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November 5, 1997

Mr. David S. Guzy
Chief, Rules and Publications Staff
Royalty Management Program
Minerals Management Service
Denver Federal Center, Building 85
Denver, Colorado 80225

Re: Establishing Oil Value For Royalty Due On Federal Leases, Notice Of Reopening The Public Comment Period, 62 Fed. Reg. 49460 (September 22, 1997)

Dear Mr. Guzy:

Union Pacific Resources Company ("UPR") appreciates this opportunity to submit these comments on the "alternatives for proceeding with further rulemaking" set forth in the Notice Of Reopening The Public Comment Period (the "Notice") published in the Federal Register on September 22, 1997 (62 Fed. Reg. 49460).[1] As discussed more fully below, UPR supports the concept of using a series of lease-based benchmarks for valuing crude oil production that is not sold in an arm's-length[2] transaction at the lease. Thus, UPR supports a valuation proposal similar, although not identical, to "Alternative 2" set forth in the Notice, which consists

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[1] MMS subsequently extended the comment period to and including November 5, 1997. See "Public Meeting on Proposed Rule; Establishing Oil Value for Royalty Due on Federal Leases," 62 Fed. Reg. 55198 (Oct. 23, 1997).

[2] As discussed in Part I.B below, UPR uses the term "arm's-length" in these comments to mean a transaction not involving an affiliate of the lessee, i.e., a non-affiliate transaction, which is also the meaning given to the term by MMS's current regulations, which define an arm's-length contract as one "arrived at in the market place between independent, nonaffiliated persons with opposing economic interests regarding the contract." 30 C.F.R. § 206.101. UPR uses the term "outright" sales or transactions to refer to non-affiliate transactions which also do not involve buy-sell or other exchange agreements.

of employing a series of benchmarks for valuing production not sold under an arm's-length contract. See Notice, 62 Fed. Reg. at 49462.

Part I below contains general comments regarding the alternatives (Alternatives 1-5) set forth in the Notice. UPR is encouraged by the movement that benchmark Alternatives 1-3 represent away from MMS's earlier proposals involving indexing systems based on NYMEX and spot prices for Alaska North Slope ("ANS") crude oil and back to the actual markets for production that exist at the lease. However, in implementing any benchmark proposal, MMS should simply distinguish between affiliate and non-affiliate transactions. In this regard, MMS should not ignore non-affiliate transactions involving (1) exchange or buy-sell agreements, (2) lessees who have purchased crude oil in the past two years, or (3) production subject to a call. No support in the record exists for MMS's expressed "concern" about use of these types of arms-length or non-affiliate transactions.

Part II discusses in more detail UPR's proposed alternative for proceeding with further rulemaking, which involves a series of benchmarks. Given MMS's repeatedly stated intention of relying less on posted prices to reveal value at the lease, UPR believes that such a series of benchmarks would enable MMS to arrive at value at the lease without relying on posted prices.[3] Part III describes the voluminous amounts of information that MMS already collects from lessees on its Payor Information Form (Form MMS-4025) and Report Of Sales And Royalty Remittance Form (Form MMS-2014). MMS can -- and should -- use this information to construct a series of benchmarks for use where the lessee sells production to an affiliate.[4] Finally, Part IV contains comments on certain remaining issues raised in the Notice.

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[3] In proposing the series of benchmarks, UPR does not intend to suggest that it shares MMS's view that posted prices are suspect or are not reliable indicators of the value of production at the lease. UPR does not share this view, and the record submitted in these rulemakings supports the conclusion that such prices remain indicative of value at the lease. See, e.g., Comments of Joseph P. Kalt, Ford Foundation Professor of International Political Economy at Harvard University's John F. Kennedy School of Government and Senior Economist with The Economics Resource Group, Inc., dated May 27, 1997 (hereafter "Kalt Comments"), at 5 (stating, "I find that the range of posted prices commonly observed at particular oil fields quite consistently lies within the range of the proceeds realized by sellers in outright arm's-length transactions occurring at the leases in those same fields"); Comments of the Independent Petroleum Association of America, dated May 15, 1997 (hereafter "IPAA Comments"), at 21-22.

