impossible to get the price and volume information needed to properly apply that aspect of the benchmarks--that's why MMS is moving away from the benchmarks' average-value concept.

Mr. Robertson once again noted the complexity of working back to value from a distant point. He said this would greatly increase the number of employees needed for royalty administration. Ms. Quarterman disagreed, saying the proposed rule would likely reduce the number of required employees.

Senator Hutchison next asked whether any of industry's proposed options would be helpful to MMS. Ms. Quarterman responded that tendering could be applied in the Rocky Mountain Region. Senator Hutchison asked why tendering or these other benchmarks couldn't apply elsewhere. Ms. Quarterman replied that there are few actual arm's-length sales in the Gulf of Mexico and that valid spot prices exist there.

Mr. Robertson said some of industry's proposed options--for example, beginning with the NYMEX price and deducting for quality and transportation--have certainty as opposed to tracing barrels. This is an option he would like. Ms. Quarterman responded that it sounded like they were in agreement. Mr. Robertson added again that he simply wants options.

Mr. White stated that if industry can run tendering programs acceptable to MMS, they represent the simplest and most productive way to make royalty payments. He implored MMS to permit industry to sell some portion of its oil as a way to represent open market sales, with the solicitations open for inspection. The results should represent royalty value.

Ms. Quarterman then asked why Mr. White doesn't do tendering now.   He replied that he does some sales at the lease now. He also buys a lot of oil at arm's length at the lease, moves it downstream and sells it at a higher incremental price than his added costs. He wants to be able to value production at the lease under a tendering program; then companies won't need multiple auditors. Ms. Quarterman asked why he doesn't sell all of its oil under tendering programs. She stressed that MMS would like its oil to "ride with" industry production on all its transactions, not just some portion. Mr. White said that marketing gets complicated. He said he is willing to let MMS share in all the benefits derived, but it's not fair for MMS to then make him independently take on all the costs and risks incurred.

Senator Breaux then asked for a discussion on duty to market. Senator Hutchison added that Mr. White is an entrepreneur and that he was saying "if you ride with me, share in the costs."

Ms. Quarterman thought industry agrees that they have a duty to market without cost under the law based on Mr. Beghini's comments at the last meeting. She believes industry was asking for a new deduction, and that perhaps this issue should be taken up by Congress.

Mr. Yates stated that he was present because Mr. Larry Nichols had to cancel. Mr. Yates stated that the duty to market issue was very important and that he wasn't sure industry and MMS would be able to bridge their disagreements on it. He was concerned about interpretations of the duty to market concept. He didn't believe that a duty to market is an obligation in terms of paying for marketing. Further, he said that some costs denied by MMS as marketing costs are really transportation costs because they are required to move production to the market.

Mr. Yates noted that he has a marketing affiliate, and market changes have forced him into moving production away from the wellhead to find a market at a reasonable price. These changes included the necessity of an expanded computer system. The only way to create market value was to be able to switch between markets on a moment's notice, so flexibility was required. He said such changes have benefitted his working interest owners as well, because they received higher additional benefits than the corresponding added administrative costs. He said such programs create the kind of competition needed, but the proposed rule would eliminate the ability to recapture the associated administrative costs.

Mr. Armstrong noted that traditionally the government gets its royalty share free and clear of costs. Senator Breaux then asked if the Department's proposed position on marketing/duty to market is thus unchanged. Mr. Yates said MMS takes that position.

Senator Hutchison asked whether anyone is claiming marketing cost problems under the current rules. Mr. Yates and Mr. Robertson said there are such problems. Mr. Yates indicated they may be solved through litigation. Ms. Quarterman noted that while the Interior Board of Land Appeals has decided some oil cases in the past, there are no outstanding oil cases in the courts.

Mr. Robertson said that Chevron is paying royalties under posted prices at the wellhead, but MMS would move the valuation point downstream under its proposal. Ms. Quarterman replied that there have always been sales away from the lease, and the values received, as adjusted for transportation costs, have formed the basis for royalty value.

Senator Hutchison asked whether MMS could change its position on marketing costs. Ms. Quarterman said no; how could she explain such a shift to the taxpayer when we have been legally upheld and it has been textbook law for years? Mr. Armstrong added that the Federal government "rides along" on a relatively small share of overall production. Mr. Yates said he understands the royalty share of 1/8 or 1/6 may be relatively small, but he was just trying to keep it from getting to 1/5 (laughter).

Mr. White then added that the fees MMS charges refiners in its RIK program represent precedent for deductions in recognition of the cost of doing business. Ms. Quarterman replied that these are costs for billing and accounting not marketing fees and are statutorily required.

Mr. Little said he wanted to cover two more items. The first involved transportation deductions. He agreed generally with beginning with an index price at St. James, for example, but the proposed MMS rule subsequently is complicated and unfair. He distributed a handout showing three producers on the same reservoir--one selling production at arm's length at the lease, one transporting production through a regulated pipeline in which it holds no interest, and one transporting production in a pipeline in which it owns an interest. He pointed out that under MMS's rules the producer with the affiliated pipeline can only deduct depreciation and operating costs, while the producer transporting production through the nonaffiliated pipeline can deduct the commercial rate. He said this results in disparate treatment.

Mr. Little then provided a second example involving lease sales. He specifically referenced the MARS field, where an existing tariff is $0.97 per barrel. But he said under MMS's rules the allowed deduction would only be $0.62 per barrel, or $0.32 after the pipeline is fully depreciated. At a lease sale, other parties would be able to factor the higher tariff rate into their bid analyses in estimating royalties due. This would give the others a competitive advantage. He believed this result defies logic, is unfair, and leads to disparate treatment.

Senator Breaux said Mr. Little's argument seemed to make sense. Ms. Quarterman said, however, that the examples presented would gain no different than results under the present rule--these are not new issues. No disparate treatment arises because each party is able to deduct its actual, reasonable costs of transportation as permitted under the current rule. This treatment does not change in the proposed rule. She noted it is not unusual for different lessees to pay different royalty values on the same lease because ultimately a lessee must pay no less than its gross proceeds. Finally, Ms. Quarterman noted that as owner of the pipeline not subject to regulation the pipeline owner lessee could raise its tariff to even the playing field.

Senator Breaux said this doesn't mean that perhaps the procedures shouldn't change. Ms. Quarterman acknowledged his point, but said she only wanted to make sure everyone at the table understood when an issue was the same in both rules. Ms. Quarterman noted not only was this a continuation of procedures in the existing rule, but the regulations in effect for perhaps 50 years say that royalties are due on the lessee's gross proceeds--part of the gross proceeds is a deduction for actual costs incurred.

