

Comments on Proposed Rule

Indian Oil Valuation Adjustments

The proposed rule uses the term Location and Crude Type Differential (LCDT) in its derivation of the Index-Based Major Portion value (IBMP). The rule would be easier to understand if it used an adjustment ratio (AR) to derive the IBMP. The AR would be defined as the ratio of the Major Portion Price to the NYMEX Calendar Month Average. The IBMP is then equal to the AR times the NYMEX Calendar Month Average. The term AR is equivalent to 1 minus the LCDT but it takes fewer steps to calculate which decreases the chance of error.

$$\begin{aligned} 1-\text{LCDT} &= 1 - ((\text{NYMEXCMA}-\text{MajorPortionPrice})/\text{NYMEXCMA}) \\ &= 1-\text{NYMEXCMA}/\text{NYMEXCMA} +\text{MajorPortionPrice}/\text{NYMEXCMA} \\ &= \text{MajorPortionPrice}/\text{NYMEXCMA} \\ &= \text{AR} \end{aligned}$$

The initial AR should be the average of the AR's for some number of previous months. Since the rule is approximating the Major Portion Price by some fraction of the NYMEX, it is statistically more supportable to average the fractions. Some statistical analysis should be performed to determine the best number of months, while best means to minimize the frequency of changing the AR.

The adjustment to the LCDT of 10% when the percent of production reported as Arm's length is less than 22% or greater than 28% is confusing. You increase the LCDT when you want to lower the IBMP and decrease the LCDT when you want to raise the IBMP. When you have more than 28% of the production being reported as Arm's length, you have all the data needed to calculate a 75% major portion price. Array the volumes by highest to lowest price and choose the price at which 75% of the production is sold. It can't be the IBMP because less than 75% of the production is reported OINX. If less than 22% of the production is reported Arm's length, an adjustment is needed, but there is a better way to make the adjustment than modifying the LCDT by 10%. The actual major portion price is somewhere below the current IBMP. Reduce the IBMP directly by multiplying the AR by .98. This seems to be more understandable and a better way to estimate the next month's AR than is the methodology proposed in the rule.

Some statistical analysis should be performed to see if it would be better to use some rolling average of several months' ARs, or if using the corrected AR for next month's AR will not lead to frequent changes in the monthly ARs.

The final rule must state that there won't be any retroactive changes to the IBMP. The rule is very dependent on Industry reporting. All companies should not have to change their reporting if

a compliance activity by ONNR at one company results in a potential change in the IBMP if the noncompliant company had correctly reported the month after the month of production. An individual company should correct their errors, but their corrections should not affect all companies with Indian leases subject to the major portion requirement.