[4] As discussed below in Part I.B, even were MMS to conclude (erroneously) that non-affiliate transactions subject to buy-sell agreements should not be used to determine a benchmark value, MMS should still work with industry to employ, and modify if need be, its current information gathering forms so that MMS can use those forms to construct benchmarks using only "outright" sales.

I. General Comments

The Notice sets forth five alternatives for proceeding with further rulemaking. Under Alternative 1, a lessee would be permitted to value "production not sold arm's-length" based on prices it receives "for outright sales of crude oil in a particular market area or region." 62 Fed. Reg. at 49462. Alternative 2 involves use of a "series of benchmarks." The first benchmark incorporates Alternative 1, i.e., "outright sales [by the lessee] of like-quality crude in the field or area, as described in Alternative 1[.]" Id. The other benchmarks in the series consist of "(2) [t]he lessee's or its affiliate's arm's-length purchases from producers at the lease in the field or area, (3) [o]utright arm's-length sales by third parties, (4) [p]rices published by MMS based on its RIK sales, [and] (5) [a] [n]etback employing price information from the nearest market center or aggregation point." Id. Under Alternative 3, "MMS [would] establish value based on geographic indexing using its own system data." Alternative 4, referred to by MMS as the "Differentials" alternative, consists of developing "fixed rate (cents per barrel) differentials" and subtracting these from NYMEX futures prices and ANS spot assessments in an attempt to arrive at the value of production at the lease. Under Alternative 5, production would be valued based on published spot prices and, apparently, adjustments made to those spot prices.

A. The "Series Of Benchmarks" Alternative Focuses On The Market For Production At The Lease And, Therefore, Generally Accords With MMS's Legal Obligation To Base Royalty Value On The Value Of Production At The Lease.

As discussed in great detail in comments submitted in response to MMS's January 24, 1997 Notice of Proposed Rulemaking (62 Fed. Reg. 3742), MMS has both a statutory and a contractual obligation to base federal oil lease royalties on the value of production at the lease.[5] Moreover, a flourishing market for production exists at the lease,[6] and that market is affected by demand and supply factors that differ from the factors that affect prices in crude oil market

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[5] See, e.g., American Petroleum Institute Comments on Minerals Management Service Proposal for Valuation of Crude Oil and Sale of Federal Royalty Oil, dated May 27, 1997 ("API Comments"), at 34-38; IPAA Comments at 6-8.

[6] See, e.g., Kalt Comments at 3 ("[t]here is an active market at the lease (or 'wellhead') level. This market is highly competitive"); IPAA Comments at 8-10; id. at 9 ("the current lease market for federal lease oil is thriving"); Comments of the Rocky Mountain Oil & Gas Association, dated May 28, 1997 (hereafter "RMOGA Comments"), at 3 ("there is a viable and active market for oil at the wellhead").

centers.[7] Use of a series of benchmarks which focus on determining the value of production at the lease therefore accords with MMS's statutory and contractual duties to base royalties on the value of production at the lease.

On the other hand, Alternatives 4 and 5 stray far from lease markets and the value of production at the lease. Under Alternative 4, as under MMS's earlier proposal involving NYMEX and ANS spot assessments, MMS would calculate "location and quality differentials" to be deducted from NYMEX futures prices and ANS spot assessments in an attempt to arrive at value at the lease. For all the reasons set forth in the comments opposing the valuation scheme in MMS's January 24, 1997 Notice of Proposed Rulemaking, Alternative 4 -- whether employing location and quality "adjustments" or "fixed rate (cents per barrel) differentials" meant to reflect location and quality differences -- would not (except by happenstance) produce accurate or reasonable values of production at the lease.[8] Similarly, Alternative 5, which involves adjustments made to "published spot prices" in an attempt to arrive at the lease value of production, strays from lease market values themselves and would likely not reproduce lease market values.

While Alternative 3 -- the calculation by MMS of geographic index values using MMS's own system data -- does appear to be more focused than Alternatives 4 and 5 on production markets at the lease, using a series of benchmarks drawn directly from lease markets is a more direct and certain way to arrive at the value of production at the lease. Unless use of a

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[7] See API Comments at 15-23 (discussing how NYMEX prices are influenced by factors not present at the lease market); Kalt Comments at 3 ("transactions at the lease level reveal market values that commonly vary significantly with supply and demand factors that are specific to individual locations, leases, and transactions").