Mr. Little replied that there are limits on tariffs and that tariffs set the market for transportation rates. Mr. Armstrong said that tariff acceptance gets MMS into an assumption of risk. Mr. Little disagreed, saying that the pipeline owner is at risk.

Senator Breaux then asked Mr. Little whether Ms. Quarterman was correct that MMS's position hasn't changed in the proposed rule regarding transportation. Mr. Little wasn't sure. Senator Domenici interjected that there are frequently common-sense ways around these issues.

Mr. Little then noted that MMS's rules allow only a BBB bond rate as an allowable return on investment. He said his company doesn't do business at that level. He reiterated that if tariffs are available, they should establish fair transportation deductions. If they don't exist, then tendering should be used, thus eliminating transportation factors entirely. If neither option is available, local third-party rates should establish permissible deductions. If none of these are available, comparable production/transportation rates in an expanded geographic area should be used. He added that he wasn't sure what the current rule said regarding transportation.

Senator Breaux asked if Ms. Quarterman had comments on Mr. Little's statements. She said MMS is in a quandary regarding tariffs for offshore oil production.. Although they are called FERC tariffs, FERC does no approval and has disclaimed jurisdiction--tariffs are simply filed with that agency as the pipeline so desires. Unless FERC actually regulates offshore pipelines, MMS can't use these rates.

Mr. Little replied that Shell has FERC-published tariffs. Ms. Quarterman responded that FERC ruled they don't have jurisdiction, however, Congress can act to change that. Mr. Little reiterated that Shell has a tariff schedule, and if a shipper doesn't like the rate, it can build its own pipeline. Ms. Farley added that whatever is paid for transportation is the actual cost and should be treated as such.

Mr. Armstrong asked how big an issue this was for industry. Mr. Little said it was worth many millions of dollars. Mr. White added that companies do what they can to avoid building pipelines.

Senator Breaux asked what resolution could be reached. Ms. Quarterman referenced Mr. Little's suggestion to use comparable rates. She noted that the current rule has a provision to compare tariff rates to other area arm's length charges, but there usually aren't comparables to be found in specific areas.

Mr. Little reiterated that MMS should permit tariffs, tendering, or third-party rates. He questioned why the government shouldn't be willing to accept these. He also repeated his contention that the rule doesn't permit a fair rate of return.

Senator Breaux asked MMS whether Mr. Little's suggestions were helpful or "doable." Senator Hutchison noted that the Department thought they were simplifying the rule by providing only one option, but multiple options may be better because of the complexities involved in oil marketing. She asked whether the Department would consider changing its proposal to permit more options.

Ms. Quarterman responded that all the options suggested are in the proposal in different places. But in the Gulf of Mexico and California/Alaska MMS used index prices as a starting point. Senator Hutchison asked whether MMS would allow several options within specific regions. Ms. Quarterman responded that each region is unique.

Senator Hutchison asked why one to three different options couldn't be permitted in each region--if options are available in the Rocky Mountain Region, why not permit them elsewhere? Mr. Little added that most larger oil companies have pipeline systems, but under the proposal, companies with affiliated transporters have only one option in the Gulf of Mexico. Ms.

Quarterman acknowledged that was true unless the affiliate sells production on the open market. Mr. Little noted that production often, however, goes to the company's own refinery. Ms. Quarterman added that the spot price then reflects market value. Mr. Little responded that tendering results in high prices and is fair and the Gulf of Mexico should receive the same treatment as elsewhere.

Mr. Keiser stated that he wants simple, clear methods. He should be able to go to MMS and propose royalty payment methodologies, including tendering and other options, and get an answer. Ms. Quarterman said MMS encourages such requests and that MMS staff explains how to interpret the rules or how to proceed otherwise. Mr. Keiser noted, however, that if he followed the path suggested by Ms. Quarterman, under the current proposal the staff response would not be binding. He wants clarity and firm decisions. MMS staff should be able to tell companies what they can and can't do.

Ms. Quarterman said that MMS personnel give their best interpretations of the rules, but if auditors later see variations in the facts as originally presented, they need some flexibility. Also, the Assistant Secretary is the final authority on appeals. Mr. Armstrong added that if all the facts were known at the beginning, this wouldn't be an issue. He also noted that variations from original interpretations are infrequent. Mr. Keiser repeated that he was only asking for opinions to be binding.

Senator Thomas said he didn't think Mr. Armstrong answered the question. The Department should be more responsive to the customer. Mr. Armstrong followed up by asking how often industry requests could be expected. Mr. True replied that a flood of requests could be expected under the proposed rule. Mr. Keiser said once again that he was only asking that if he followed MMS's instructions, they would be considered binding.

Senators Breaux and Hutchison asked whether the comment period could be extended. Senator Hutchison said that while the general understanding of all parties was progressing, she didn't think the parties were "there" yet. Senator Breaux thought some progress had been made regarding affiliates and duty to market. He asked the industry representatives whether they thought it was worthwhile to continue such meetings.

Mr. Armstrong hoped the Department had dispelled some objections. He acknowledged that industry had given the Department something to think about, but that much of their proposal was already in the proposed rule in one form of another. Senator Breaux concurred that some progress had been made. Ms. Quarterman noted that MMS had attempted to respond to industry concerns regarding arm's-length contracts and exchanges.

Mr. White believed that MMS's revised proposal requiring index pricing if multiple exchanges occur was a step backwards. He wanted to know if there was a sincere MMS interest in amending the rule to include the benchmarks suggested by industry. Ms. Quarterman responded that on the issue of arm's-length sales after exchanges, MMS could be flexible--index prices could be applied after one exchange, or arm's-length prices received after multiple exchanges could be considered royalty value.

Mr. True noted that he wants options available, and not just an option to apply proceeds received after one or multiple exchanges. He wants to continue to work with MMS.

Mr. Little was concerned about the comment period limitation. He didn't think much progress had been made and that MMS simply pushed industry suggestions back across the table. He wants agreement, but MMS seems to find ways not to do so.

Senator Breaux noted that he knows many people think his sympathies are with the oil companies alone, but that he is just trying to find reasonable solutions. Ms. Quarterman noted that yesterday's meeting with Representatives Miller and Maloney and various other groups produced sentiments totally opposite from those expressed in today's meeting. She believed MMS had accommodated all interests as much as possible. Mr. Little said he didn't think the participants in the other meeting understood the industry.

