

the business days for which differentials are published during the period January 26 through February 25. Note, in this example, that the days used in the monthly average calculation of the WTI differential are different than the days used to calculate the NYMEX price and are different than the days used to calculate the roll.

This definition is intended to allow the lessee a method of calculating an accurate price at a market center near the lease so that crude oil produced from the lease can be accurately valued. The price at each market center would be the average of the daily NYMEX settlement prices published during the calendar month of production (including the roll, if applicable) plus or minus the appropriate WTI published differential. The lessee would then calculate a further differential from the market center to the lease.

For example, if a producer does not have an arm's-length exchange agreement to Cushing, and the applicable NYMEX price (including the roll) is \$29.00/bbl, and the WTI differential for Light Louisiana Sweet (LLS) crude oil is plus \$.30/bbl at St. James, Louisiana, the value at St. James would be \$29.30. That value must be further adjusted from the market center to the lease by applicable location and quality differentials and for actual transportation costs between the lease and the market center.

Continuing the example, if a lessee produced Eugene Island (EI) sour crude and transported it from the lease to Burns Terminal at a cost of \$1.19 per barrel, where it exchanged it at arm's length for LLS at St. James on the basis of \$27.50/bbl for the EI crude and \$28.80/bbl for the LLS, the value of the EI crude would be \$29.30 (the LLS value at St. James) less the location and quality differential from the exchange agreement (\$1.30), or \$28.00. The lessee could then take the transportation allowance of \$1.19 to get a value of \$26.81 at the lease.

Changing from spot market index price-based valuation to NYMEX-based valuation and adding a definition for "WTI differential" would require a revision in the definition of "MMS-approved publication." In the context of the proposed valuation scheme, and because NYMEX prices are widely available, the only context in which MMS approval of a publication would be needed is for determining the WTI differential. Accordingly, the proposed rule would revise the definition of "MMS-approved publication" to read:

*MMS-approved publication* means a publication MMS approves for determining WTI differentials.

### 3. Specific Comments Requested

MMS requests specific comments about changing the valuation basis for transactions not at arm's length from spot to NYMEX prices, and to a calendar month average of such prices. MMS also requests specific comments on whether weekends and holidays should be included in the calculation of the average NYMEX price (and, if so, what price should be assigned to days on which no price is published). Further, MMS requests comments on whether it should include the "roll" in the calculation of the proper NYMEX price and whether the roll should apply only to areas other than California, Alaska, and the Rocky Mountain Region. MMS also requests comments on (1) whether lessees should use the location and quality differentials in their own arm's-length exchange agreements between Cushing and the lease or market center in preference to WTI differentials and (2) the circumstances under which they should use one or the other.

Under proposed section 206.103(a), for leases in California and Alaska, you must adjust the NYMEX price for applicable location and quality differentials and you may adjust for actual transportation costs, as described at section 206.112. MMS also requests comments on whether it should retain ANS spot prices as the valuation basis for crude oil produced in California and Alaska instead of changing the valuation basis to the NYMEX price.

#### *B. Determining Differentials When Using NYMEX-Based Valuation When Lessees Do Not Have Information From Their Own Exchange Agreements— §§ 206.103 and 206.104*

Based on requests we have received for valuation guidance and future valuation agreements for the Rocky Mountain Region, as well as our experience with RIK in that area, we believe that very few producers in the Rocky Mountain Region have actual trades of crude to Cushing. The same situation may apply to production in other areas, especially California. Therefore, in many cases producers do not have access to information to make adjustments to a price at Cushing. MMS therefore is proposing a change in how location and quality adjustments are made when you don't have an actual location and quality differential between Cushing and either the lease or a location to which you actually transport or exchange the oil.

For example, in the Rocky Mountain Region for sweet crude oil produced from leases in Wyoming, the market center would be Guernsey, Wyoming.

Under the proposed rule, you would use the WTI differential for Wyoming Sweet at Guernsey for sweet crude oil, as published in an MMS-approved publication. If you use the WTI differential for Wyoming Sweet at Guernsey, and you transport your oil to Guernsey, you may also subtract actual transportation costs from the lease to Guernsey. If you exchange your oil from the lease to Guernsey, you must apply the appropriate location and quality differential to Guernsey. In the case of much of the crude oil produced from Federal leases in California, MMS anticipates that the market center would be Line 63 (for crude oil of like-quality to the crude oil for which Line 63 spot prices are published) or Kern River (for crude oil of like-quality to the crude oil for which Kern River spot prices are published).

More specifically, if the NYMEX price (unadjusted by the roll) is \$29.00 and you do not have an arm's-length exchange agreement between Cushing and anywhere in Wyoming from which you could calculate a location and quality differential for your sweet crude, you would use the Guernsey WTI differential to value your sweet crude oil if you transport or exchange some or all of your oil to Guernsey. If the Guernsey WTI differential, calculated by taking the average of the daily high and lows and then averaged over the published days of the month, was – \$.50/bbl, the value at Guernsey would be \$29.00 – \$.50 = \$28.50/bbl. From this value, you could then subtract your transportation costs (or you would adjust for location and quality) from the lease to Guernsey.

If you did not move or exchange any of your oil to Guernsey, you would have to propose an alternative location and quality differential (between the lease and Guernsey) to MMS. You would then apply the WTI differential at Guernsey to adjust to Cushing. MMS is proposing that you may use the differential from the lease to Guernsey that you propose until MMS prescribes a different differential. If MMS prescribes a different differential, you would have to apply MMS' differential to all periods for which you used your proposed differential. You would have to pay any additional royalties resulting from using MMS' differential, plus late payment interest from the original royalty due date, or you would report a credit for any overpaid royalties plus interest under 30 U.S.C. 1721(h).

MMS also requests comments regarding alternative valuation procedures, including differentials, in valuing sour crude oil in light of the fact that the WTI price at Cushing is for light