[8] Those reasons include the fact that Alternative 4 starts at markets very different from and far removed from the lease markets -- i.e., the NYMEX futures market, and the Los Angeles and San Francisco spot markets for ANS -- and attempts to work back to lease market values through mechanical adjustments that do not account for numerous factors that create different values at the lease than the values reflected in the NYMEX futures and ANS spot markets. Those factors include value that is added as crude oil is aggregated and moved away from the lease and as various risks are assumed -- including risk of loss, risk of market price changes, and risk of environmental harm. Additional factors include the fact that different demand and supply factors are at work at the lease than in the NYMEX futures and ANS spot markets, causing fluctuations in the difference between prices in the lease markets and prices in these latter markets, which fluctuations are not captured through a system of adjustments to the NYMEX and ANS prices. See, e.g., Kalt Comments at 7 ("a netback methodology fails to account both for the demonstrable dependence of market value at the lease on supply and demand factors particularized to leases and transactions, and for value added to crude oil by downstream marketing functions").

series of benchmarks were demonstrated to be unworkable, there does not appear to be a need for MMS to rely solely on geographic index values that it would derive from its data.

B. MMS Should Accept Use Of All Prices Arising In Non-Affiliate Transactions In Constructing The Series Of Benchmarks.

In describing benchmark Alternatives 1 and 2, MMS uses the terms "arms'-length sales" and "outright sales" without defining them. MMS also refers to "outright arm's-length sales." Under MMS's current regulations, an arm's-length contract is one "arrived at in the market place between independent, nonaffiliated persons with opposing economic interests regarding the contract." 30 C.F.R. § 206.101. Thus, "arm's-length," under the current regulations, means non-affiliate. In the proposed regulations contained in MMS's January 24, 1997 rulemaking, MMS continues to define "arm's-length contract" as one "between independent, nonaffiliated persons with opposing economic interests regarding the contract." Proposed Rule 206.101 (62 Fed. Reg. 3751). However, this definition is qualified by five "exceptions," three of which would virtually swallow the rule permitting use of non-affiliate contracts and for which no need has been demonstrated. Specifically, MMS would prohibit use of non-affiliate contracts "to value oil disposed of under an exchange agreement" or "for production subject to crude oil calls," Proposed Rule 206.102(a)(4) (62 Fed. Reg. 3752), or where a lessee or its affiliate "purchased crude oil from an unaffiliated third party in the United States in the 2-year period preceding the production month." Proposed Rule 206.102(a)(6) (62 Fed. Reg. 3753). It is unclear whether, in using the term "outright sales" in describing the benchmarks in Alternatives 1 and 2, MMS is seeking to exclude certain non-affiliate transaction prices from the transaction prices that would be used to construct the benchmarks.

In any event, in constructing the series of benchmarks (and determining whether there is a need to resort to the benchmarks in the first place), MMS should use prices from non-affiliate transactions regardless of whether (1) the production is subject to a call, (2) the lessee or its affiliate has purchased crude oil from a third party in the last two years, or (3) the production is subject to an exchange agreement. With respect to MMS's proposed restriction on production subject to a call, such restriction is unwarranted and unworkable. MMS has not provided any reason why calls either negotiated with the United States or negotiated privately would cause call owners or the callee to have less incentive to maximize income on the sale of production.[9] Similarly, there is no basis for MMS's restriction in its January 24, 1997 proposal on use of non-affiliated transaction prices where a lessee or its affiliate purchased crude oil from a third party in

[9] See, e.g., IPAA Comments at 15-17 (discussing lack of basis for and unworkable nature of MMS's proposed call restriction).

the two-year period preceding a transaction.[10] Imposing such a restriction in determining whether a lessee had arm's length transactions (and thus whether resort to any benchmark alternative was warranted in the first place) and in constructing the series of benchmarks would be unwarranted.

