

**Rocky Mountain
Oil & Gas Association**

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Cliff Dodge
Executive Vice President
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November 5, 1997

Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
P.O. Box 25165, Mail Stop 3101
Denver, CO 80225-0165

**RE: Rocky Mountain Oil and Gas Association Comments on Alternatives for
Establishing Oil Value for Production on Federal Leases, 62 FR 49460
(September 22, 1997)**

Dear Mr. Guzy:

The Rocky Mountain Oil and Gas Association (RMOGA) welcomes this additional opportunity to submit written comments on the alternatives published at 62 FR 49460 (September 22, 1997) and the related discussions occurring at the Denver workshop (September 30th and October 1st) and the Houston workshop (October 7th and 8th). These comments support and augment the RMOGA comments filed on May 27th, 1997 and August 4th, 1997.

The Rocky Mountain Oil and Gas Association (RMOGA) is a trade association whose 300 members (both majors and independents) are responsible for 90 percent of the exploration, production, refining, marketing and transportation of oil and gas in the eight-state Rocky Mountain region it serves.

The members of the Rocky Mountain Oil and Gas Association have made clear from the beginning of this process their opposition to the introduction of an index as the starting point for determining the value of crude oil in most cases. The original proposal contemplates using the New York Mercantile Exchange price as the starting point for the valuation of most of the crude, while using ANS (Alaska North Slope) prices on the West Coast. It seems that despite many, many meetings and lots of intelligent discussion, the Minerals Management Service continues to be fixed on an index with a few very minor alterations.

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RMOGA strongly objects to MMS' continued consideration of the use of index pricing for establishing the value of crude oil produced on federal lands. The methodology is unsound in both theory and application. It does not work nationally and it most certainly does not work in the Rockies.

MMS appears to believe that a "one price fits all" approach can work to establish value if only the proper adjustments are selected. RMOGA disagrees. NYMEX cannot and will not work in the Rockies because Rockies lease prices do not move in the same direction at the same time as NYMEX. The only approach that will properly establish value is to measure it at the lease.

While MMS has identified "more certainty" as a primary goal in proposing the rule, it sacrifices accurate pricing at the lease. Indeed, four benchmarks were discussed at the Denver and Houston meetings, including tender/bid out and even RIK have a place in a benchmark scheme. The key is the valuation of the oil at or near the wellhead/lease. While RMOGA members agree that simplicity and certainty are appropriate objectives, they should never be used as a justification for misvaluation.

RMOGA is particularly distressed that MMS is unwilling to even consider a Royalty-In-Kind (RIK) approach for comment. In soliciting comments, MMS said, "it will continue to pursue input on that program through other avenues." RMOGA believes an RIK methodology is indeed one of the most appropriate approaches yet identified and it is entirely inappropriate for MMS not to consider it as part of this rulemaking.

One of the problems that members of the oil and gas industry have in dealing with the Minerals Management Service is attempting to comply with the very tight and inflexible time deadlines that are imposed. It is most difficult to gather a diffuse membership together to discuss a problem and come up with a unified position in a very short timeframe. These decisions need to be fed into the "chain of command" and that takes time. If MMS is to have full participation and hear all sides, additional time is critical so that industry can comply and participate. The oil and gas industry wants to participate, but the short timeframes tend to preclude full and open discussion.

The members of the Rocky Mountain Oil and Gas Association continue to urge the Minerals Management Service to allow sufficient time for fact-finding and full and open discussions on a wide range of solutions including the topics suggested in this comment period, but also the rest of the issues including a Royalty-In-Kind proposal. The mandatory implementation of an index-based valuation system will not solve the problem, and will create even more problems as we move forward.

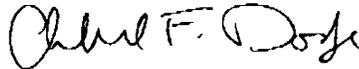
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Finally, RMOGA is pleased to submit and associate itself with a brief report by Barents Group LLC regarding certain procedural issues with which MMS must comply in this rulemaking. Barents calls for MMS to analyze any new approach as "an economically significant rule" before proceeding further. RMOGA strongly agrees.

Again, RMOGA appreciates the opportunity to provide you with our views and comments. Please do not hesitate to contact me if you have any questions or would like to discuss these comments in greater detail.

Sincerely,



Clifford F. Dodge
Executive Vice President
Rocky Mountain Oil and Gas Association

Enc. Barents Group Analysis

**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

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 comments⁴, 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

⁴ Page 2.

significant. This result could follow from the misvaluation inherent in using any averaging 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 rule⁷:

(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;

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 distort 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.