Mr. Robertson added that he was willing to foot additional system costs in return for more certainty.

Senator Domenici stated that he heard several times during the discussions that MMS hasn't changed provisions of the existing rule. He said that's not a good starting point. The paries should instead look at the changes <u>needed</u>. If something doesn't work, it should be changed. Industry is in terrible shape now--he gave examples of two companies that visited his office today and who were in dire conditions. He believes that such companies should be able to come to MMS and get fixed answers--MMS should be required to provide certainty.

Senator Breaux asked where the participants should go from here. He noted that a legislative fight on this issue is a lose/lose situation--both sides have enough votes to block one another. The best solution may be to keep talking. Should we do so? Another option is to continue to delay the regulations. He suggested taking another look at what was discussed today and try one more time to clarify the issues.

Mr. Armstrong asked if Senator Breaux was suggesting another meeting, and he responded yes, after digesting today's proposals. He suggested that the end of next week might be appropriate. Mr. Armstrong asked Mr. Little whether he thought that was necessary given his earlier comments. He stated a reluctance to continue extending the comment period. Mr. Little wondered how much progress might be made in another meeting--perhaps it would be better for MMS to summarize in writing some of the things they propose to do and send them out to industry. Senator Breaux agreed that would be helpful.

Mr. Robertson believed that some of the fixes proposed by MMS so far were nothing more than "around the edges" and weren't substantial.

Senator Breaux requested MMS summarize and reply to industry's proposed changes and get them to everyone at the table. If that's MMS's final offer, "so be it." Mr. Little suggested MMS's reply should be in the form of a response to the proposals industry offered today. Senator Breaux agreed.

Mr. Armstrong added that this process hadn't simply begun recently. He noted the Department had been working on it for nearly 3 years.

Ms. Quarterman agreed to provide its response as part of the minutes put on the Internet to the Senators attending this meeting and to API for distribution to industry participants.

The meeting adjourned at 4:25 p.m.

AMENDED: July 29, 1998

Note: The following are MMS' preliminary responses to industry's comments received at the July 22, 1998, Senate meeting regarding MMS' proposed Federal oil valuation regulations. Pursuant to the Administrative Procedures Act, MMS cannot provide final decisions as long as the comment period on the proposed oil valuation rule is still open. All public comments must be received and reviewed before final decisions are made. MMS' final comments will be published in its final rule.

July 24, 1998

Summary of Industry Recommended Improvements to MMS Oil Valuation Proposed Regulations and MMS Responses Discussed at July 22, 1998, Senate Meeting

Arm's-Length Contracts

<u>Industry Recommendation</u>

MMS should continue to honor prices received by willing sellers from willing buyers (arm's length agreements) and not reject these prices due to multiple buy/sells or exchanges, or second guess these transactions.

<u>MMS Response</u>

- Gross proceeds received under an arm's-length contract is the royalty value and MMS will not second guess a company's marketing decisions.

  <u>Breach of Duty to Market</u>

  During the July 22 meeting, industry representatives stated that the language contained in the July 16, 1998, further supplementary proposed rule regarding MMS not second guessing marketing decisions added more confusion to the rule. MMS stated that the only purpose of the additional language was to clarify that this provision would not be used to routinely reject arm's-length contracts in response to industry comments. Industry thought the additional terms created uncertainty and requested that MMS remove that language and instead retain the language contained in the existing regulations.

  <u>Multiple Exchange Agreements</u>

  Some industry representatives objected to the July 16, 1998, proposal to require index pricing after two or more exchanges while others objected to the administrative burden of tracing multiple exchanges.

MMS has in the past expressed a willingness to go any of a number of directions on this issue. That is, in the final rule MMS could adopt either:

(1) the July 1998 proposal to use the "first-exchange" rule where value will be determined based on the arm's-length sale after a single arm's-length exchange, or

(2) the February 1998 proposal to expand gross proceeds valuation to include situations where the oil received in exchange is ultimately sold arm's-length, regardless of the number of arm's-length exchanges involved, or

(3) the July 1997 proposal that allowed the lessee the option of valuing exchanged oil using either 1) its gross proceeds under an arm's-length sale after the exchange(s) or 2) the index pricing method. That election would be for a 2-year period and the lessee must value all oil production disposed of under all of their arm's-length exchange agreements in the same manner.

In its written comments on the July 16, 1998, further supplementary proposed rule, MMS asked that commenters clearly state which option best reflects their position on this issue.

Non-Arm's-Length Contracts

Industry Recommendation

The MMS should replace the proposed cumbersome, three-region approach with a menu of valuation benchmarks flexible enough to accommodate diverse transactional settings nationwide and arrive at a reasonable value of production at the lease. Such a menu should include:

- A viable tendering for sale program.
- Reliance on comparable arm's length transactions, including purchases, by a lessee, a lessee's affiliate, or other parties (if published) at or near the lease.
- A methodology to net back to the lease from an index or affiliate re-sales if deductions are provided that adequately account for factors that add value as crude oil moves downstream from the lease.

MMS Response

The primary considerations MMS has expressed for revising the Federal oil valuation rule are to ensure the public receives fair market value for its oil; to eliminate reliance on posted prices; to simplify royalty reporting, payment, collection, and auditing; and to provide certainty for both royalty payors and government.

○ All of the items from the industry "menu" are included in the proposal for the Rocky

Mountains, but not in the menu format. The benchmarks are ordered according to which is most likely to reflect fair market value for the area. Lessees should not be permitted to choose among a menu of options. Such a choice would not ensure fair market value, simplify the royalty process, or provide certainty.

- Under the February 1998 proposed rule, MMS would consider a series of valuation benchmarks for valuing production that is not sold at arm's-length in the Rocky Mountain Region, where there is not a publicly available, reliable indicator of market value. Those benchmarks are: 1) tendering; 2) weighted-average of arm's-length sales and purchases in the field or area; 3) netback from an index price; and 4) an MMS-established method.

- In February 1998, for the rest of the country, MMS proposed only netback from index, the third item in the "menu" suggested at the July 22, 1998, meeting. MMS expressed the following reasons why the other benchmarks were not proposed:

Menu

- The Department is required to receive fair market value by setting the most appropriate valuation standard(s) for each market. Having industry choose among options for valuation will likely result in undervaluation. It will also increase complexity in the royalty process.

Tendering

- Tendering is an artificially-created market for the purpose of paying royalties. It does not represent how companies actually market their production and accordingly cannot represent market value. If there truly were an active, transparent, and competitive market at the lease, there would be no reason to establish a tendering program.