There is also no basis for excluding non-affiliate transactions involving production subject to an exchange agreement when (1) determining whether a lessee has arm's-length transactions (and thus whether there is any need to resort to benchmarks), and (2) identifying transactions and prices from which to construct the series of benchmarks. The notion that prices set forth in exchange agreements do not matter and can be manipulated and lowered as the contracting parties desire does not comport with the realities of the marketplace.[11] For example, it is not uncommon that an exchange partner will fail or be unable to deliver all or a portion of production contracted for, with the legal remedy being collection of the price set forth in the contract. A market, rather than nominal, price is necessary in an exchange contract for purposes of both minimizing cost of covering and settling imbalances with the exchange party, which routinely and necessarily occur -- particularly in purchases from the lease, where one never knows the exact quantity of crude oil that will be produced in a given month. Furthermore, the claim that the prices in exchange agreements do not matter ignores the fact that such contracts frequently involve crude oils of differing qualities. As one commenter has stated, "the dynamics of the market would automatically create winners and losers if the contract prices were undervalued because the [price] spread between various grades of crude frequently changes between the date of the contract and the date of delivery."[12] Moreover, exchange agreements frequently incorporate a party's posted prices. Those same posted prices are used in other contracts, including contracts pertaining to crude oil of differing and unequal grades, quantities and delivery times. As the use of such prices as benchmarks is not limited to symmetrical exchange contracts, they must reflect market, rather than nominal, values.

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[10] See, e.g., IPAA Comments at 12-15 (criticizing this proposed restriction and pointing out, inter alia, that there is no proof that a problem involving "overall balances" even exists, and that MMS's powers under 30 C.F.R. § 206.102(b)(1)(iii) to require an otherwise arm's-length sale to be valued under benchmarks if the lessee's proceeds "do not reflect the reasonable value of production because of misconduct by or between two contracting parties ..." would be sufficient to deal with such a problem).

[11] See Comments of Scurlock Permian Corporation, dated April 17, 1997, at 9-10 (stating that such a notion "could only be advanced by someone lacking overall experience in buying and selling crude oil in today's marketplace" and providing examples of why such prices matter and must accurately reflect the market).

[12] Comments of Scurlock Permian Corporation at 10.

MMS has not produced evidence from its own vast collection of data that transactions involving exchange agreements tend to involve lower prices than "outright" sales of production. Nor has MMS explained why its own ability to compare the prices in exchange agreements to prices in comparable "outright" transactions is not a sufficient safeguard for weeding out any artificially lowered exchange sale price.[13] As there is no evidence that production in exchange transactions is undervalued,[14] and as market dynamics would tend to prevent use of artificial pricing in such transactions, MMS should not exclude them from the class of "arms-length" transactions.[15]

However, even assuming, arguendo, that there were evidence to support exclusion of exchange transactions, UPR would continue to recommend development of a "series of benchmarks" for valuing production at the lease. Instead of including non-affiliate exchange transactions among the arm's-length transactions used to determine whether resort to benchmarks was necessary and to construct those benchmarks, MMS would use only "outright" arm's-length transactions in making such determinations.

II. Use Of A Series Of Benchmarks Drawn From The Lease Market Would Be An Appropriate Method Of Valuing Non-Arm's-Length Transactions.

In Alternative 2, MMS sets forth a series of five benchmarks as a proposed method of valuing production not sold arm's-length. UPR proposes that MMS adopt a series of benchmarks largely similar, though not identical, to those set forth in Alternative 2. As discussed above, UPR believes that MMS should include non-affiliate transactions even if they involve production subject to calls, lessees who previously purchased crude oil from third parties, or

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13 See IPAA Comments at 19 ("IPAA agrees with the principle that the 'sale' component of an arm's-length buy/sell agreement needs to be within the range of comparable arm's-length sales in the field. It believes, based on the experience of its membership (as summarized above), that there are ample real-world safeguards to protect the lessor against price manipulation in a buy/sell").

14 See, e.g., Kalt Comments at 6 n.2 ("[s]uch assertions are, in fact, not supported by the evidence. Conclusions that the facts of vertical integration and/or exchanges result in uncompetitive marketplace results or otherwise depressed wellhead values for crude oil represent incompetent economic analysis").

