

prices are most appropriate to value crude oil not sold at arm's length and what transportation deductions should be allowed. Experience thus far with the 2000 rules, some years of experience in taking and selling royalty-in-kind oil, and information learned during litigation challenging the 2000 rules indicate a potential for improving those rules in some respects.

DATES: Comments must be submitted on or before September 19, 2003.

ADDRESSES: Address your comments, suggestions, or objections regarding this proposed rule to:

By regular U.S. mail. Minerals Management Service, Minerals Revenue Management, Records and Information Management Team, P.O. Box 25165, MS 320B2, Denver, Colorado 80225-0165; or

By overnight mail or courier. Minerals Management Service, Minerals Revenue Management, Building 85, Room A-614, Denver Federal Center, Denver, Colorado 80225; or

By e-mail. mrm.comments@mms.gov. Please submit Internet comments as an ASCII file and avoid the use of special characters and any form of encryption. Also, please include "Attn: RIN 1010-AD04" and your name and return address in your Internet message. If you do not receive a confirmation that we have received your Internet message, call the contact person listed below.

Address your comments on the information collection requirements in this proposed rule by either fax (202) 395-6566 or e-mail (OIRA_docket@omb.eop.gov) to the Office of Information and Regulatory Affairs, OMB, Attention: Desk Officer for the Department of the Interior (OMB Control Number 1010-NEW). Send copies of your comments to Sharron L. Gebhardt, Regulatory Specialist, Records and Information Management Team, Minerals Management Service, Minerals Revenue Management, P.O. Box 25165, MS 320B2, Denver, Colorado 80225. If you use an overnight courier service, the MMS courier address is Building 85, Room A-614, Denver Federal Center, Denver, Colorado 80225. You may also e-mail your comments to us at mrm.comments@mms.gov. Include the title of the information collection and the OMB Control number in the "Attention" line of your comment. Also include your name and return address. Submit electronic comments as an ASCII file avoiding the use of special characters and any form of encryption. If you do not receive a confirmation that we have received your e-mail, contact Ms. Gebhardt at (303) 231-3211.

FOR FURTHER INFORMATION CONTACT:

Sharron L. Gebhardt, Regulatory Specialist, Records and Information Management Team, Minerals Revenue Management, MMS, telephone (303) 231-3316, fax (303) 231-3385, or e-mail sharron.gebhardt@mms.gov. The principal authors of this rule are Geoffrey Heath of the Office of the Solicitor and David A. Hubbard of Minerals Revenue Management, MMS, Department of the Interior.

SUPPLEMENTARY INFORMATION:

I. Background

The MMS is proposing to amend the existing regulations at 30 CFR 206.100 *et seq.*, governing the valuation of crude oil produced from Federal leases for royalty purposes, and related provisions governing the reporting thereof. The current regulations became effective on June 1, 2000. The producing industry filed a lawsuit challenging several of the provisions in the 2000 rule.

Independent Petroleum Association of America v. Baca, Civil No. 00-761 (RCL) (D.D.C.), and *American Petroleum Institute v. Baca*, Civil No. 00-887 (RCL) (D.D.C.) (consolidated). That lawsuit is still pending.

MMS conducted four public workshops on March 4-6, 2003, in Denver, Colorado; Albuquerque, New Mexico; Houston, Texas; and Washington, DC. At those workshops, MMS asked for discussion regarding, among other things, the best published index to use in valuing production not sold at arm's length and related timing issues, greater specificity regarding allowable transportation costs, the rate of return on undepreciated capital investment in calculating actual transportation costs, and the royalty effect of sales under joint operating agreements. After considering the input from these workshops, MMS is proposing these amendments in an effort to improve the current rule.

The amendments proposed do not alter the basic structure or underlying principles of the June 2000 rule. In proposing these amendments, the Department of the Interior reaffirms that the value for royalty purposes of crude oil produced from Federal leases is value at or near the lease. But in determining value at the lease of production not sold under an arm's-length contract at the lease, MMS is not restricted to a comparison to arm's-length sales of other production occurring in the field or area. MMS may begin with a "downstream" price or value, and determine value at the lease by deducting the costs of transporting oil to downstream sales points or

markets, or by making appropriate adjustments for location and quality.

Federal lessees are not obligated to sell crude oil downstream of the lease. Lessees are at liberty to sell production at or near the lease, even if selling downstream might have resulted in a higher royalty value for the production than selling it at the lease. If lessees do choose to sell downstream, the choice to sell downstream does not make otherwise non-deductible costs deductible (for example, marketing costs). See *Independent Petroleum Association of America, et al. v. DeWitt*, 279 F.3d 1036 (D.C. Cir. 2002), cert. denied sub nom., *Independent Petroleum Association of America, et al. v. Watson*, ___ U.S. ___, 123 S. Ct. 869 (Jan. 13, 2003).

In the following discussion, we group the proposed changes by issue category and discuss the specific proposed changes to specific sections of the rule in that context.

A. Change to NYMEX-Based Valuation—§ 206.103

1. Determining the NYMEX Price To Use for Valuation

For crude oil not sold at arm's length, the existing rule at § 206.103 provides for the use of spot prices at defined market centers published in approved publications both of which are listed in **Federal Register** Notices available on the MMS Internet site at http://www.mrm.mms.gov/Laws_R_D/FRNotices/, as the basis for valuation of crude oil for most of the country except the Rocky Mountain Region. (In the Rocky Mountain Region, spot prices are the basis for the third "benchmark.") Our experience with the rule and comments we have received lead us to believe that, at this time, New York Mercantile Exchange (NYMEX) futures prices may represent a more reliable and better assessment of current oil values than spot prices.

Use of the NYMEX price as the basis for royalty value may have several advantages, not the least of which is the fact that the volume of transactions and the number of participants is so large that, at least theoretically, no one entity could manipulate the resultant price. This is an issue partly because of the recent publicity and questions about the information provided to spot price reporting services and the effect such potentially inaccurate information has on spot prices in general. In addition, there is only one NYMEX price, and it is available from any number of sources. There would be no question about the "correct" publication to use to obtain the applicable index price.