- Tendering is not a legitimate measure of market value where it involves only small volumes of production from company-selected properties that would be used to value large volumes of production sold to an affiliate and either resold or refined.

- Tendering is a more administratively burdensome means than index prices for valuing production not sold at arm's length. Spot prices play a major role in crude oil marketing and are readily available through price reporting services.

Comparable Arm's-length Transactions

- We have found through our audits that very little Federal oil is sold at arm's length.

- After a decade of experience under our current regulations, we have found the application of comparable arm's-length criteria to be costly and difficult to administer.

- Producers generally do not have access to prices paid under other producer's arm's-length contracts and we are not aware of any situations in which those prices are publicly available.

Duty to Market

Industry Recommendation

Where the starting point for valuation is away from the lease, the MMS should allow lessees to claim an administrative fee -- similar to the fee MMS charges small refiners in its set aside program.

MMS Response

○ In the February 1998 proposed rule, MMS did not allow deductions from royalty value for marketing or administrative costs. It is long and clearly established law that a Federal oil and gas lessee has the obligation to market the lease production for the mutual benefit of the lessee and the lessor, without deduction for the costs of marketing. This is an implied covenant of the lease and is not unique to Federal leases. Reversing legal precedent through this rulemaking would be inappropriate. Congress could act to provide a marketing deduction.

○ The administrative fee MMS charges small refiners who participate in the existing RIK program covers MMS' administrative costs of billing and accounting for the oil sold to the small refiner during the period of the contract. It is not a marketing fee. MMS does not market the oil to the small refiners, but rather makes available to them a consistent supply of oil for refining.

Transportation

Industry Recommendation

Reasonable commercial value of transportation should be the basis for calculation of transportation allowances.

Actual payments made under tariffs should be acceptable.

For lines handling multiple shippers, the payments by non-affiliated third parties should be used. In the absence of third parties, payments for comparable service areas should be used.

With the use of a tendering for sale program, the sale at the lease eliminates the issue of a transportation deduction.

MMS Response

MMS' February 1998 proposal would allow each lessee to deduct from gross proceeds or from an index price its reasonable, actual, and necessary costs of transportation.

Tariffs

- Because FERC does not have jurisdiction over movement of crude oil from the OCS to an adjacent State and because our audits have found that FERC tariffs signicantly exceed a pipeline's actual costs of transportation, MMS's proposals have not accepted FERC tariffs as the costs of transportation to be deducted from an index price or from gross proceeds in situations where the lessee or its affiliate owns the pipeline. Congress could fix this problem by giving FERC jurisdiction over movement of oil from the OCS to an adjacent State and requiring FERC to review all tariff rates to assure that they reflect a pipeline's reasonable and actual costs of transportation.**(Paragraph amended 7/29/98.)**

- Under the Secretary's general rulemaking authority under 43 U.S.C. 1334, or the Secretary's rulemaking authority regarding pipeline rights-of-way on the OCS under 43 U.S.C. 1334(e), should MMS consider developing a procedure to set pipeline transportation rates and correspondingly the transportation allowances for royalty purposes?

Tendering

- Tendering does not solve the transportation issue. When a purchaser bids on tendered volumes, it must take into account the costs of transporting production away from the lease. In most cases, the purchaser will have to transport that production through a pipeline owned by the lessee and pay tariff rates that are not reviewed by FERC to assure that they are just and reasonable. A purchaser of such crude will often have to negotiate carriage rates on proprietary pipelines off the lease. A captive marketplace can result. Therefore, the price bid by the purchaser and used by the lessee to compute its royalty obligation will necessarily be discounted to reflect these lessee-established tariff rates.

- Under the OCSLA, offshore lessees are required to pay royalties on the "production saved, removed, or sold" and "production" is defined to include the "transfer of minerals to shore." Therefore, tendering at the lease offshore will not reflect the legal requirements of lessees to transfer minerals to shore.

- Under existing tendering programs, companies do not tender production from every lease in a particular field or area, but use the price received from those leases from which they do tender to value production sold to an affiliate from all of their leases in a field or area. For those leases from which they do not tender production, they must make transportation adjustments to the tendered-price to arrive at the value of production from those leases.

Third Party Rate or Comparable Costs of Service Rates

- We have found through our audits that very little oil is transported at arm's-length. Generally, lessees have joined together to build pipelines and each of them maintain an ownership interest in these pipelines. Therefore, payments by non-affiliated third parties frequently do not exist.

- Likewise, payments by third parties on other pipelines in the same area do not generally exist.

- Identifying comparable pipelines is difficult given the variations that can exist in pipelines' capacity, length, date they are placed in service, throughput, etc. Disputes would likely arise between the producer and MMS as to what constitutes a comparable cost of service, similar to what we have experienced when evaluating comparable arm's-length contracts.

Non-binding Guidance

Industry Recommendation

The MMS should simplify and clarify its valuation requirements as much as practicable.

MMS should maintain a process by which lessees can procure binding valuation determinations.

MMS Response

- In its February 1998 proposed rule, MMS did not provide for binding valuation determinations, because it cannot bind the Department. However, the Assistant Secretary has the necessary authority to make such determinations. Therefore, if requested, the Assistant Secretary may issue binding valuation determinations.

Agenda -- MMS Proposed Crude Oil Valuation Rule
July 22, 1998

Discussion of Issues

Benchmarks

- Does the proposed rule establish workable benchmarks to value oil from the lease?

- Has consideration been given to arms-length sales and/or purchases in a field or area as the basis of value?

- Has consideration been given to tendering programs at the lease?

Transportation costs

- What are legitimate transportation costs that should be deductible from gross sales proceeds before royalty is calculated?

Exchanges

- Independent producers say they often have to make several exchanges to get their crude oil from the wellhead to their purchaser. However, the MMS proposed rule provides that if two or more exchanges are involved, even if they are all at arm's length, the lessee must use index pricing.

Duty to market

- How broad is a lessee's "duty to market" crude oil for the mutual benefit of the lessor and lessee? Does the duty to market require only that the lessee place the crude oil in merchantable condition, or does require more?

Industry Recommended Improvements to MMS Oil Valuation Proposed Regulations

Arm's Length Contracts

MMS should continue to honor prices received by willing sellers from willing buyers (arm's length agreements) and not reject these prices due to multiple buy/sells or exchanges, or second guess these transactions.