15 See IPAA Comments at 19 ("the soundest policy would be that oil disposed of under an arm's-length buy/sell agreement would be valued using the lessee's proceeds under the agreement, unless that value is unreasonably low because of misconduct by the parties").

exchange agreements. Therefore, UPR will use the term "arm's-length" in its description of the benchmarks to include such transactions, i.e., as synonymous with non-affiliate transactions.

Where a lessee does not itself sell production from a lease pursuant to an arm's-length, i.e., non-affiliate, contract, MMS should look to the following benchmarks for valuing that production:

(1) Negotiated prices the lessee receives under other comparable arm's-length transactions in the same field. Included in this benchmark, for example, would be prices bid in response to a "tendering" program of the kind referred to in the comments of the IPAA[16] and MMS's Notice (62 Fed. Reg. at 49462);

(2) Prices paid by the lessee or its affiliates for production from the lease or from other leases in the same field in comparable arm's-length purchases, including purchases made at the lease by the lessee or by the lessee's affiliate from third-party working interest owners of the lease;

(3) Prices received by third parties in comparable arm's-length transactions occurring in the same field;

(4) Prices received by MMS, adjusted back to the lease, from its sales of royalty oil taken in kind from the lease or field; and

(5) A netback method appropriate to a particular lease. For example, where circumstances permit, the netback could employ published spot assessments from the aggregation point or market center nearest the lease, adjusted back to the lease.

In the Notice, MMS asks whether such benchmarks should be considered in any particular order. 62 Fed. Reg. at 49462. UPR submits that the answer is "yes". The benchmarks should be considered in the order presented above -- i.e., examining first the prices received by the lessee for comparable arm's-length transactions in the same field or area; next, the prices paid by the lessee or its affiliates to third parties for production from the lease or from other leases in the same field, and so forth. Alternatively, MMS could, for example, look at the range of prices represented by benchmarks (1) through (4), and accept as a royalty value any price obtained by a lessee in a non-arm's-length transaction that fell within such range of prices. Permitting use by the lessee of a price that falls within the range would give greater assurance to lessees that the prices they reported for royalty values on non-arm's-length transactions would not later be held to be non-representative of arm's-length sale prices.

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[16] IPAA Comments at 25.

In the Notice, MMS also asks how it can be certain that "the contracts" used to create the benchmarks "are indeed arm's-length sales and that they reflect the total consideration for the value of production other than through audit?" 62 Fed. Reg. at 49462. As discussed above in Part I, UPR believes that MMS's concerns that the prices used in transactions between non-affiliated parties may be artificial are not supported by the record and contrary to the actual realities of the marketplace, which work to prevent use of artificial prices in such transactions. Furthermore, because of the Federal government's royalty interest in numerous leases across the country, MMS receives voluminous information each month on the prices that lessees are receiving, and that MMS is itself receiving for its royalty in kind. MMS should be able to detect artificially depressed royalty values reported by a lessee through a comparison to prices reported to MMS for comparable transactions by other lessees. Moreover, MMS may take RIK from every field where it distrusts the information it is receiving from the lease market.

With regard to the fifth benchmark identified above, MMS asks how such a "netback" should be determined. 62 Fed. Reg. at 49462. First, the fifth benchmark, because it begins with prices received away from the lease and field, is generally less likely to result in a true market value for production at the lease, and is therefore inferior to the preceding four benchmarks. MMS should consider not developing the fifth benchmark where one or more of the first four benchmarks are available, although the fifth benchmark might be developed where only benchmark 4, or benchmark 3, were available. Furthermore, it has been recommended that MMS take its royalty in kind from any lease where it "distrusts the information from the lease market ...."[17] Where MMS is taking RIK, it may be unnecessary to develop benchmark 5. In any event, if it is necessary to develop such a benchmark, MMS should look to spot assessments published for crude oil of similar quality at the aggregation point or market center nearest the lease. MMS would need to develop location, quality and transportation adjustments to be applied to the reported assessment. In developing transportation adjustments, MMS should employ the transportation charge set forth in FERC tariffs, where such are available.

III. Much, If Not All, Of The Data MMS Needs To Construct A Series Of Benchmarks Is Already Reported To MMS In The Mountain Of Data MMS Currently Receives From Lessees.

