

pipeline's transportation service, and therefore is a cost of moving the oil. MMS welcomes comments on whether these are reasonable ways to calculate the actual costs of assuring a lessee's creditworthiness.

You may not use any cost as a deduction that duplicates all or part of any other cost that you use under this paragraph. MMS seeks comments regarding whether these various costs should be allowed, and whether there are other costs directly attributable to the transportation of crude oil that should be included in the final rule.

In section 206.110, MMS proposes a new paragraph (c) that would specify certain costs as not deductible. Those include:

(1) Fees paid for long-term storage (more than 30 days).

(2) Administrative, handling, and accounting fees associated with terminalling.

(3) Title and terminal transfer fees.

(4) Fees paid to track and match receipts and deliveries at a market center or to avoid paying title transfer fees.

(5) Fees paid to brokers.

(6) Fees paid to scheduling service providers.

(7) Internal costs, including salaries and related costs, rent/space costs, office equipment costs, legal fees, and other costs to schedule, nominate, and account for sale or movement of production.

(8) Gauging fees.

At the workshops, MMS received some comments that internal costs should be deductible. One person suggested that if an employee's only function were to arrange for downstream transportation of production, that person's salary should be deductible. MMS does not agree. Under the proposed rule, these types of indirect, internal costs are not deductible.

MMS does not believe that any of the above-described costs are incurred directly as part of the process of physically moving the crude oil. MMS seeks comments on whether any of these costs should be deductible.

#### (ii) Non-Arm's-Length Transportation

In section 206.111, MMS proposes to add a new paragraph (b)(6) that would specify many of the costs incurred for transporting oil under a non-arm's-length contract that are allowable deductions, but only to the extent they have not already been included in the actual cost calculation under paragraphs (d) through (j) of this section. Many of these costs are the same as those associated with arm's-length

transportation contracts. Those costs include:

(1) Volumetric adjustments for actual line losses.

(2) The cost of carrying on your books as inventory a volume of oil that the pipeline operator requires you to maintain, and that you do maintain, in the line as line fill. You must calculate this cost as follows:

(A) Multiply the volume that the pipeline requires the shipper to maintain, and that it does maintain, in the pipeline by the value of that volume for the current month calculated under section 206.102 or section 206.103, as applicable; and (B) multiply the value calculated under paragraph (i) by the monthly rate of return, calculated by dividing the rate of return specified in section 206.111(i)(2) by 12.

(3) Fees paid to a non-affiliated terminal operator for loading and unloading of crude oil into or from a vessel, vehicle, pipeline, or other conveyance.

(4) Transfer fees paid to a hub operator associated with physical movement of crude oil through the hub when you do not sell the oil at the hub. These fees do not include title transfer fees.

(5) A volumetric deduction to cover shrinkage when high-gravity petroleum (generally in excess of 51 degrees API) is mixed with lower-gravity crude oil for transportation.

These costs parallel those costs itemized in the arm's-length transportation provisions in section 206.110(b) insofar as appropriate for non-arm's-length situations. Several of the specific items allowed under the arm's-length provisions do not occur or are not appropriate for inclusion in a non-arm's-length transportation situation. Specifically, in a non-arm's-length situation, there is no arm's-length transportation tariff. (Instead, the lessee must calculate its actual costs of building and operating the pipeline.) In addition, MMS believes that even if an affiliated pipeline charges quality bank administrative fees to its own affiliate, the lessee/shipper is simply paying its affiliate and that it should not be regarded as part of the actual costs incurred to move oil. Further, in a non-arm's-length situation, decisions regarding short-term storage (and the cost associated with that storage) are under the lessee's or its affiliate's control, and likely may be avoided. MMS therefore believes that it is not appropriate to allow a short-term storage cost. Also, in a non-arm's-length situation, any fees charged by an affiliated pipeline to pump oil over to a

third party-carrier's system are paid within the same corporate organization and are not an additional actual cost of transportation. Finally, in non-arm's-length situations, MMS expects that requiring a letter of credit from an affiliated producer is unnecessary and that the corporate organization ordinarily would avoid incurring the costs of the premium necessary for the letter of credit. MMS therefore believes it inappropriate to allow such a deduction.

In contrast to the 2000 rule, which disallows all line losses in non-arm's-length transportation situations, MMS proposes to allow actual, but not theoretical, line losses. MMS believes that actual line losses properly may be regarded as a cost of moving oil. In addition, if there is a line gain, the lessee must reduce its transportation allowance accordingly. In a non-arm's-length situation, however, a charge for theoretical line losses would be artificial and would not be an actual cost to the lessee. While a lessee may have to pay an amount to a pipeline operator for theoretical line losses as part of an arm's-length tariff, in a non-arm's-length situation, line losses, like other costs, should be limited to actual costs incurred.

The MMS also is proposing to add a new paragraph (b)(7) to section 206.111 that would list the costs that expressly are not deductible as transportation costs. These are the same costs discussed above in the section on arm's-length transportation contracts (section 206.110), with one addition, namely, that theoretical line losses are not deductible under non-arm's-length transportation arrangements.

#### 3. Technical Correction to § 206.111(h)(5) Regarding Redepreciation

We propose to modify existing § 206.111(h)(5) to remedy an unintended consequence regarding depreciation when calculating a transportation allowance not involving an arm's-length transportation contract. When we amended the rules in March 2000, we intended the revisions regarding depreciation in the current rule to permit, one time only, a new depreciation schedule based on your purchase price when you purchase a transportation system from a previous owner. If a transportation system were sold more than once, subsequent purchasers would have to maintain the then-existing depreciation schedule.

However, existing paragraph (h)(5) says "if you or your affiliate purchase a transportation system at arm's length after June 1, 2000, from anyone other