Non-Arm's Length Contracts

The MMS should replace the proposed cumbersome, three-region approach with a menu of valuation benchmarks flexible enough to accommodate diverse transactional settings nationwide and arrive at a reasonable value of production at the lease. Such a menu should include:

- A viable tendering for sale program.
- Reliance on comparable arm's length transactions, including purchases, by a lessee, a lessee's affiliate, or other parties (if published) at or near the lease.
- A methodology to net back to the lease from an index or affiliate re-sales if deductions are provided that adequately account for factors that add value as crude oil moves downstream from the lease.

Duty to Market

Where the starting point for valuation is away from the lease, the MMS should allow lessees to claim an administrative fee -- similar to the fee MMS charges small refiners in its set aside program.

Transportation

Reasonable commercial value of transportation should be the basis for calculation of transportation allowances.

Actual payments made under tariffs should be acceptable.

For lines handling multiple shippers, the payments by non-affiliated third parties should be used. In the absence of third parties, payments for comparable service areas should be used.

With the use of a tendering for sale program, the sale at the lease eliminates the issue of a transportation deduction.

Non-binding Guidance

The MMS should simplify and clarify its valuation requirements as much as practicable.

MMS should maintain a process by which lessees can procure binding valuation determinations.

July 22, 1998

Texas and Alberta, Canada have demonstrated major cost savings for those governments. It takes hundreds of employees at MMS to administer the current system compared to 33 to oversee RIK in Canada.

As I said a few minutes ago, we take these issues very seriously. And for good reason. We've been down this road before. You may recall the lawsuit IPAA filed against Interior in 1993 to prevent the illegal collection of royalties involving take-or-pay contract settlements. Five years later, not much has changed. The federal government is trying to claim a larger share of royalties through regulation. It's been a problem for decades. It's about time we figure out how to change that, before the problem gets worse."

February 25, 1998

IPAA Tells MMS That Proposed Royalty Rule Increases Uncertainty

Royalty In-Kind Is Only Way To Resolve Disputes

America's oil and gas producers expressed their disappointment today at a Minerals Management Service proposed rule on the royalty valuation of oil produced on federal lands, during a public hearing at the Department of the Interior in Washington, D.C. IPAA Vice President of Public Resources Ben Dillon testified that while MMS' stated intention was to write a rule to capture the arm's-length value of oil at the lease in a more simplistic and certain manner, the proposed rule has brought new uncertainties to oil producers.

"Independents have concluded that the rule has digressed to an arbitrary departmental desire to force everyone who has an eventual arm's-length sale to use a netback method-the most administratively burdensome and complex method available to the government today," Dillon said. MMS decided to write a valuation rule because it was suspicious of posted prices. Independent producers also supported a decreased reliance on posted prices. "Our payback has been a proposal that makes it harder for independents to determine the appropriate royalty value with certainty," he said, noting that the rule is so complex that people are referring to it as the "auditor employment act."

The unwillingness by MMS to produce a simplified method that captures the arm's-length value of oil at or near the lease, likely stems from a lawsuit that the government has brought against four oil companies operating in Texas. "MMS has been pressured by lobbying interests who have a financial stake in the litigation brought forth in Texas," said Dillon. "These alleged 'third parties' seem to believe they can bolster their extreme scheme for royalty payments by encouraging MMS to promulgate similar regulation. If they are successful, this may improve their chances by applying these theories retroactively in the lawsuit."

"We are continually frustrated at the ignorance that these third parties show in their testimony," said Dillon. "By pressuring MMS to disallow even those costs that are clearly ordinary and necessary expenses to transport the product to the point of sale, they demonstrate a lack of a basic understanding of the established federal lease contract between oil producers and the federal government. It is particularly disturbing that such groups have a strong influence on the writing of Department of the Interior rules."

Another provision in the MMS proposed rule would "gouge the industry by forcing the costs associated with marketing the oil to be included in the royalty payment equation," said IPAA Land and Royalty Committee Chairman Diemer True. "This is in direct conflict with the lease contract between oil and gas producers and the federal government. If MMS wants to get into the marketing business, it should take its oil in-kind."

While MMS has recently attacked Royalty In-Kind (RIK) proposals as a diversionary tactic on the valuation issue, the agency was the first source to suggest that an RIK system would be cost-effective, providing certainty and simplicity to its vast and expensive royalty collection staff. It would also reduce the need for expensive, wasteful lawsuits. "Model programs based on RIK systems in Texas and Alberta, Canada, have demonstrated major cost savings for those governments," Dillon said. "We agree with an MMS consultant, who says, 'The only way to be absolutely certain that a fair market value is received for royalty oil is to take the oil in-kind for sale by the agency.'"

February 19, 1998

PLATT'S

Oilgram News

Volume 76 Number 138 July 21, 1998

IPAA SAYS MMS OIL VALUE RULE IS STILL FLAWED

Washington--Changes proposed by the Minerals Management Service to its proposed oil valuation rule generally failed to ease concerns raised by independent producers, said Ben Dillon, vice-president, natural resources, for the Independent Petroleum Association of America.

Dillon said independents are pleased with the MMS decision to retain the current definition of affiliate, and its willingness to receive comment on whether the movement of production from subsea production over long distances (gathering) should be deductible as a transportation allowance (ON 7/16).

However, the proposed language on exchanges and duty to market remains a problem, Dillon said.

MMS said it is modifying the proposal to make clear that a lessee's duty to market, i.e., to market the oil for the benefit of both the lessee and the government, will not force companies to use an index-based valuation.

But Dillon said MMS has included a number of "subjective" criteria "that would provide an opportunity to second guess" the producers.