MMS already receives voluminous quantities of information on a monthly basis regarding the price at which crude oil production is sold at the lease. MMS receives this information through MMS's "payor reporting structure," which is described in the Oil And Gas

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[17] IPAA Comments at 25 (stating that "[i]f MMS is reluctant to commit to a full RIK program, it should at least take RIK from every field where it distrusts the information from the lease market and should sell that oil competitively. With this information available, MMS is well positioned to employ benchmarks to test the values received under non-arm's-length arrangements").

Payor Handbook -- Volume I (MMS/RMP Release 3.0, dated 9/17/93)("MMS's Payor Handbook"). This reporting structure basically consists of three forms. The first is the Payor Information Form (Form MMS-4025) (the "PIF"), which is filled out and submitted to MMS by a lessee for each individual "selling arrangement" and each type of product sold under such selling arrangement. As stated in MMS's Payor Handbook at p. 2-1:

> The PIF is used to transmit lease and payor information to MMS. Information supplied on the PIF establishes and (or) updates the MMS database for a specific payor reporting on a specific lease for a particular revenue source, selling arrangement, and product. The MMS uses PIF information to establish and maintain the lease and payor accounts for monthly reporting [of sales amounts and royalties owed] ....

After receiving and evaluating a PIF, MMS sends to the lessee a Payor Confirmation Report ("PCR"), which identifies and confirms "the correct lease, revenue source, selling arrangement and product code combination" to be used by the lessee when reporting royalties on a monthly basis. Id. Each month, the lessee/payor then fills out and submits to the MMS a Form MMS-2014, also known as the "Report of Sales and Royalty Remittance," which identifies, inter alia, the volume, quality and dollar amount of sales occurring that month of a particular product, under a particular selling arrangement, from a particular revenue source within a particular lease, and the dollar value of MMS's royalty share of the sales amount.

A somewhat more in-depth look at the detailed nature of the information already collected by MMS is warranted. First, MMS assigns a 10-digit lease number (the "MMS lease number") to each onshore or offshore lease. MMS creates this number through converting from the BLM- or OMM-assigned lease number that already exists for the property. MMS's Payor Handbook at p. 2-5. Thus, either by using its own lease number, or by linking its lease number back to the original BLM- or OMM-assigned lease number, MMS can (or could) determine what prices are being reported for leases in the same field, and from fields located near each other. In addition, MMS assigns "revenue source" numbers, which represent "accounting subdivision[s] of a lease." Id. at p. 2-6. A revenue source "is a source of production from which MMS expects to receive royalties, " and could be (i) wells located in a lease and not committed to a unit participating area or communitized area; (ii) a unit participating area from which the lease receives an allocation; (iii) a communitized area from which the lease receives an allocation; (iv) a compensatory royalty assessment against a lease; or (v) a compensatory royalty agreement. Id. MMS assigns "revenue source numbers" sequentially for a given lease. MMS further assigns product codes to identify what is being produced, i.e., 01 for Oil; 03 for processed gas; 04 for unprocessed gas; 07 for gas plant products. Id. at pp. 2-7, 2-9. MMS further assigns a five digit code to each payor.

In addition, MMS requires payors to identify "selling arrangements," and MMS assigns a code to each such arrangement. "The selling arrangement is used to identify marketing outlets for products sold on the revenue source." Id. at p. 2-8. Moreover, MMS's Payor Handbook states that

> A separate selling arrangement must be established for:
>
> - Each RIK contract
> - Each conventional/dedicated sales contract (each non-arm's length allowance rate [such as transportation allowances] requires a separate selling arrangement)
> - Spot sales and (or) direct market sales

Id. at p. 2-8. MMS's Payor Handbook further states that "[s]elling arrangement numbers are assigned sequentially for a payor within a revenue source. Each product has its own numbered series." Id. at p. 2-9.

Thus, in keeping with the instructions in the MMS Payor Handbook, Section I of the PIF contains a box for the "payor's" name, code, and telephone number. Section II contains a box for the Bureau of Land Management or Outer Continental Shelf Lease Number of the lease at issue or, if the payor is updating lease information, the previously assigned MMS Lease number. In Section III, the payor identifies the type of revenue source, i.e., from a unitized production area allocation, a communitized production allocation, production from lease wells or compensatory royalty payments. In Section IV, the payor identifies the product and the selling arrangements, including the buyer's name if sold under a conventional/dedicated sales contract, or the RIK contract number and RIK refiner's name if taken in kind. The payor checks a box next to "Spot Sale?" if that is the nature of the selling arrangement.

