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RECEIVED AUG 1997

August 2, 1997

<u>Via Facsimile & Federal Express</u>
Mr. David S. Guzy, Chief
Rules and Publications Staff
Minerals Management Service
Royalty Management Program
Building 85
Denver Federal Center
Denver, Colorado 80225

Re: Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, Notice of Proposed Rulemaking, 62 Fed. Reg. 3742 (Jan. 24, 1997), and Supplementary Proposed Rule, 62 Fed. Reg. 36030 (July 3, 1997)

Dear Mr. Guzy:

Union Pacific Resources Company ("UPR") submits these comments on the Minerals Management Service's proposed rule and supplementary proposed rule in the above-referenced matter.

UPR endorses the comments of the American Petroleum Institute ("API") and of Professor Joseph P. Kalt of Harvard University submitted in response to MMS's Notice of Proposed Rulemaking. Those comments, as well as the comments of the Independent Petroleum Association of America, the Domestic Petroleum Council, the Rocky Mountain Oil & Gas Association (and accompanying report by the Barents Group) and Scurlock Permian Corporation (a non-producer and one of the largest independent crude oil gatherers and marketers in the United States), correctly identify numerous fundamental flaws in MMS's proposed rule. As summarized by Professor Kalt, "the MMS proposal to work back from crude oil prices on the New York Mercantile Exchange ("NYMEX") and from quoted market centers is unsupported by both basic economic principles and the evidence from actual arm's-length transactions." Kalt Comments at 5.

Since the filing of comments on the proposed rule, MMS has issued a supplementary proposed rule. However, the minor changes embodied in the supplemental proposal do not even purport to address, much less cure, the flaws in the proposed rule identified by numerous commenters.

Based on the existing record and the comments filed to date, it is apparent that the NYMEX futures market is a different and distinct market from the markets for crude oil at the lease. It is also readily apparent that MMS's proposed rule for establishing crude oil value attempts to appropriate a portion of any value added to crude oil by activities occurring downstream from the lease -- such as aggregation, marketing, and other entrepreneurial activities. As Professor Kalt states, the "gaps" that can be observed between crude oil values at the lease "and prices netted back from selected trade centers are not components of the wellhead market value of crude oil. The 'gaps,' in fact, are the market's measure of the value of broker and marketer services and functions performed downstream of the wellhead." Kalt Comments at 6-7. Such appropriation of downstream added value is contrary to statutory authority and would occur without the federal government bearing any of the attendant costs and risks inherent in these activities.

Any rule for establishing crude oil value for royalty purposes should focus on ascertaining the market value of crude oil at the lease, which is the value on which royalties are required to be based. Accordingly, UPR strongly urges MMS either to maintain its existing regulations for valuing crude oil, or to fine tune and further focus those regulations on ascertaining the market values actually received at the lease for crude oil.

Very truly yours,

Eugene R. Elrod

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