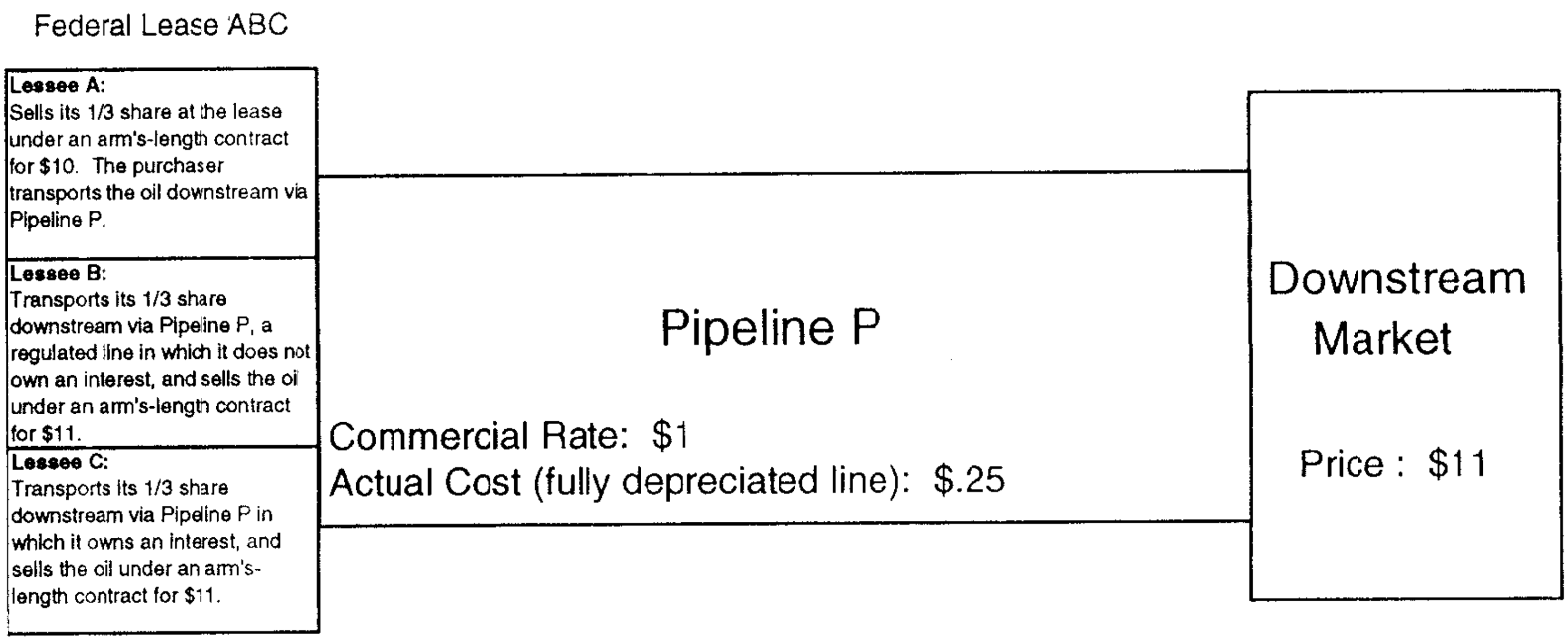
MMS also said it would return to the "first-exchange" rule, part of an earlier proposal that extended the use of gross proceeds valuation to oil sold at arm's length after a single arm's length exchange. However, MMS proposed modifying the rule so that if two or more exchanges are involved, even if they are at arm's length, the lessee must use index pricing.

Independents are vehemently opposed to index pricing, and Dillon said the provision dealing with multiple exchanges means that significantly more independents may have to use it. IPAA's position is that "if you exchange arm's length, you should be allowed to look through all such exchanges to get the actual sales price and net it back to the lease," Dillon said.

In any event, the MMS "continues to ignore the fundamental issues" raised by the IPAA in objecting to the proposal, Dillon said. "But we are optimistic that people in the Senate are beginning to understand our position," he said. A second meeting involving oil patch senators and industry and MMS officials is scheduled to be held July 22.--Gerald Karey

Proposed Federal Oil Valuation Regulations

Transportation: Commercial Rate vs. Actual Cost



Federal Royalty Price Under Proposed Regulations:

Lessee A: $10
Lessee B: $11 - $1 = $10
Lessee C: $11 - $.25 = $10.75

Note: This example only focuses on transportation and does not consider other factors which can cause a difference between the lease market values and downstream values.

PROPOSED FEDERAL OIL VALUATION REGULATIONS
TRANSPORTATION: COMMERCIAL RATE VS. ACTUAL COST

Issue: Proposed MMS regulations result in competitive disadvantage when bidding on new offshore leases.

Situation:

Bidder A: Does not own an interest in a pipeline in lease area.

Bidder B: Owns interest in a pipeline through which oil from a new lease(s) would be transported.

Estimated potential field volume on new lease(s) = 100 million barrels.

Production commences in 2002 and field depletes in 2008.

Transportation Deduction Comparison*:

	New Pipeline	Fully Depreciated
Commercial transportation rate (No cost escalation)	$0.97/bbl.	$0.97/bbl.
MMS allowable deduction** (O&M costs escalated 2%/yr)	$0.62/bbl.	$0.32/bbl.
Bidder A transportation deduction (PV @ 10%)	*$7.0 million*	*$7.0 million*
Bidder B transportation deduction (PV @ 10%)	$4.5 million	$2.5 million
Bidder B additional royalty payment	$2.5 million	$4.5 million

Conclusion:

Bidder A would have an unfair competitive advantage vs. *Bidder B as a result* of the proposed oil valuation regulations.

* Transportation cost figures based on Shell's Mars pipeline actual 1997 data.
**Deduction for new line = O&M + depreciation + 7% return on undepreciated capital.
**Deduction for fully depreciated line = O&M costs.

regulatory evaluation prepared for this action is contained in the Rules Docket. A copy of it may be obtained by contacting the Rules Docket at the location provided under the caption **ADDRESSES.**

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Safety.

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration proposes to amend part 39 of the Federal Aviation Regulations (14 CFR part 39) as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

SAAB Aircraft AB: Docket 98–NM–176–AD.

Applicability: Model SAAB 340B series airplanes, manufacturer serial numbers 380 through 499 inclusive; certificated in any category.

Note 1: This AD applies to each airplane identified in the preceding applicability provision, regardless of whether it has been modified, altered, or repaired in the area subject to the requirements of this AD. For airplanes that have been modified, altered, or repaired so that the performance of the requirements of this AD is affected, the owner/operator must request approval for an alternative method of compliance in accordance with paragraph (b) of this AD. The request should include an assessment of the effect of the modification, alteration, or repair on the unsafe condition addressed by this AD; and, if the unsafe condition has not been eliminated, the request should include specific proposed actions to address it.

Compliance: Required as indicated, unless accomplished previously.

To prevent a short circuit caused by fluid leakage, which could result in inability to extend or retract the landing gear, accomplish the following:

(a) Within 400 flight hours after the effective date of this AD, accomplish the actions required by paragraphs (a)(1), (a)(2), (a)(3), and (a)(4) of this AD, in accordance with Saab Service Bulletin 340–32–115, dated April 7, 1998.

(1) Perform a detailed visual inspection to detect moisture or other contamination of the electrical wiring harness above relay consoles 305VU and 306VU. If any moisture or other contamination is found, prior to further flight, clean the wiring harness.