After receiving its Payor Confirmation Report containing the code numbers that MMS determines a payor should use, each lessee/payor completes and submits to MMS Form 2014 on a monthly basis. That form identifies each sale by MMS lease number, revenue source number, product code, selling arrangement code, sales month, sales quantity, measure of quality (degrees gravity API for crude oil), sales value received, royalty quantity and royalty value or amount owed to MMS. Thus, it is quite clear that MMS is already receiving an enormous amount of information that is coded by lease and, even within each lease, by revenue source and selling arrangement. MMS could use this information to establish a series of benchmarks involving the sale of production at the lease.

It has been recognized that MMS is in a superior position vis-a-vis the individual lessee to use the information it collects to determine whether a contract price is reasonable and reflects the market. Individual lessees lack the breadth of information available to MMS, and may be prevented by antitrust concerns from obtaining such current price information. As the IBLA stated in Mobil Oil Corp., 112 IBLA 56 (1989):

> [W]e note that a lessee could have difficulty in making a showing as to the validity of the price it used to value [natural gas liquid products], as compared with other contract prices, since a lessee will not likely have complete information regarding all sales contracts in an area. In fact, a lessee might run afoul of price-fixing restrictions if it attempted to assemble this data. On the other hand, MMS, which receives contract data from all Federal lessees, is in a much stronger position to assert, and defend against challenge, a determination as to whether a particular contract price is permissible.

Id. at 63-64 n.8. MMS already collects voluminous information from which, with little or no further organizing and information, it could construct a series of benchmarks for use with respect to prices used in non-arm's-length transactions.[18]

IV. Additional Matters Raised By MMS.

With respect to Alternatives 1-3, MMS asks whether it should apply any of them only to the Rocky Mountain region while maintaining NYMEX prices as the basis for Mid-Continent and OCS leases and ANS prices for California and Alaska leases. 62 Fed. Reg. 49462. As noted above, UPR respectfully submits that MMS should adopt a series of benchmarks similar, although not identical, to those set forth in Alternative 2, rather than adopting either Alternative 1 or 3. In addition, no grounds appear for applying Alternative 2 (or Alternatives 1 and 3) to just the Rocky Mountain region. While MMS received comments indicating that use of NYMEX-based prices would fail to produce appropriate lease values for production in the Rocky Mountain region because of that region's peculiar demand and supply factors, the record further demonstrates that the demand and supply factors in lease markets throughout the country are sufficiently different from those affecting NYMEX futures prices and ANS spot assessments to render the latter incapable of being adjusted to arrive at the market value of production at the lease. Thus, the criticisms raised concerning use of NYMEX and ANS prices apply to attempts to value production at lease markets outside, as well as within, the Rocky Mountain region.

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[18] See, e.g., Form MMS-4025 (the "Payor Information Form"), Form MMS-2014 (the "Report Of Sales And Royalty Remittance") and MMS's Oil And Gas Payor Handbook, discussed supra at pp.10-12; RMOGA Comments at 5 ("MMS has a sufficient database to determine values using comparable sales of like quality crudes in the area. RMOGA does not understand MMS'[s] unwillingness to recognize and utilize such a valuable tool that is so readily available").

CONCLUSION

UPR appreciates this opportunity to submit comments on the "alternatives for proceeding with further rulemaking" set forth in MMS's Notice. UPR applauds MMS for considering alternatives, such as Alternatives 1 and 2, that focus on the market existing at the lease. UPR believes such focus is required by MMS's statutory and contractual obligations to value production at the lease, and by the fact that active lease markets exist and are subject to factors different from those affecting the NYMEX futures and ANS spot markets. Given MMS's repeatedly stated intention of relying less on posted prices, UPR urges MMS to choose as the alternative to be pursued in any further rulemaking the development of a series of benchmarks focusing on the value of production at the lease, as described above.

Respectfully submitted,

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