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FAX COVER SHEET

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DATE: November 5, 1997

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Instruction/Comments:

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Chevron

November 5, 1997

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ORIGINAL TO FOLLOW BY REGULAR MAIL

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ESTABLISHING OIL VALUE FOR ROYALTY DUE ON FEDERAL LEASES; NOTICE OF REOPENING THE PUBLIC COMMENT PERIOD; 62 FED. REG. 49460 (SEPTEMBER 22, 1997)

Dear Sir:

Chevron U.S.A. Production Company, a division of Chevron U.S.A. Inc. ("Chevron"), appreciates the opportunity to comment on the subject notice reopening the public comment period on MMS' January 24, 1997, proposed rule (62 Fed. Reg. 3742), amended by supplementary notice of proposed rulemaking dated July 3, 1997 (62 Fed. Reg. 36030). As one of the largest payors of royalties on oil produced from federal leases, Chevron is significantly affected by the notice reopening the comment period ("notice").

Chevron endorses the comments dated November 4, 1997, submitted by the American Petroleum Institute. In addition, certain recent statements of two members of Congress lead to the inference that the January 24, 1997, proposed rule may comprise an "economically significant rule" as defined in Executive Order 12866. Attached hereto as Exhibit "A" is a report entitled "Analysis of the Department of Interior, Minerals Management Service Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases and on Sales of Federal Royalty Oil under Executive Order 12866." Chevron endorses this report and encourages MMS to take all steps necessary to comply with Executive Order 12866 in proposing any new oil valuation rule which would be "economically significant".

In conclusion, Chevron would like to take this opportunity to point out that MMS can do the right thing for the American taxpayer by taking the federal royalty in kind. In so doing, the value of production would be established at the time of production, by means of an agreed upon sale price, rather than many years later, as in the case with royalty paid in value. It is indeed unfortunate that writing a royalty check to the government has become the equivalent of writing America a blank check, with the amount not determined until years later, after costly and unnecessary audits, administrative appeals, and litigation. This is because the current state of the law confers upon the Secretary of the Interior broad discretion in interpreting the Department's valuation rules. However, the Department's interpretation invariably does not occur until many years after its regulations are promulgated. By way of example, what lessee could have foreseen when making royalty payments on natural gas liquids ("NGL") how the Department would eventually interpret its NGL valuation regulations in the infamous "Procedure Paper"? And who could have known when the 1988 valuation rules were adopted that the Department would, many years later, adopt the position that ANS spot prices should have been used to calculate royalty value on oil produced from federal leases in California rather than posted prices?

MMS proposes to fix the inherent problems which have arisen from requiring royalty payments in value with new and different valuation rules, but this does not address the recurring cycle of publishing valuation rules but then not interpreting them until many years later.

Chevron suggests that a comprehensive royalty-in-kind program would allow the government to eliminate cadres of federal employees required to monitor, verify, and ascertain correct royalty value. It would allow the government to participate in downstream markets, in the hope of achieving higher revenues, without imposing on federal lessees an obligation to market production downstream rather than at the lease. Finally, a comprehensive royalty-in-kind program would achieve what all Americans, from federal lessees to the school children of California, should have the right to know, namely, the value of production from federal lands at the time of severance.

Respectfully submitted,

GW Butler

George W. Butler, III

Attachment

EXHIBIT "A"

ANALYSIS OF THE DEPARTMENT OF INTERIOR, MINERALS MANAGEMENT SERVICE PROPOSED RULE ESTABLISHING OIL VALUE FOR ROYALTY DUE ON FEDERAL LEASES AND ON SALE OF FEDERAL ROYALTY OIL UNDER EXECUTIVE ORDER 12866

NOVEMBER 5, 1997

Barents Group LLC, a wholly owned subsidiary of KPMG Peat Marwick LLP, was retained by Gardere & Wynne LLP on behalf of a group of companies having significant crude oil production on Federal lands, to assist in analyzing the Department of Interior, Minerals Management Service (MMS) supplementary proposed rule establishing a new method for valuing oil for royalties due on Federal leases, and on the sale of Federal royalty oil.[1]

In previous comments, Barents has described how the Minerals Management Service underestimated compliance and economic costs of implementing the proposed rule.[2] Underestimated costs include those requiring evaluation under the Paperwork Reduction Act and under Executive Order 12866. In addition to satisfying procedural issues raised by previous reports, before MMS publishes a further notice of proposed rulemaking, it should fully and carefully analyze any proposed rule according to procedures required for economically significant rules under Executive Order 12866.

Review of previous comments on cost of proposed rule

Questions and concerns raised in our comments and those of others contributed to an Office of Management and Budget decision to reject proposed Form MMS 4415, which MMS proposed to implement the rule. The purpose of the proposed Form MMS 4415 was to capture information between the "market centers" and leases. MMS published a supplementary rule on July 3, 1997 to address some of these concerns.[3] On September 22, 1997, as a result of further public comment, MMS reopened the comment period and announced a series of workshops to explore alternative approaches. MMS also

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[1] References to the proposed rule refer to 30 CFR Parts 206 and 208 as published in Federal Register, January 24, 1997, Volume 62, Number 16.