(2) Perform a detailed visual inspection to detect moisture or other contamination of electrical relay 15GA and its socket. If any moisture or other contamination is found, prior to further flight, accomplish corrective actions.

(3) Perform a detailed visual inspection for electrical damage of electrical relay 15GA and its socket. If any sign of electrical damage (arcing, discoloration, or charring) is detected, prior to further flight, replace the existing relay and socket with new parts.

(4) Replace the existing nut plates on the floor of the cockpit with new, improved nut plates, on the left and right sides of the airplane.

(b) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, International Branch, ANM–116, FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, International Branch, ANM–116.

Note 2: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the International Branch, ANM–116.

(c) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be accomplished.

Note 3: The subject of this AD is addressed in Swedish airworthiness directive SAD 1–125, dated April 7, 1998.

Issued in Renton, Washington, on July 8, 1998.

S.R. Miller,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 98–18949 Filed 7–15–98; 8:45 am]

BILLING CODE 4910–13–U

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: Further supplementary proposed rule.

SUMMARY: The Minerals Management Service (MMS) is proposing additional changes to its second supplementary proposed rulemaking regarding the valuation of crude oil produced from Federal leases.

DATES: Comments must be submitted on or before July 24, 1998.

ADDRESSES: Mail comments, suggestions, or objections regarding the proposed rule to: Minerals Management Service, Royalty Management Program, Rules and Publications Staff, P.O. Box 25165, MS 3021, Denver, Colorado 80225–0165, e-mail address is RMP.comments@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, e-mail RMP.comments@mms.gov.

SUPPLEMENTARY INFORMATION:

I. Background

MMS published an advance notice of its intent to amend the current Federal oil valuation regulations in 30 CFR parts 202 and 206 on December 20, 1995 (60 FR 65610). The purpose of this notice was to solicit comments on new methodologies to establish the royalty value of Federal (and Indian) crude oil production in view of the changes in the domestic petroleum market and particularly the market's move away from posted prices as an indicator of market value.

Based on comments received on the advance notice, together with information gained from a number of presentations by experts in the oil marketing business, MMS published its initial notice of proposed rulemaking on January 24, 1997 (62 FR 3742), applicable to Federal leases only. MMS held public meetings in Lakewood, Colorado, and Houston, Texas, to hear comments on the proposal.

In response to the variety of comments received on the initial proposal, MMS published a supplementary proposed rule on July 3, 1997 (62 FR 36030). This proposal expanded the eligibility requirements for valuing oil disposed of under arm's-length transactions.

Because of the substantial comments received on both proposals, MMS reopened the rulemaking to public comment on September 22, 1997 (62 FR 49460). MMS specifically requested comments on five valuation alternatives arising from the public comments. MMS held seven public workshops to discuss valuation alternatives.

As a result of comments received on the proposed alternatives and comments made at the public workshops, MMS published a second supplementary proposed rule on February 6, 1998 (63 FR 6113). The comment period for this second supplementary proposed rule was to close on March 23, 1998, but was extended to April 7, 1998 (63 FR 14057). MMS held five public workshops (63 FR 6887) on this second supplementary proposed rule: in Houston, Texas, on February 18, 1998; Washington, D.C., on February 25, 1998; Lakewood, Colorado, on March 2, 1998; Bakersfield, California, on March 11, 1998; and Casper, Wyoming, on March 12, 1998.

By **Federal Register** notice dated July 8, 1998, (63 FR 36868) MMS reopened the comment period for the February 6, 1998, second supplementary proposed rule from July 9, 1998, until July 24, 1998, to receive further comment on the proposed rule. A meeting involving MMS, several industry representatives, and members of Congress was held in Washington, D.C., on July 9, 1998.

II. Revisions to Supplementary Proposed Rule

In response to comments received so far, MMS is proposing some changes to the February 6, 1998, second supplementary proposed rule. MMS is requesting public comments on these further proposed provisions.

Definition of ''Affiliate''

Several commenters to the February 6, 1998, second supplementary proposed rule objected to the proposed definition of ''affiliate'' in § 206.101. Under this proposed definition, 10 percent ownership was the threshold for defining control, requiring non-arm's-length valuation for transactions between persons with such a degree of affiliation. Commenters argued that 10 percent was too low because affiliates with this small amount of ownership actually have no control over the affiliated entity. Accordingly, they believed that too many lessees would be excluded from using their gross proceeds as value in bona fide arm's-length transactions. They suggested retaining the current definition of affiliate, as defined by the term ''arm's-length contract,'' where ownership of 10 percent through 50 percent creates a presumption of control. One commenter suggested 20 percent to 50 percent ownership as the criteria for creating a presumption of control, consistent with the definition used by the Bureau of Land Management. One commenter suggested deleting reference to partnerships and joint ventures because lessees might not have access to records of these entities and these terms could create confusion as to whether the affiliate test applies to the property, field, or corporate level.

MMS understands the concern raised in the industry comments regarding presumption of control. Therefore, MMS now is proposing to retain the current meaning of affiliate embodied in the current rules at proposed § 206.101. Less than 10 percent ownership would create a presumption of non-control. Ownership of between 10 and 50 percent would create a presumption of control that the lessee could rebut. Ownership in excess of 50 percent would establish control.

However, in the current rule, affiliation is defined within the definition of the term ''arm's length.'' In this proposed rule, although we have retained the current meaning of affiliation, we have made ''affiliate'' a separate definition from ''arm's length.'' We believe this clarifies and simplifies the definitions and should promote better understanding of both ''arm's length'' and ''affiliate.''

Breach of Duty to Market

Some commenters were concerned about the provision in proposed § 206.102(c)(2)(ii) which allows MMS to disallow arm's-length gross proceeds as royalty value if the lessee breaches its duty to market its oil for the mutual benefit of the lessee and lessor. The concern expressed was that MMS would use this provision to ''second-guess'' a lessee's marketing decision and thereby force the lessee to use index-based valuation.

The provision which is the subject of the commenters' concerns is identical to the provision in the existing rules (see 30 CFR § 206.102(b)(1)(iii)) and has been in the rules for more than 10 years. This provision has never been used to ''second-guess'' a lessee's marketing decisions to try to impose benchmarks of § 206.102(c) on arm's-length transactions. Nevertheless, MMS is also proposing to modify the proposed § 206.102(c)(2) to clarify that the lessee's duty to market does not mean that MMS will second-guess a company's marketing decisions. Lessees generally may structure their business arrangements however they wish, and absent misconduct, MMS will look to the ultimate arm's-length disposition in the open market as the best measure of value. The provision's purpose is to protect royalty value if, for example, a lessee were to inappropriately enter into a substantially below-market transaction for the purpose of reducing royalty.

