



April 2, 1998

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HUNT OIL COMPANY

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Re: Comments of Hunt Oil Company
To Proposed Rule Establishing Oil Value for Royalty Due on Federal Leases
Vol. 63, No. 25, February 6, 1998, p. 6113 ff.

Hunt Oil Company (Hunt) is an independent producer of crude oil. Hunt markets its entire crude oil production under arm's-length sales contracts. The fact that Hunt sells all its crude oil through arm's-length sales contracts aligns the MMS and Hunt in a way that serves the legitimate interests of both parties. However, the proposed regulations would appear to be an attempt to allow the MMS to treat arm's-length sales as if they were not arm's-length sales. The proposed rules might be used (or misused) in an attempt to value arm's-length marketing arrangements using the indexing method of valuation under Sec. 206.103. If promulgated and allowed to stand, this could effectively and unfairly take away without due process a portion of the value of Hunt's rights and interests.

1. The "duty to market" concept, which underpins many of the proposed rules, is not appropriate. Hunt disagrees with many of the costs MMS suggests be borne only by the lessee under the so-called duty to market. Many costs that the MMS lumps under the duty to market actually enhance the value of the product. It is not fair or appropriate to use any pricing method that moves the "valuation point" away from the lease. That is what the index pricing method of Sec. 206.103 would do. Then it would attribute costs incurred before reaching the valuation point to the lessee.
2. In connection with Sec. 206.102 (c) (3) dealing with exchange agreements, Sec. 206.112 (b) (2) requires the MMS to publish a list of location and quality differentials on an annual basis. These differentials are much more fluid and elastic than that. They change on a monthly and sometimes daily basis. Therefore, the MMS proposal would result in arbitrary and fictitious "determinations" of location or quality differentials.

Further under Sec. 206.102 (c) (3), the MMS seems to be attempting to create the right in the MMS to retrospectively determine what is a reasonable location or quality differential. The MMS should drop this requirement entirely. Instead, the MMS should rely on the competing interests of the parties utilizing their business judgment and contemporaneous market forces to arrive at the best deal for the lessee and, therefore, the MMS, its lessor. If, however, the MMS insists on attempting to give itself sole discretion to determine that the negotiated location

or quality differentials of an arm's-length agreement are not reasonable, the entire contract should not be valued under the index pricing of Sec. 206.103. Rather, only the differentials should be revalued. It must be remembered that this situation could arise even though the parties arrived at the differentials used in the agreement through the process of arm's-length negotiation between parties with competing economic interests. An arm's-length arrangement is by nature the most likely to be the best available deal at the time for the buyer and the seller.

3. Under Sec. 206.102 (d) (3), the MMS seeks to substitute its hindsight judgment as to what is reasonable effort on the part of a lessee to enforce its contract rights under a contract negotiated at arm's length. This section provides that if the lessee fails to take proper or timely action to receive the price or benefits it is entitled to under the contract, then it will nevertheless be required to pay the highest price it might have obtained under the agreement. This will, of course, involve hypothetical speculation with the benefit of hindsight and may not give due regard to the costs and contingencies of legal proceedings. To our recollection, this is the first time the MMS has sought to intervene in a lessee's deliberative process as to whether pursuing legal remedies in a contract dispute is a good business decision. This deliberative process should not be second guessed by the MMS. Further, there is no definition as to what action the MMS deems "timely and proper." Without change, Sec. 206.102 (d) (3) might appear to require the parties to litigate every price dispute arising out of their arm's-length contract to a conclusion at great expense to the litigants. Under the proposed rule, a lessee could actually be criticized for negotiating a prudent and reasonable arm's-length compromise to a contract dispute no matter what the outcome. If the MMS is insistent that this provision remain in the final regulations, the MMS should, at a minimum, attempt to define what action is "timely and proper" to enforce rights to a contract price. That attempt will reveal how arbitrary, speculative and hypothetical the determinations will be if this proposed regulation is adopted.
4. Section 206.102 (c) (1) provides that if the MMS determines that the arm's-length contract does not reflect "total consideration" actually transferred, then the lessee may be required to value the agreement under the index pricing method of Sec. 206.103. In order to avoid the potential for application of this section in an arbitrary, capricious or discriminatory manner, the MMS should provide a definition of the elements that constitute "total consideration" received by the lessee.
5. Section 206.102 (d) (3) requires that any amendments that reduce prices or benefits must be in writing and signed by all the parties. This regulation should be dropped entirely. The MMS should allow established legal principles and practices to determine how an agreement between parties should be documented to become legally binding. There is a rapid trend away from signed contracts toward legally-binding exchanges of faxes and internet communications.
6. Hunt is a member of both the American Petroleum Institute ("API") and the Independent Petroleum Association of America ("IPAA"). Hunt hereby adopts the comments filed by the API and IPAA in this proceeding regarding the proposed

David S. Guzy, Chief
April 2, 1998
Page 3

regulations and incorporates those comments into these comments as though fully referenced herein.

In the final analysis, the MMS could eliminate most of the legal issues, administrative costs, complexities and challenges to the proposed regulations by embarking on a true take-in-kind program for its royalty oil. It would then have full opportunity to maximize its return, be totally in control of obtaining the best value for its royalty oil and capture downstream pricing at market points. Accordingly, Hunt urges the MMS to consider adopting a take-in-kind program.

Respectfully submitted.

Very truly yours.

HUNT OIL COMPANY

A handwritten signature in black ink, appearing to read "Arie C. Britt". The signature is written in a cursive, flowing style.

Arie C. Britt
Vice President-Oil & Gas Marketing

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