[2] "Preliminary Analysis of the Department of Interior, Minerals Management Service Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases and on Sales of Federal Royalty Oil," March 25, 1997; "Analysis of the Department of Interior, Minerals Management Service Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases and on Sales of Federal Royalty Oil," May 28, 1997; and "Analysis of The Department of Interior, Minerals Management Service Supplementary Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases and on Sale of Federal Royalty Oil Under the Paperwork Reduction Act," August 4, 1997.

[3] References to the supplementary proposed rule in this report refer to 30 CFR Part 206 as published in the Federal Register, July 3, 1997, Volume 62, No. 128.

announced its intention to issue a further notice of proposed rulemaking following the comment period.

In evaluating the proposed rule, MMS said the reporting burden associated with the rule would cost the industry approximately $800,000 annually. As described in our August 4 comments, MMS' understatement of these costs has been well documented. Before MMS proposed the rule, it filed a brief Executive Order 12866 analysis with the Office of Management and Budget estimating an annual cost of $54 million, although this analysis was not published in the proposed rule.

In our August 4 comments[4], we briefly discussed MMS' approach and said an expanded analysis is required:

> *Before discussing the Paperwork Reduction Act, we briefly note that MMS is required to comply with several other administrative requirements in proposing a rule. One of these is Executive Order 12866, which requires the preparation of a detailed cost-benefit analysis for rules that have significant economic effects. For this purpose, private sector costs in excess of $100 million annually are considered significant. When discussing Executive Order 12866 in the proposed rule, the agency stated that the rule will not have significant economic effects [page 3750]. In a previous submission supporting this conclusion, the MMS estimated that the rule would result in additional revenues of $54.2 million and industry reporting costs of $845,600.*
>
> *This finding has now been called into question by a member of Congress. In July 31, 1997 testimony before the House Resources Committee, Subcommittee on Energy and Mineral Resources, Congresswoman Carolyn Maloney (D-NY) stated that the proposed MMS oil valuation rule would annually raise $100 million in revenue to the U.S. Treasury. Particularly when Congresswoman Maloney's estimated costs are added to other costs described in this report, as well as in numerous other comments provided during the public comment period, it is clearly appropriate for MMS to perform the more detailed economic analysis required by Executive Order 12866 to determine whether the rule has significant economic effects.*

More recently in an October 10, 1997 letter to Secretary of the Interior Bruce Babbitt, members of Congress George Miller and Carolyn B. Maloney estimated that the U.S. Government "lost" $133 million over sixteen months of investigation and rulemaking proceedings – this is equivalent to an annual rate of $100 million. We do not agree with this amount being characterized as "lost," because it implicitly assumes that additional government proceeds result from undervaluation. Should, however, the industry be required to pay an additional $100 million in federal royalties annually under the proposed rule, the rule would meet the Executive Order's test of being economically significant. This result could follow from the misvaluation inherent in using any averaging

[4] Page 2.

methodology that does not rely on lease market prices. Regardless of the cause MMS should comply with the Executive Order's requirements.

Executive Order 12866 requirements for economically significant rules

In publishing the proposed rule, the Office of Management and Budget determined that the rule raises "novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order."[5] At that time, however, MMS did not consider the proposed rule to have "a significant economic effect, as defined by Section 3(f)(4) [sic] of this Executive Order."[6] Section 3(f)(1) of the Executive Order defines an economically significant rules as follows:

> *(1) Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;*

While Barents Group has not performed an independent analysis meeting the requirements of Executive Order 12866 and cannot substantiate either MMS' original estimate or that prepared by Mr. Miller and Ms. Maloney, we believe, however, that sufficient concerns have been raised over the economic impact of the proposed and supplementary rule to require MMS to comply with Executive Order 12866 procedures for economically significant rules before a new rule is proposed.

The Executive Order calls for the following analysis of an economically significant rule[7]:

> *(C) For those matters identified as, or determined by the Administrator of OIRA to be, a significant regulatory action within the scope of section 3(f)(1), the agency shall also provide to OIRA the following additional information developed as part of the agency's decision-making process (unless prohibited by law):*
>
> *(i) An assessment, including the underlying analysis, of benefits anticipated from the regulatory action (such as, but not limited to, the promotion of the efficient functioning of the economy and private markets, the enhancement of health and safety, the protection of the natural environment, and the elimination or reduction of discrimination or bias) together with, to the extent feasible, a quantification of those benefits;*

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[5] Proposed rule, page 3750.
[6] *Ibid.*
[7] Analytical requirements are more fully described in a January 11, 1996 Memorandum for Members of the Regulatory Working Group from Sally Katzen, "Economic Analysis of Federal Regulations Under Executive Order No. 12866."

(ii) An assessment, including the underlying analysis, of costs anticipated from the regulatory action (such as, but not limited to, the direct cost both to the government in administering the regulation and to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness), health, safety, and the natural environment), together with, to the extent feasible, a quantification of those costs; and

(iii) An assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, identified by the agencies or the public (including improving the current regulation and reasonably viable nonregulatory actions), and an explanation why the planned regulatory action is preferable to the identified potential alternatives.

Conclusion

In conclusion, two members of Congress have developed independent estimates that the proposed rule is economically significant, many companies and trade associations have commented on the high costs imposed by the proposed rule, and our own previous reports discuss how the rule would be not only costly to administer, but also would mismeasure value and distorts economic activity and investment. Given this evidence, we believe that MMS will not have satisfied the intent of the Executive Order if it does not prepare a complete and careful Executive Order 12866 evaluation for economically significant rules before proceeding with any new rulemaking.