Exchanges

The July 3, 1997, supplementary proposed rule extended the use of gross proceeds valuation to oil exchanged and then sold at arm's length. In those cases where a lessee disposed of the produced oil under an exchange agreement with a non-affiliated person, and after the exchange the lessee sold at arm's length the oil acquired in the exchange, the lessee would have had the option of using either its gross proceeds under the arm's-length sale or the index pricing method to value the lease production (proposed paragraph 206.102(a)(6)(i)). This option would have applied only when there was a single exchange. If the lessee chose gross proceeds under this option, the lessee would have valued all oil production disposed of under all other arm's-length exchange agreements in the same manner (proposed paragraph 206.102(a)(6)(iii)). For any oil exchanged or transferred to affiliates, or subject to multiple exchanges, the lessee would have used the index pricing method to value the lease production (proposed paragraph 206.102(a)(6)(ii)).

Participants in MMS's workshops held in October 1997 indicated that they often use several exchanges to transport their production from offshore leases to onshore market centers. They believed that MMS should give the lessee an option of valuing exchanged oil either by using so-called ''lease-market'' benchmarks (rather than index prices) or by using the lessee's resale price less an exchange differential, regardless of the number of exchanges needed to reposition the crude oil for sale.

In response to those comments, in the February 6, 1998, proposal, MMS expanded gross proceeds valuation to include situations where the oil received in exchange is ultimately sold arm's-length, regardless of the number of arm's-length exchanges involved. However, because of the numerous industry and State comments now claiming that tracing multiple exchanges would be overly burdensome, if not impossible, MMS is proposing to return to the July 3, 1997, proposal's ''first-exchange'' rule, where value will be determined based on the arm's-length sale after a single arm's-length exchange. MMS is proposing to modify § 206.102 (c)(3) so that if two or more exchanges are involved, even if they are all at arm's length, the lessee must use index pricing.

Gathering vs. Transportation

MMS received comments on the definition of ''gathering'' as contained in the existing regulations in 30 CFR 206.101, which is the same as in proposed § 206.101. The commenters noted that development, especially of deepwater leases, often involves a sub-sea completion with no platform. Bulk, unseparated production is moved sometimes in excess of 50 miles to a platform where it first surfaces and is treated. The commenters asserted that in these situations the movement of production from sub-sea production over long distances should be deductible as a transportation allowance. MMS specifically requests comment on whether the definition of gathering should be modified to address this situation.

MMS requests comments on the revisions to the second supplementary proposed rule (63 FR 6113) including this notice or any other comments you may want to submit on this proposed rule. If you have commented already on other portions of the rule, you do not need to resubmit those comments since they are already part of the rulemaking record. MMS will respond to comments in the final rule.

List of Subjects in 30 CFR Part 206

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

Dated: July 14, 1998.

Sylvia V. Baca,

Acting Assistant Secretary, Land and Minerals Management.

For the reasons set forth in the preamble, the second supplementary proposed rule published at 63 FR 6113 on February 6, 1998, amending 30 CFR Part 206, is further amended as follows:

PART 206—PRODUCT VALUATION

1. The Authority citation for Part 206 continues to read as follows:

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.*

Subpart C—Federal Oil

2. Section 206.101 as proposed to be revised at 63 FR 6113 is further amended by revising the following definition to read as follows:

§ 206.101 Definitions

Affiliate means a person who controls, is controlled by, or is under common control with another person.

(1) For this subpart, based on ownership of an entity's voting securities, interest in a partnership or joint venture, or other forms of ownership:

(i) Ownership greater than 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 that MMS may rebut if it demonstrates actual or legal control, including but not limited to interlocking directorates.

(2) MMS may require the lessee to certify the percentage of ownership. Aside from the percentage ownership criteria, relatives, either by blood or marriage, are affiliates.

3. Section 206.102 as proposed to be revised at 63 FR 6113 is further amended by revising paragraphs (c)(2) and (c)(3) to read as follows:

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

* * * * *

(c) * * *

(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. MMS will not use this provision to dispute lessees' marketing decisions made reasonably and in good faith. It will apply only when a lessee or its affiliate inappropriately sells its oil at a price substantially below market value.

(3) You must use § 206.103 to value oil disposed of under an exchange agreement. However, if you enter into a single arm's-length exchange agreement, and following that exchange you dispose of the oil received in the exchange 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. If you enter into more than one sequential exchange agreement to dispose of your production, you must use § 206.103 to value that production.

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FEDERAL COMMUNICATIONS COMMISSION

47 CFR PARTS 73 and 74

[MM Docket No. 98–98; FCC 98–130]

Call Sign Assignments for Broadcast Stations

AGENCY: Federal Communications Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: In this *Notice of Proposed Rulemaking (NPRM),* the Federal Communications Commission proposes to modify its practices and procedures regarding the assignment of call signs for radio and television broadcast stations. Pursuant to these proposals, the Commission's existing manual procedures will be replaced by an on-line system for the electronic preparation and submission of requests for the reservation and authorization of new and modified call signs.

DATES: Comments are due on or before August 17, 1998, and reply comments are due on or before August 31, 1998. Written comments by the public on the proposed information collections are due August 17, 1998.

ADDRESSES: Comments and reply comments should be sent to the Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W., Washington, DC 20554. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov, and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725–17th Street, N.W., Washington DC 20503, or via the Internet to fain__t@al.eop.gov.

FOR FURTHER INFORMATION CONTACT: James J. Brown or Jerianne Timmerman at (202) 418–1600. For additional information concerning the information collections contained in this *NPRM* contact Judy Boley at (202) 418–0214, or via the Internet at jboley@fcc.gov.

SUPPLEMENTARY INFORMATION:

Synopsis of Notice of Proposed Rulemaking

In this *Notice of Proposed Rulemaking (NPRM),* the Federal Communications Commission is proposing to modify its practices and procedures regarding the assignment of call signs to radio and television broadcast stations. Pursuant to this proposal, the Commission's existing manual procedures will be replaced by an on-line system for the electronic preparation and submission of requests for the reservation and authorization of new and modified call signs. Because the Commission believes that the new electronic call sign reservation and authorization system will significantly improve service to all radio and television broadcast station licensees and permittees, the *NPRM* requests